Indian Takeover Regulations up for Overhaul!

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Arun Scaria, Sahil Shah and Nischal Joshipura from Nishith Desai Associates write on the recommendations made by The Takeover Regulations Advisory Committee (TRAC) to review the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. They provide a comparison between some of the key provisions of the extant Takeover Code and the recommendations of TRAC.

The Takeover Regulations Advisory Committee ("**TRAC**") constituted by Securities Exchange Board of India ("**SEBI**") to review the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("**Takeover Code**") submitted its report to SEBI on July 19, 2010. Inspired by various decisions of Courts in India and rulings of Securities Appellate Tribunal, international best practices and motivated by the objective to provide equitable treatment to all the public shareholders, TRAC has proposed a new set of regulations that seems to balance the interests of all stakeholders. The recommendations of TRAC to SEBI are open for suggestions till August 31, 2010.

We have provided below, in tabular form, a comparison between some of the key provisions of the extant Takeover Code and the recommendations of TRAC.

Sr. No.	Provisions of Extant Takeover Code	Recommendations of TRAC
	Trigger of the Takeover Code	**Trigger of the Takeover Code**
	(i) 15% - Acquisition of shares or voting rights exceeding 15% or more.	(i) 25% - The threshold for triggering of the Takeover Code has been increased from 15% to 25%
	(ii) 15% to 55% - Creeping acquisitionbetween 15% to 55% - Acquisition exceeding 5% (up to 55%) in a financial year will trigger open offer.	(ii) 25% to 75% - The creeping acquisition limit of 5% in one financial year increased from 15% - 55% to 25% - 75%. Such acquisition can be made in any manner (including through open market purchases, negotiated deals, bulk or block deals, preferential allotment, etc)
1.	(iii) 55% to 75% - Acquisition exceeding 5% (up to 55%) in the life time of the company will trigger open offer only if such acquisition is through open market purchases or buyback.	(iii) Acquisition of control over a target company would require the acquirer to make an open offer.
	(iv) Acquisition of control - Irrespective of acquisition of shares or voting rights in a company, any acquisition of control over the target company will trigger open offer requirement.	
	Exemption: Acquisition of control pursuant to a special resolution through postal ballot passed by the shareholders in a general meeting.	Exemption: Omitted

	Size of open offer	**Size of open offer**
2.	The open offer made by the acquirer to the shareholders of the target company has to be for a minimum 20% of the voting capital of the company.	The size of open offer has been increased from 20% to 100% of the shares of the company.
	Offer Price	**Offer Price**
	(i) For direct acquisition	(i) For direct acquisition
	Highest of:	Volume-weighted average market price ("VWAP") for 60 trading days prior to the public announcement to replace average of the weekly high and low of the closing prices of shares for past 26 weeks or 2 weeks. Further, in addition to highest negotiated price between parties and highest price paid by acquirer and PAC during 26 weeks prior to public announcement, VWAP for shares acquired by acquirer and PAC during past 52 weeks also to be considered for determining open offer price.
	· highest negotiated price between the parties;	
	· highest price paid by the acquirer or persons acting in concert ("PAC") for shares or voting rights during 26 weeks prior to public announcement;	
3.	· average of the weekly high and low of the closing prices of shares on the stock exchange during 26 weeks or the average of the daily high and low of the prices quoted on the stock exchange during the two weeks prior to date of public announcement.	
		(ii) For indirect acquisition
	(ii) For indirect acquisition	
		New price indicator introduced in the form of highest price paid by acquirer or PAC between date of primary acquisition and date of public announcement for indirectly acquired target company, in addition to the existing price indicators. Further, offer price shall stand enhanced by additional 10% p.a. for the period between date of primary acquisition and date of detailed public statement.
	Highest price amongst the offer prices calculated under the mechanism provided in (i) above, using the date of public announcement of the direct target company and the date of public	

	announcement of the indirect target company.	
	Definition of 'control'	**Definition of 'control'**
4.	Control includes "the right to appoint majority of the directors or to control the management or policy decisions of the target company......".	The definition of 'control' to include not only the right but also the ability to appoint majority of the directors on the board of the target company.
	Deemed direct acquisition	**Deemed direct acquisition**
5.	No concept of deemed direct acquisition.	Concept of deemed direct acquisition introduced if the proportionate net asset value / sales turnover / market capitalization of the indirectly acquired target company as a percentage of the consolidated net asset value / sales turnover / market capitalization of the directly acquired entity is in excess of 80%, on the basis of the most recent audited annual financial statements.
	Voluntary open offer	**Voluntary open offer**
	An acquirer whose shareholding in the target company (together with PAC) is between (55%) and (75%) can make a voluntary open offer to increase shareholding up to minimum level of public shareholding permitted by the Listing Agreement.	Specific framework proposed for voluntary open offer. Shareholders holding 25% or more in the target company may, without breaching minimum public shareholding requirements under the Listing Agreement, voluntarily make an open offer.
6.	Size of voluntary open offer	Size of voluntary open offer
	Minimum - No minimum limit.	Minimum - 10%. Maximum - Up to the minimum level of public shareholding permitted in the Target Company by the Listing Agreement.
	Maximum - Up to the minimum level of public shareholding permitted in the Target Company by the Listing Agreement.	
	Key Exemptions	**Key Exemptions**
	(i) Inter se transfer of shares amongst qualifying promoters exempt. Exemption for group companies as defined under MRTP Act.	(i) Inter se transfer of shares amongst qualifying parties exempt. Exemption for group companies under the MRTP Act removed. The exemption has now been restricted to transfers between co-subsidiaries and their parents.
		(ii) Increase in voting rights pursuant to buy-back of shares exempt subject to certain conditions being fulfilled.

7.		(iii) Acquisition pursuant to a scheme of arrangement is exempt only if the target company is a party to such scheme. If the target company is not a party to a scheme of arrangement, any acquisition under the scheme is exempt only if certain prescribed conditions are fulfilled.
	(ii) No explicit exemption for increase in voting rights pursuant to buy-back of shares.	
	(iii) Acquisition pursuant to a scheme of arrangement or reconstruction including amalgamation or merger or demerger under any law or regulation, Indian or foreign, exempt.	
8.	**Delisting**	**Delisting**
	· If the acquisition in the open offer reduces the public shareholding below the minimum level under the Listing Agreement, the acquirer shall take necessary steps to bring the shareholding below the prescribed threshold as per the Listing Agreement within the prescribed time period.	· An acquirer would be required to state upfront in public announcement its intention to delist the target company. If the shareholding of the acquirer is between 75% to 90% after the open offer, the acquirer would be required to either bring his holding down to ensure compliance 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.
		· No requirement to make a separate delisting offer under Delisting Regulations if acquirer crosses 90% delisting threshold through the open offer under the Takeover Code.
	· If the acquirer chooses to delist the target pursuant to acquisition in open offer, it should be in accordance with provisions of SEBI (Delisting of Equity Shares) Regulations, 2009.	
9.	**Competing offers**	**Competing offers**
	· Within 21 days of public announcement of open offer by the acquirer, any other person can make a competing offer for acquisition of shares from the public shareholders of the target company.	· The period for making competing offer changed to 15 business days from the date of detailed public statement of open offer.

		· Further, within 21 business days from expiry of the offer period, any competing acquirer would be free to negotiate and acquire the shares tendered to the other competing acquirer, at the same price that was offered by him to the public.
10.	**Non-compete fees**	**Non-compete fees**
	Non-compete fees up to 25% of the offer price permitted to be paid to the promoters of the target company, in addition to the offer price.	Omitted. Promoters to be paid the same price per share as the public shareholders.
11	**Open Offer Process**	**Open Offer Process**
	(i) Timing of public announcement	(i) Timing of public announcement
	Public announcement to be made within 4 working days of entering into an agreement or making a decision for acquisition.	A summary public announcement on the same day of agreeing to acquire shares or voting rights in, or control over the target company.
		A detailed public statement within 5 business days from making of the summary public announcement.
		(ii) Timeline for open offer: 57 business days
	(ii) Timeline for open offer: 95 calendar days	
12.	**Governance Issues**	**Governance Issues**
	· The acquirer debarred from disposing of assets of the company other than in ordinary course of business for a period of 2 years from the closure of open offer, if such intention to dispose assets is not mentioned in public announcement	· The acquirer can dispose assetsinspite of not stating such intention in public announcement if approval of shareholders of the target company is obtained through a special resolution.
	· The Board of the target company may, if they desire, send their recommendations on the offer to the shareholders.	
		· A committee of independent directors of the target company mandatorily required to give its reasoned recommendations on the open offer to the shareholders.
	Obligations of the Manager	**Obligations of the Manager**

13.	The manager is free to deal with the shares of the target Company after 15 days from the closure of offer period.	The manager is free to deal with the shares of the target Company after the offer period.
	Regulation 25(7) states that the merchant banker shall send a final report to the Board within 45 days from the date of closure of the offer.	The manager shall file a report with the Board within 15 business days from the expiry of tendering period
14	Timelines were based on 'calendar days'.	Timelines are based on 'business days'.

Recommendations to other Regulators

Apart from the recommendations as mentioned above, TRAC has also indirectly given its recommendations to:

a. Reserve Bank of India: for relaxing the norms for lending to domestic acquirers for the purpose of acquisition of shares;

b. SEBI: for modifying ICDR Regulations to relax pricing norms for preferential allotment of equity shares when the equity shares of the acquirer are proposed to be used in the open offer as acquisition currency;

c. Ministry of Company Affairs: for relaxing the squeeze out provisions; and

d. Central Board of Direct Taxes: for exempting capital gains tax on the transfer of shares tendered in open offer.

Implications

On basis of the recommendations given by TRAC, we have analysed the impact of such recommendations on each of the stakeholders:

Promoters of the Target Company

1.Due to increase in initial trigger threshold from 15% to 25%, hostile takeovers for some of the listed companies with lower promoter shareholding could become easy.

2.Increase in voting rights due to buyback of shares has been exempted subject to certain conditions. This should offer some respite for the substantial shareholders who, in spite of not participating in certain type of buy back offers, end up crossing the threshold for open offer.

3.Creeping acquisition has been permitted to the extent of 5% per annum till 75% for any acquirer holding 25% or more voting rights in the target company. This would be beneficial for the promoters to gradually consolidate their shareholding upto 75% in the target company without triggering open offer. The extant Takeover Code permits creeping acquisition only up to 55%.

4.Promoters may now not be able to charge a premium on their stake sale as non-competefees and will be eligible for only such price as is paid to other public shareholders of the target company. This could dissuade many promoters from selling their stakes in listed companies.

Public Shareholders

1.Increasing the offer size from 20% to 100% would give all the shareholders an exit opportunity for all their shares.

2.TRAC has recommended to CBDT to provide capital gains tax exemption on the shares being tendered in an open offer. Currently, such transfers are subject to capital gains tax under the Indian tax laws.

3.The recommendations of TRAC attempt to ensure equitable treatment of public shareholders which is clearly evidenced by the deletion of concept of noncCompete fees. The rationale for omitting non-compete fees is to negate all sorts of differences between promoters and public shareholders so that an price offered remains uniform for all.

4.The shortened timeline for open offer will reduce the market risk for the public shareholders since the open offer price determined as per the Takeover Code could at times be substantially lower than the market price at the time of tendering of shares in the open offer.

5.The public shareholders would benefit from the wisdom of committee of independent directors who will have to mandatorily make reasoned recommendations on open offer.

Strategic Acquirers

Considering the increase in threshold for triggering open offer as well as the offer size, only serious strategic investors would indulge in acquisitions.

1.The cost of acquiring a listed company to substantially increase on account of the increased open offer size.

2.Domestic acquirers may have an issue in funding the acquisitions as banks have limitations on financing for acquisition of shares of another company. However, it would be beneficial for foreign acquirers to acquire an Indian company as finance should be easily available outsideIndia at a cheaper cost.

3.The acquirers have the option to directly delist the target company if the stake of acquirer exceeds delisting threshold without complying with the onerous requirements under the Delisting Regulations.

4.The acquirers can use their own liquid shares or convertible securities as an acquisition currency.

Private Equity Investors

1.The Private Equity investors will get a higher headroom to acquire stake in a listed company since they can now acquire a stake upto 24.99% without triggering an open offer. This could result in more PIPE transactions.

2. No clarity on the definition of ‘control’ especially in situations where PE investors get only minority rights without positive control over the affairs of the target company. More emphasis has been laid on “*defacto control*” as compared to “*dejure control*”.

Target Company

1.The Independent directors of the target company are required to play an active role and give their reasoned recommendations to the shareholders of the target company for or against the open offer. Such a provision would clearly increase the accountability of independent directors who have already become more cautious post Satyam scam. This could also have an impact on the universe of independent directors available for listed companies.

2.A special resolution shall be required to be passed by the shareholders of the target company before alienating any assets of the target company within a period of 2 years from the end of offer period. Currently, Indian corporate laws require only an ordinary resolution of shareholders for disposal of assets / undertaking.

Conclusion

TRAC has attempted to simplify the Takeover Code and align it with the international best practices. The report of TRAC sets a benchmark to emulate before any new legislation is introduced since some of the important principles followed by TRAC such as sound statistical analysis, relying on past Court and SAT rulings, analyzing international takeover codes, plugging the loopholes based on some of the recent cases, etc are extremely important for developing a robust legislation which can stand the test of time.

If SEBI stamps the recommendations of TRAC with force of law, replacing the extant Takeover Code, then the Report of TRAC will be guiding light for takeover regime in India in the next decade to come as was Bhagwati Committee Report, 1997 in the previous decade.