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Threshold for open offer may rise to 35%

Lawyers point out that if a company acquiring a stake in excess of 35% in another is required to make an open offer for all shares, it could lead to the delisting of the target company

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Mumbai: The mergers and acquisitions, or M&As, game in India may change for ever with a Securities and Exchange Board of India, or Sebi, appointed panel likely to raise the shareholding threshold that triggers open offers from 15% to 35%. According to two people close to the development, the panel is inclined to do this though it has received some suggestions to make it 30%.

The panel has been assessing the feedback from Indian companies and law firms since October and a final report on its recommendations is likely to be ready by the end of April, according to one of the members of the committee. The first draft will be ready this week but will not be made public.

At present, if a company acquires a stake of at least 15% in another firm, it is required to make a mandatory open offer to buy at least another 20% of the second company's shares from the market.

With the increase in the threshold to 35%, the mandatory open offer limit too will be raised. In a recent interview with CNBC-TV 18, chairman of panel C. Achuthan said the open offer could be for the entire stake of the target firm.

If that happens, it will significantly increase the cost of acquisitions in India.

In September, Sebi formed the panel to review and recommend changes in the existing rules under the Substantial Acquisition of Shares and Takeover (SAST) regulations. SAST regulations were last reviewed in 1997 and the capital market regulator felt that these norms required changes in the wake of a changed market environment.

While an increase in the open offer threshold could have far-reaching implications, lawyers say the move is in keeping with changes in the external environment over the past 15 years and will be in sync with international standards.

"India has the lowest threshold for triggering an open offer in the world. If the threshold is increased from the existing 15% to more than 25%, from a corporate law perspective, it would mean that the acquirer would get statutory rights to block special resolution matters without triggering an open offer..," said Nishchal Joshipura, head of mergers and acquisitions at Nishith Desai Associates, a Mumbai-based international law firm.

According to the Companies Act, 1956, the passing of a special resolution requires a minimum of 75% shareholding. Therefore, the new threshold will help strategic investors to acquire powers to block a resolution. "At present, they get these rights contractually by getting into shareholder agreements; now these powers will be statutory once they acquire a stake of 26%," Joshipura said.

Nitin Potdar, partner, **J Sagar Associates**, another Mumbai-based legal services firm, said: “The first reaction that comes to my mind is what happens to the promoter who is holding less than 35%?” Potdar added that such promoters should, if they increase their stake beyond 35% to prevent a hostile bid later, be exempt from having to make an open offer.

A *Mint* analysis shows a majority of listed firms have a promoter holding of 35% or more. Among BSE-500, the top 500 firms by market capitalization listed on the Bombay Stock Exchange, at least 406 firms have promoter holdings in excess of 35%. Among the 50 Nifty firms, 38 fell in this category.

Lawyers point out that if a company acquiring a stake in excess of 35% in another is required to make an open offer for all shares, it could lead to the delisting of the target company. These rules need to be suitably amended, they say.

At present, there are two limits that trigger the delisting clause. For a majority of companies, the delisting trigger is activated when public shareholding falls below the 25% mark. For some large companies such as DLF Ltd, Tata Consultancy Services Ltd and some government-owned companies, this limit is 10%. According to the listing agreement, the company and stock exchange will together decide on the further course, depending on whether the concerned firm wants to proceed with delisting or not.

Some companies believe there should be “more objective definition” of control. In the UK and Germany, control is defined as an interest, or interests, in shares carrying in aggregate 30% or more of the voting rights of a company. In India, Sebi defines control as “the right to appoint majority directors on board or control the management or policy decisions...directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.”

Current norms require an acquirer to give the public shareholders an exit option after acquiring 26% or more. This norm might also need an alteration if the open offer trigger threshold is increased to 35%, company lawyers pointed out.

There are also apprehensions that the move might deny an exit option for small and minority investors or allow unfriendly foreign investors to acquire a stake in an Indian firm. Kanu Doshi, Mumbai-based chartered accountant said the move would be investor unfriendly. “The move effectively means that a corporate can acquire up to 34% in a company without other shareholders even getting a whiff of it.”

According to him, this will mean the acquirer crosses the 26% limit which will allow it to block special resolutions. “The basic rationale for not only this code but other regulations like Fema (Foreign Exchange Management Act) and FDI (foreign direct investment) rules to limit foreign investments at 24% is to prevent them from taking this control. If foreigners get this power, they will make life miserable for Indian promoters.”

Globally, the threshold for open offers is higher in most of the countries. For instance, in Hong Kong, Singapore, Russia and the UK it is 30% and for Malaysia it is 33% and Norway 33.33%. The guidelines in most of these countries are less rigid owing to the more evolved character of the markets.

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