CIRC Working Paper

09

Battle for Regulatory Supremacy: Ambiguity in the Definition of "Control" between SEBI and CCI

Cyril Shroff
Nisha Kaur Uberoi

JUNE 2014

CUTS Institute for Regulation & Competition

Suggested Citation:

Shroff, Cyril & Uberoi, Nisha Kaur. 2014. 'Battle for Regulatory Supremacy: Ambiguity in the Definition of "Control" between SEBI and CCI', CIRC Working Paper No. 09. New Delhi: CUTS Institute for Regulation & Competition.

Authors Bio:

Mr. Cyril Shroff is the Managing Partner of Amarchand & Mangaldas & Suresh A. Shroff & Co., Mumbai region.

Email: cyril.shroff@amarchand.com

Nisha Kaur Uberoi is a Partner and Head of the Competition Law Practice, Amarchand & Mangaldas & Suresh A. Shroff & Co., Mumbai region.

Email: nishakaur.uberoi@amarchand.com

The authors would like to acknowledge the contribution of Bharat Budholia, Senior Associate, Surya Kiran Banerjee and Jayati Handa, Associates in the Mumbai Competition Law Practice. The views expressed in the paper are personal.

Published By:

CUTS Institute for Regulation & Competition
R 75, First Floor
Greater Kailash I
New Delhi 110048
http://circ.in
circ@circ.in
+91 11 26463021/22/23

Copyright & Disclaimer:

Any reproduction in full or part must indicate the title of the paper, name of the publisher as the copyright owner, and a copy of such publication may please be sent to the publisher.

© Authors & CIRC, 2014

Abstract

The Indian regulatory regime is a complex system with multiple regulators actively implementing parallel regulatory practices. There are regulatory bodies established in various sectors ranging from the Securities and Exchange Board of India ("SEBI"), the Competition Commission of India ("CCI"), the Reserve Bank of India ("RBI"), Telecom Regulatory Authority of India("TRAI"), the Insurance Regulatory and Development Authority("IRDA"), the Central Electricity Regulatory Commission ("CERC"),etc. The overlapping jurisdictions of these regulators carries the risk of transactions being needlessly stalled due to the multiple (and in some cases, contradictory) regulatory requirements that need to be met to get a transaction approved. In light of the above, it is critical that the various parallel regulatory approval processes are aligned to ensure that the merger and acquisition ("M&A") activity is not hindered due to lack of co-ordination between the various regulators or cumbersome procedural formalities. This working paper analyses the potential areas of overlap between the CCI and SEBI in reviewing transactions which require merger control approval as well as trigger open offer obligations.

In the multi-regulator regime of India, co-ordination between regulators is essential to ensure certainty and clarity in the law, to provide a degree of comfort to corporates and market players in relation to the outcome of transactions and extent of liability for their day-to-day business conduct. The requirement for co-ordination stems from the overlap in the governing legislations of such regulators and differing trigger points prescribed in the legislation. To ensure that such lack of co-ordination between multiple regulators does not result in unnecessary delay, it is imperative to harmonize parallel regulatory approval processes.

*With respect to M&A, there are multiple overlaps between the governing legislations of the SEBI and the CCI, i.e. the SEBI Act, 1992 and the accompanying SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**") on the one hand and the Competition Act, 2002 ("**Act**") and the accompanying Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (as amended) ("**Combination Regulations**") on the other. Under these two legal regimes, there are parallel triggers for the requirement to make an open offer, as well as the requirement to file a merger notification with the CCI. While there is now consistency in terms of triggers, the incongruence in terms of timelines, differing definitions and concepts, etc. is discussed below in the context of acquisitions of shares and acquisitions of control over a listed company.*

Treatment of Share Acquisitions

Under the Takeover Code, a mandatory open offer inter alia gets triggered on the acquisition of shares or voting rights entitling the acquirer (along with persons acting in concert with it) to 25% or more of the voting

rights in the target company. Similarly, under the Combination Regulations, any acquisitions of shares or voting rights entitling the acquirer to less than 25% of shares or voting rights in the target enterprise, directly or indirectly, solely as an investment and not resulting in the acquisition of 'control' is exempt from the requirement to file a merger notification with the CCI. Thus, in relation to share acquisitions, only acquisitions of above 25% in any target company would trigger the merger control regime, subject to the jurisdictional thresholds prescribed under Section 5 of the Act being crossed.

*It is interesting to note that when the Combination Regulations were first notified, the threshold for share acquisitions was 15%, even though the new Takeover Code had already been brought into force, prescribing a 25% initial threshold for open offers. This for a while resulted in a situation where the merger control requirement was triggered, even when there was no open offer requirement. This incongruity was partially resolved by way of the first amendments to the Combination Regulations, which were given effect to in February 2012 ("**First Amendment**"), where the merger control threshold was brought in line with the Takeover Code threshold. However, the Takeover Code exempts options from the computation of this 25% threshold until they are exercised, while the Act still computes options within this 25% threshold still resulting in an anomaly between the two legislations.*

Further, the Combination Regulations also did not initially provide for an exemption for creeping acquisitions, i.e. acquisitions of shares of up to 5% in a financial year (which was entitled to an exemption from the requirement to make an open offer under the Takeover Regulations). Only acquisitions of shares by an acquirer which already holds more than 50% of the shares in any company were exempt (as long as the target company was not jointly controlled by enterprises that are not part of the same group). As a result, the acquisition of even a single share over 15% (subsequently amended to 25%) up to 50% of the shares in a target company required a merger filing, subject to the jurisdictional thresholds being crossed under the Act. Understandably, this position was criticized as it was detrimental to promoters and investors alike as it resulted in unnecessary drawing out of transaction timelines, apart from being illogical from a competition law standpoint – any transaction, including an acquisition of shares or voting rights that does not result in a change of control (and consequently, a change in market structure), ought not to be scrutinized by the CCI. In addition, making a merger filing and awaiting CCI approval for creeping acquisitions normally executed on the stock exchange instantaneously could also result in share price fluctuations making the acquisition itself unnecessarily expensive.

*Responding to industry feedback, the exemptions under Schedule I were amended again in April 2013 ("**Second Amendment**") to be brought in line with the Takeover Code position, to ensure that the investors do not suffer due to the disparity in the two regulations. The current position under the Combination Regulations is that any gross acquisition of additional shares of less than 5% of the shares or voting rights of the target enterprise in a financial year by the acquirer or group which already holds 25% or more but less than 50% of the voting rights in the target*

enterprise, is exempt from filing a merger notification under the Act. Further, acquisitions of shares or voting rights where the acquirer already holds 50% shares in the target enterprise, are also exempt. Unlike the Takeover Code, the Act does not prescribe the mode of computation of 'gross acquisition' which leaves open the scope of further divergence between the Takeover Code and the Act.

Treatment of Acquisitions of Control

Other than share acquisitions, the Takeover Code and the merger control regime are also simultaneously triggered in cases where there is an acquisition of "control". However, the precise scope and threshold for the definition of "control" under the Takeover Code and under the Act is the subject of closely scrutinized litigation and review by both regulators and is determined on a case-by-case basis.

The threshold for control under the Act is much lower than under other regulatory regimes. Under the Act, 'control' has been defined in a circular manner to include '*controlling the affairs or management of one or more enterprises or group, either jointly or singly*.' The definition of control under other legislations/regulatory regimes: for instance, the RBI's revised definition of control with respect to foreign direct investment ("**FDI**") rules states that '*Control shall include the right to appoint a majority of the directors or to* ***control the management or policy decisions*** *including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.*' (emphasis supplied). Similarly, the Takeover Code definition provides that '*Control includes the right to appoint a majority of directors, or* ***to control the management or policy decisions*** *exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.'* (emphasis supplied) The definition of 'control' under the Takeover Code and new Companies Act is similar but not in *pari materia* with the definition of control under the Act. Further, it is interesting to note that unlike the Takeover Code, acquisition of control delinked from the level of shareholding or acquisition of shares does not trigger the mandatory tender offer obligations in certain other jurisdictions such as United Kingdom and South Africa.

The interpretation of the concept of control based on case law varies from the interpretation under other legislations. The concept of negative control under the Takeover Code was tested in the ***SEBI v. Subhkam Ventures(I) Pvt. Ltd***.[1] In this case, MSK Project (India) Limited ("**MSK**") made a preferential allotment of equity shares to Subhkam Ventures (I) Private Limited ("**Subhkam**") which constituted 17.90% of the shareholding in MSK. Subhkam made a public announcement for an open offer to acquire shares of MSK from its shareholders. The SEBI required the draft letter of offer to be revised to reflect that the open offer was being made under Regulation 10 (acquisition of shares, now Regulation 3) as well as Regulation 12 (acquisition of control, now Regulation 4) of the then Takeover Code. Regulation 12

[1] MANU/SC/1587/2011.

circ Enhancing Knowledge, Strengthening Capacity

provides that irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire "control" over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the regulations. The point of law that was being disputed in this case was therefore "*whether the right to nominate a director on the board of the company, the right to be present to constitute quorum and the affirmative voting rights all of which is essentially "negative control rights" constituted "control" for the purposes of the Regulations*". SEBI held that the acquisition should be treated as an acquisition of control. On appeal, the Securities Appellate Tribunal ("**SAT**") held that '*control is a proactive and not a reactive power*'. The power by which an acquirer can only prevent a company from doing what the latter intends to do, i.e. negative control is by itself not control. SEBI appealed the SAT's decision to the Supreme Court. However, given that SEBI and Subhkam resolved the matter by way of an out-of-court settlement, the Supreme Court passed an order disposing of the appeal and did not rule on the issue. As such, the precedent value of the SEBI and SAT rulings in the *Subhkam* case is uncertain and there is no real clarity in terms of the SEBI definition of "control".[2]

The CCI, on the other hand, has clarified that under the Act, negative control amounts to control for the purposes of the Act. In *MSM India/SPE Holdings/SPE Mauritius*[3], the CCI has effectively concluded that the right to block special resolutions (by way of a more than 26% equity stake) amounts to 'negative control', which is 'control' for the purposes of the Act. Further, in *Century Tokyo Leasing Corporation/Tata Capital Financial Services Limited*, the CCI held that affirmative rights relating to the following items would be considered "control" for the purposes of the Act:

(i) annual budget;

(ii) annual business plan;

(iii) exit and entry into lines of business;

(iv) appointment of management and determination of their remuneration; or

(v) strategic business decisions (no materiality threshold specified).

Most recently, in *Etihad/Jet*[4], the CCI held that "*the Parties entered into a composite combination constituting the IA, SHA and the CCA, with the common objective of enhancing their airline business* ***through joint initiatives. The effect of these agreements including the governance structure envisaged in the CCA establishes Etihad's joint control over Jet, more particularly over the assets and operations of Jet***." (emphasis supplied)

The CCI's observations in the *Etihad/Jet* order potentially lower its threshold for the acquisition of control under the Act. The CCI's ruling is particularly surprising, given that in this case, Etihad was acquiring a 24% stake and did not have any veto rights or quorum rights. Further, Etihad only had the right to appoint 2 out of a board of 12 directors with no casting vote. Furthermore, the Foreign Investment Promotion Board ("**FIPB**") had already cleared the transaction and had taken

[2] The Supreme Court's order clearly states that the "*impugned order passed by SAT will not be treated as a precedent*".

[3] C-2012/06/63.

[4] C-2013/05/122.

the view that Etihad was not acquiring "effective control" of Jet, in compliance with FDI requirements.[5] Interestingly, after the CCI's observation on control, SEBI re-investigated the *Etihad/Jet* case in order to determine if the requirement to make an open offer had been triggered by the transaction. In this regard, SEBI passed an order[6], holding that Etihad has not acquired control over Jet under Regulation 2(1)(e) read with Regulation 4 of the Takeover Code. While coming to this conclusion, SEBI *inter alia* observed that the definition of 'control' under Section 5 of the Act, is different from that in Regulation 2(1)(e) of the Takeover Code, in meaning, scope, and purpose. SEBI further observed that one regulatory agency may be guided by the findings of other regulatory agency on a particular issue only if the two laws are *pari materia* in their substance and are being applied on the same set of facts and circumstance.

While the SEBI order has brought some clarity in relation to the application and meaning of the term 'control' under the Act and Takeover Code, having multiple definitions of 'control' under different legislations has detrimental consequences for the parties to a transaction. This can affect deal certainty, as each regulator may be influenced by the other's definition of control and either initiate or re-open investigations, as was the case in the *Etihad/Jet* transaction. Further, in complex transactions, involving more than one regulator, each regulator may be reluctant to be the first to take a view, which in turn, results in prolonging transaction timelines.

Mismatch of Timelines

A big concern is the potential mismatch between the timelines for an open offer and the review of a merger notification for a listed company. While both these processes run in parallel, there have been instances where an acquirer has had to pay interest under the Takeover Code on account of the CCI review process taking longer than the open offer process (typically 60-90 days). The CCI is required to provide its prima facie view within 30 days (excluding clock stops) of receipt of a merger notification ("Phase I" review). If the CCI is of the view that the proposed transaction could raise competition concerns, it can conduct an in-depth review of a further 180 days (excluding clock stops) ("Phase II " review).

The proposed combination cannot be given effect to until the CCI approves the merger notification under the Act. However, under the Takeover Code, the acquirer is required to pay the shareholders who have tendered shares within 15 days from closure of the open offer process or pay interest until such payment is made (even if such delay is on account of other pending regulatory approvals). Unlike the UK City Code on Takeovers and Mergers, there is no process for suspension of the Takeover Code while the CCI is reviewing the merger notification.

Further, it should be noted that the Combination Regulations provide for a standard carve-out from the exemptions set out above, i.e. the acquisition of control, by

[5] The parties had modified the transaction documents numerous times in line at the behest of FIPB, specifically to ensure that the documents were in compliance with FDI regulations.

[6] http://www.sebi.gov.in/cms/sebi_data/attachdocs/1399545948533.pdf

way of additional rights in the target company by the acquirer. Thus, even where an acquirer is acquiring less than 25%, falls under the creeping acquisition limit or is acquiring additional shares above 50%, any acquisition of joint or sole control, or change from joint to sole control would require the filing of a merger notification, the rationale being that any change in control would result in a change in the business operations of the target enterprise and accordingly, a change in market structure.

Mismatch of Remedies

The Act allows the CCI to propose commitments for problematic combinations. Such commitments may be behavioural or structural and need to be addressed within a specific timeframe. Structural commitments could include divestment of assets (whether by the acquirer or target). Under the Takeover Code, an acquirer is required to declare its intention to alienate any material assets of the company in the open offer documents. As this declaration is prior to the stage at which the CCI may propose commitments, an acquirer is effectively precluded from making commitments to the CCI unless it obtains a special resolution of its shareholders permitting it to do so.

Conclusion

At present, there seems to be a lack of consistent coordination/co-operation between CCI and other regulators in India. However, this position is partially sought to be addressed under the Competition (Amendment) Bill, 2012 ("**Bill**"), which includes a proposal that other regulators are required to mandatorily refer issues of competition law to the CCI in the course of their review. The Bill also provides for the converse, i.e. an obligation on the CCI to mandatorily refer matters relating to other regulatory regimes to such other regulator. This provision, if brought into force, clearly draws the line between the responsibilities and jurisdictions in India's multi-regulator regime. However, pending harmonization of some of the inconsistencies identified above, even a mandatory reference will not result in an effective and efficient resolution. The need of the hour is likely the constitution of the joint task force to identify inconsistencies between the Act and the Takeover Code.

ABOUT CIRC

CUTS Institute for Regulation & Competition (CIRC) was established in 2008 by CUTS International (www.cuts-international.org). With the mission to *be a Centre of Excellence on Regulatory and Competition Issues*, CIRC primarily focuses on economic regulation in infrastructure sectors, and competition policy and law with an objective of reaching out to the target audience in India and other developing countries in Asia and Africa. Its crucial role in research and capacity building in the area of competition policy and law and regulatory reforms has created an intellectual knowledge base. This rich experience of working on regulatory issues and competition policy and law has resulted in many national and international publications which has enriched a more informed discourse on public policies and greatly benefited different stakeholders in the society. Since its inception, CIRC has been undertaking several trainings, seminars and public lectures on competition policy and law in India and abroad. It also organises international symposia on the political economy of competition and regulation in the developing world and India.

CIRC offers practical focus on educational and training programmes on economic regulation, and competition policy and law. The Institute aims to facilitate research to enhance understanding and explore inter-disciplinary linkages among the identified subjects. Increasing demand of long and short-term courses offered by CIRC is appreciated by many national and international organisations. The Institute has also made cerebral contribution in the work of the High Level Committee on National Competition Policy.

CUTS Institute for Regulation & Competition
R 75, First Floor, Greater Kailash I
New Delhi 110048, INDIA
Tel: +91 11 26463021/22/23, Fax: +91 11 40535921
Email: circ@circ.in, Web: www.circ.in