

Analyzing the new Takeover Code

I. Introduction.

The Securities and Exchange Board of India ('SEBI'), vide a notification dated September 23, 2011, notified the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('**2011 Regulations**'), which has since replaced the erstwhile SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('**1997 Regulations**'). The 2011 Regulations, which came into effect from October 22, 2011, govern all acquisitions or sale of shares of listed companies. This article charts out the key changes introduced under the 2011 Regulations and the impact of the same on hostile takeovers.

II. Key Changes.

- 1) Definition of 'Control' modified: The definition of 'Control' has been modified in the 2011 Regulations to make it in tune with the recommendation of the Takeover Regulations Advisory Committee ('TRAC'). Under the 2011 Regulations a director or officer of a target company will not be considered to be in control over a target company, merely by virtue of holding such position. [*Regulation 2(1)(e)*]
- 2) Initial trigger threshold increased to 25% from the existing 15%: The initial threshold limit provided for open offer obligations which was 15% of the voting rights of the target company has been increased to 25%. In addition, if a party already holds at least 25% of the target's voting rights, a mandatory open offer will be triggered if that party acquires more than 5% of the target's voting rights in any financial year. [*Regulation 3*]
- 3) Open Offer Trigger Point based on Individual Holding: Individual acquirer shareholding will be considered for determining the open offer trigger points apart from consolidated promoter shareholding. [*Regulation 3*]
- 4) Changes in Open Offer Exemptions: Under the 1997 Regulations acquisitions resulting from certain types of transactions were exempt from the open offer requirements, such as transfers to relatives, acquisitions of shares by invoking pledge made to a scheduled commercial bank or public financial institution, or under a scheme of arrangement pursuant to a court order. The 2011 Regulations have modified some of these specific exemptions. For instance, the conditions that applied to some of the earlier exemptions have been changed, in certain cases by adding prior notification requirements and in some cases new exemptions have been added (e.g., covering certain types of buy-back related increases in shareholding). SEBI continues to hold the authority to exempt applicability of the open offer requirements in particular cases, for which the reasons are to be recorded in writing.
- 5) No exemption of Change in Control from open offer obligations: The 2011 Regulations do not exempt change of control pursuant to special resolution of shareholders of the target company by postal ballot process, from open offer obligations (which was known as whitewash provisions and was available under the 1997 Regulations) This appears to be in sharp contrast with Regulation 12 of the SEBI (SAST) Regulations, 1997 which provides for change in control through the special resolution passed by way of postal ballot. [*Regulation 4*]
- 6) Elaborate provisions about Indirect Acquisition: The 2011 Regulations prescribe detailed provisions relating to indirect acquisitions and define situations that will be deemed as indirect acquisition. [*Regulation 5*]
- 7) Concept of voluntary open offer separately dealt with: In the case of a voluntary open offer an acquirer along with persons acting in concert should be holding at least 25% or more shares in the target company. The acquirer along with the persons acting in concert should not have acquired any shares of the target company in the preceding 52 weeks without attracting the

obligation to make a public announcement. After the completion of the open offer, their aggregate share holding should not exceed the maximum permissible non-public share holding. An acquirer cannot acquire further shares in the target company for a period of 6 months after the completion of the open offer except by another open offer or a competing offer. In case of voluntary open offer, the offer size may be of 10% or more of the voting rights at the will of the acquirer. [*Regulation 6*]

- 8) *Increase in Offer Size from 20% to 26%*: Under the 2011 Regulations, the minimum size of a mandatory open offer is 26% of the target's voting rights. Therefore, if a party already holds at least 25% of the target's voting rights, such party can make a "voluntary" open offer for 10% or more of the target's voting rights, provided certain additional conditions are met. These additional conditions relate to the party's acquisition of the target company's stock in the preceding 52 weeks, and vary according to the circumstances in which the "voluntary" open offer is made (e.g., if competitive offers are being made). If a conditional open offer is made, and the minimum level of acceptance set out in the conditional offer is not achieved, any agreement triggering the open offer requirement has to also be rescinded. [*Regulation 7*]
- 9) *Changes in case of increase in shareholding beyond the maximum permissible non-public shareholding due to Open Offer*: In case of increase in shareholding beyond the maximum permissible non-public shareholding due to open offer, the acquirer is required to bring down the non-public shareholding to the level specified and within the time permitted under Securities Contract (Regulation) Rules, 1957. [*Regulation 7(2)*]

The acquirer whose shareholding exceeds the maximum permissible non-public shareholding, pursuant to an open offer under the Regulations, will not be eligible to make a voluntary delisting offer under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, unless a period of twelve months has elapsed from the date of the completion of the offer period. [*Regulation 7(5)*]

- 10) *Price and Payment*: The 2011 Regulations specify the basis on which the minimum offer price for open offers has to be computed. This basis varies depending on the type of acquisition being undertaken. The offer price can be paid in cash or in specified securities of the acquirer or in a combination of these various forms. However, certain additional conditions have to be met for the non-cash payments to be made. Also, all shareholders have to be given the same exit price and any amounts paid as a control premium or non-compete fees have to be considered when computing the minimum offer price.

The 1997 Regulations permitted payment of a non-compete fee of up to 25% of the offer price to the exiting promoters of the target company, in addition to the offer price. The promoters of the target company cannot now be paid any additional consideration in comparison to the public shareholders. This serves to protect the interests of the minority shareholders. [*Regulation 8, 9*]

- 11) *Process of Open Offer*: Two key changes connected with the open offer process under the 2011 Regulations are: (i) competing open offers have to be made within 15 working days of the detailed public announcement made by the acquirer making the first open offer, and (ii) a committee of independent directors of the target company has to provide reasoned recommendations on each open offer. Such recommendations will be published at least two working days before the commencement of the tendering period in the same newspapers where the public announcement of the open offer was published and a copy of the same has to be sent to SEBI, Stock Exchange and Manager to the Offer. [*Chapter III*]

III. Impact of changes in 2011 Regulations on Hostile Takeovers.

Pursuant to notification of the 2011 Regulations, the ability of acquirers to undertake hostile takeovers of an Indian listed company has been much scrutinized. Earlier, under the 1997

Regulations, the concept of voluntary open offer was not dealt with under a distinct category. Therefore, nothing prevented a non-promoter (with or without any shareholding in the target company) from making an unsolicited open offer to the public shareholders of such company. Under the 2011 Regulations, only persons already holding a minimum of 25% in a target company are eligible for making voluntary offers for 10% or more. Further, such persons cannot make voluntary offers if they have purchased shares from the market in the preceding one year.

In view of the above, in direct offers, potential acquirers will have to buy shares through the stock exchange or negotiated deals to first cross the 25% threshold. The prior holding criteria (of the preceding one year) and the limits on market purchases appears to have made voluntary offers by outsiders difficult, time-consuming and expensive and given promoters the time to consolidate their holding against potential hostile takeovers.

However, pursuant to the 2011 Regulations being notified, some quarters emphasized that a more liberal interpretation of the above could be taken, where there is no prohibition on voluntary offers by persons holding less than 25% so long as the minimum offer size is 26%.

In a set of subsequent FAQs on the 2011 Regulations issued by SEBI, the question as to whether hostile offers/bids are permitted under the 2011 Regulations has been dealt with. The FAQs clarify that any person with or without holding any shares in a target company, can make an offer to acquire shares of a listed company subject to minimum offer size of 26%. The FAQs also distinguish between a voluntary offer by a person holding less than 25% of shares/voting rights in a target company and a voluntary offer by a person holding more than 25% of shares/voting rights.

However, the question as to whether negative control though veto rights would qualify as "control" has not been dealt with in the 2011 Regulations or the subsequent FAQs and is left open to interpretation.