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A summary of the major recommendations of SEBI appointed Achuthan Committee on Takeover Regulations

The SEBI appointed Takeover Regulations Advisory Committee (" TRAC") headed by Mr. C. Achuthan has recommended far reaching changes in the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 **(" Regulations")**. The report prepared by TRAC includes the draft text of the proposed Takeover Regulations **(" PTR")**. A brief overview of some of the major recommendations by TRAC are as follows:

1. Increase in threshold limit

The existing Regulations provide for a threshold of 15 % for making an open offer. The 15% limit was fixed in a scenario where it was possible to control listed companies with holdings as low as 15 %, and therefore the threshold was considered to denote a substantial voting power.

TRAC has suggested that the initial acquisition threshold for a mandatory open offer be raised to 25 % of the voting capital of the target company (refer Regulation 3(1) of PTR) as against the present 15% stake. This recommendation is in view of the recent trends in shareholding pattern of the companies listed on the national stock exchanges and public comments that convinced TRAC that the threshold limit of 15% is no longer relevant. Many jurisdictions have a trigger limit of 30 % to 35 %. Further, the Companies Act, 1956 recognizes any holding in excess of 25 % as the threshold at which special resolutions can be blocked. Based on market observation and the above mentioned reasons, TRAC concluded that 25 % shareholding would be an appropriate level at which a new shareholder could reasonably be expected to exercise positive control.

2. Increase in Offer Size

The present Regulations prescribe for a mandatory minimum requirement of an open offer for 20% stake in the target company.

However, TRAC has recommended that every open offer should be for every share held by all the shareholders of the target company (refer Regulation 7 of PTR) as against the existing rule. This change was brought about as TRAC has shown through market data that acquirers rarely make an offer for more than the minimum stipulated stake of 20%. Mandating an open offer to acquire every share tendered by any shareholder in acceptance of the open offer would be more equitable than the current rule because if a shareholder desires to exit a target company at the offer price, there should be no reason for the law to pre-empt him from a complete exit. TRAC has also noted that several international jurisdictions require acquirers to make an offer for 100 % of the outstanding shares.

Justice to minority shareholders is ensured through this recommendation. The downside is that it may also act as an obstacle to takeovers since mergers and acquisitions may become more expensive. It may also result in an unequal playing field between the foreign and the Indian acquirers as the foreign acquirers would have better access to funding compared to their Indian counterparts.

3. Creeping acquisition

Regarding creeping acquisition, the Regulations presently state that an acquirer can acquire up to 5% of the voting rights in a financial year without making an open offer if the acquirer holds a stake of 15% to 55% in the target company. If the acquirer' s holding is 55% to 75% in the target company, the acquirer is permitted a onetime allowance to increase their shareholding by 5% without an open offer (subject to fulfillment of certain conditions).

TRAC has suggested that creeping acquisition up to 5 % per annum be allowed only to acquirers holding more than 25% of the voting capital subject to the maximum permissible non-public shareholding limit (refer Regulation 3(2)

of PTR). TRAC felt that the threshold under the current Regulations, beyond which creeping acquisition is no longer permitted is not appropriate in the context of a mandatory 100 % open offer and hence recommended that creeping acquisition of 5 % per annum be allowed up to the maximum permissible non-public shareholding limit.

In the intervening time before the proposals of TRAC become law, promoters having less than 25% stake may look to transfer shares from their other undisclosed accounts to their own names so as to get more than a 25% stake.

4. Voluntary open offer

Currently, the Regulations provide for consolidation of shareholding by an acquirer who is desirous of maximizing his shareholding without breaching the minimum public shareholding requirements. The offer size for an open offer is currently the lower of 20 % or the maximum permissible acquisition without breaching the minimum public shareholding requirement.

TRAC has recommended that acquirers collectively holding shares entitling them to 25 % or more voting rights in the target may voluntarily make an open offer to consolidate their shareholding. Furthermore, TRAC has proposed a minimum open offer size of 10 % with the objective of providing a consolidation option outside the creeping route. TRAC has further suggested that voluntary offers should not be of a size that could lead to breach of the maximum permissible non-public shareholding. (Refer Regulation 6 of PTR). TRAC believes that there is a need to provide for flexibility to acquirers to voluntarily make open offers outside the mandatory public offer requirements since the PTR provides for an increase in the open offer size to 100 % of the voting capital of the target company.

5. Option to delist

The current Regulations regarding delisting stipulate that when the acquirer' s stake falls below the minimum level as per the listing agreement, the acquirer is obligated to take steps to facilitate compliance with the relevant provisions within the time period specified.

However, TRAC has suggested that if the acquirer states its intention to delist the target company and the response to the open offer is such that the acquirer' s shareholding crosses the delisting threshold, the target company should stand delisted. If the target company gets delisted, every shareholder who has not tendered an acceptance of the open offer shall be entitled to require the acquirer to acquire his shares at the offer price within a specified period. This exit window would also be available to the holders of all equity-linked instruments in the company. TRAC has proposed that if such an intention to delist is not stated upfront, or the response to the open offer is such that the public shareholding could fall below the minimum level required under the listing agreement but remains above the delisting threshold, the acquirer would then be required to either bring his holding down to ensure compliance by the target company with the listing agreement, or proportionately reduce both his acquisitions under the agreement that triggered the open offer and the acquisitions under the open offer (Refer Regulation 7 of PTR).

The implementation of this recommendation would make the takeover process less onerous for the acquirer. But the other side of the coin is that this proposal could provide a delisting route through an open offer which may be used by the acquirers to prevent the public from participating in the profits of the target company.

6. Exemptions from open offer obligations

The existing Regulations empower SEBI to grant exemption from making an open offer and to give relaxation from strict compliance with procedural requirements. Presently, SEBI is required to make a mandatory reference to a panel before granting an exemption.

TRAC has proposed doing away with the mandatory reference to a panel by SEBI before granting an exemption by making this requirement discretionary. (Refer Regulation 11 of PTR). Exemptions have been streamlined and a list of exempted acquisitions has been proposed, with specific conditions to be fulfilled for claiming such exemptions. Some of the areas where clarity has been brought in include increase in voting rights due to buy-back of shares, schemes of arrangement that do not involve the target company, certain *inter se* transfers, corporate debt restructuring and rights issues. (refer Regulation 10 of PTR).

7. Indirect Acquisitions

In the existing Regulations, there is no difference between open offers arising due to direct acquisitions vis-à-vis indirect acquisitions from the perspective of calculation of the open offer price and the same offer price formula

prescribed for direct acquisitions is used for indirect acquisitions as well.

Regarding indirect acquisitions, TRAC has suggested that irrespective of whether the target company is material to the parent transaction, open offer obligations have to be triggered. If a change in control over the target company occurs, shareholders of the target company ought to rightfully get an adequate exit opportunity. The ability to indirectly exercise voting rights beyond the trigger threshold limits, or exercise control over a target company, would attract the obligation to make an open offer, regardless of whether such target company is a predominant part of the business or entity being acquired. TRAC has further recommended that if the indirectly-acquired target company is a predominant part of the business or entity being acquired, the same would be treated as a direct acquisition for all purposes. TRAC has also formulated parameters for determination of whether the indirectly-acquired target company is a significant part of the acquisition. (refer Regulation 5 of PTR) Further, TRAC has recommended separate criteria to price open offers triggered on account of indirect acquisitions (refer Regulation 8 and 13 of PTR).

8. Mode of Payment

The current Regulations with regards to mode of payment are that the offer consideration shall be payable either (a) by way of cash; (b) by issue, exchange and, or transfer of shares (other than preference shares) of acquirer company, if the person seeking to acquire the shares is a listed body corporate; or (c) by issue, exchange and, or transfer of secured instruments of acquirer company with a minimum ' A' grade rating from a credit rating agency registered with SEBI; or (d) a combination of clause (a), (b) and (c) as stated above.

TRAC has stipulated in the PTR that the offer price may be paid in the form of cash or securities like shares, convertibles, secured debt instruments of the acquirer or of persons acting in concert with him or a combination of these modes. To ensure that the equity shares given in consideration for the open offer are liquid, eligibility conditions have been stipulated. However, if shares of the target company carrying more than 10 % voting rights have been acquired for cash in the preceding 52 weeks, shareholders to whom the open offer is made may opt to receive the offer price only in cash. (Refer Regulation 9). TRAC has brought in clarity with regard to valuation in case offer price is being paid through shares. TRAC noted that although the current regulations provide for exchange offers, the same has not been used for want of clarity on whether such issuance would attract provisions of preferential allotment and public issue requirements. Further, TRAC has recommended that SEBI may consider making suitable amendments to ICDR/ other regulations as applicable.

9. Offer Price to be based on 12 weeks volume weighted average of market prices as against higher of weekly averages of market prices for 26 weeks or 2 weeks

The current provisions regarding offer price have various parameters for the frequently traded shares, such as price under the agreement for acquisition that attracted the open offer, the " look back period" of 26 weeks preceding the public announcement, the historical market average price of the shares for a proximate period etc.

While considering the continued market price linkage, TRAC concluded, that the 26-week average is too long a period to consider and that a 2-week average is a too volatile period to consider. TRAC considered 12-week i.e. 60 trading day volume-weighted average price to arrive at the optimum period for the market price linkage as the appropriate period and recommended the same under Regulation 8 of the PTR. The Volume- weighted method will ensure that the resultant price is more representative and eliminates the outlier effects of high and low prices and is a more accurate determinant of the prices at which shares are actually transacted.

10. Short Public Announcement on the date of entering into the agreement followed by a detailed public statement within five business days thereafter.

Currently, an announcement has to be made directly within 4 working days of acquiring or agreeing to acquire shares in the target company.

There have been significant changes proposed with respect to public announcement requirements by TRAC. The PTR states that a short public announcement shall be made on the same day as the date of the transaction which triggered the open offer and subsequently a detailed public statement will need to be made within a period of 5 business days to give the acquirer sufficient time to work out the logistics. This change was brought about as it was felt by TRAC, that the parties involved in such a deal were too many and so the time period was short, and yet,

permitting a longer period of time to make a public announcement may lead to selective leakage of such price-sensitive news regarding the impending deal with the possibility of price distortions in respect of the scrip, therefore the two fold announcement system has been brought about to cure the problem.

11. Mandatory execution of the agreement within 26 weeks after the offer period

To bring about commercial expediency, Regulation 22(3) of PTR has been proposed which states that the acquirer shall complete the acquisitions contracted under any agreement attracting the obligation to make an open offer not later than twenty-six weeks from the expiry of the offer period. However, in case of any extraordinary and supervening circumstances rendering it impossible to complete such acquisition within such period, a reasoned extension of time may be given by SEBI

12. Non Compete Fees

The current regulations require addition to the open offer price, of any amount paid towards non-compete fee in excess of 25 % of the open offer price.

TRAC has recommended that the clause relating to non-compete fee be deleted from the current regulations, and any consideration paid in any form inclusive of all ancillary and collateral agreements shall form part of the negotiated price. Based on an examination of the equities and merits involved, as also the law in other jurisdictions, and market realities, TRAC decided that payment of a control premium would not be fair to minority shareholders. TRAC noted that it is very difficult to assess whether such non-compete consideration is reasonable, and that such payments may often be a disguise for making payments to controlling shareholders without paying the same to the public shareholders, thus allowing scope for abuse. TRAC concluded that once the exemption in respect of non-compete fee is deleted from the Regulations, and it is clearly articulated that apart from the share acquisition agreement, consideration in any form inclusive of all ancillary and collateral agreements shall form part of the negotiated price, it is in the selling shareholders interest to ensure that the negotiated price truly reflects the value of the scrip fairly. Since this negotiated price in any case would be one of the parameters for fixing the offer price, if such price were higher than other proposed parameters, all shareholders will get the same negotiated price.

This proposal is favourable from the perspective of public shareholders, though it fails to recognize the reality that the premium might often be paid to retain a controlling stakeholder who could have an in depth knowledge about the business. There may also be apprehensions that doing away with non compete fees may result in certain off the radar dealings between the concerned parties.

13. Governance Issues

There are 2 main governance issues addressed:

a) Increasing Responsibilities of the Board of Directors: The current Regulations entirely leave it to the discretion of directors of the target company to issue their recommendations, if any, on an open offer. It has been noticed that this provision has seldom been used.

   Therefore, the need was felt by TRAC that the board of directors of the target company ought not to play a passive role but take a more conscious position when an open offer is made for its shares as the board of directors in particular have a fiduciary responsibility towards the shareholders. Changes have been proposed as a step towards increasing practice of corporate governance principles. As per Regulation 26(6) of the PTR, a committee of independent directors of the target company shall be formed to consider and give its reasoned recommendations on the open offer, which shall be published by the target company. Most jurisdictions the world over including U.K, Canada, Singapore and Hong Kong mandate that the board of directors of the target company issues its considered recommendation on the open offer to the target‘ s shareholders.

b) Material Transactions during offer period: A balance between the conflicting requirements of curbing a target company from carrying out any material transaction during the offer period without the consent of shareholders even while ensuring that the target company‘ s freedom to carry out its day-to-day affairs is not curtailed has been addressed by TRAC by stating in Regulation 26 that the transaction of the Company and subsidiaries can take place by the consent of shareholders of the target company in the form of a Special Resolution. TRAC thought it fit to enhance the scope of such restrictions to include transactions by

subsidiaries since potentially material transactions can be undertaken at the level of any subsidiary of the target company without approval of shareholders of the target company.

The report by TRAC is available on SEBI' s website **http://www.sebi.gov.in/commreport/tracreport.pdf**. Public comments on the same may be sent to trac@sebi.gov.in by August 31, 2010.

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