Competition Law Hotline

April 18, 2017

MERGER CONTROL EXEMPTIONS EXPANDED- BETTER LATE THAN NEVER!

- De-minimus exemption extended to mergers and amalgamations as well.
- Asset and turnover of only the portion which is being transferred to be considered for the purposes of the merger control thresholds.
- Method of calculation of assets and turnover of such portion also provided.

INTRODUCTION

On March 27, 2017 the Ministry of Corporate Affairs issued a notification ("**2017 Notification**") under the Competition Act 2002 ("**Competition Act**") which provides for the following (i) an increase in the type of transactions that would be exempt from seeking approval from the Competition Commission of India ("**CCI**") under Section 5 and Section 6 of the Competition Act on basis of certain *de-minimis* thresholds; (ii) a more commercial way of computing the value of assets and turnover for the purposes of Section 5 of the Competition Act in case of acquisition, taking control of, or merger of a portion of an enterprise or division or business; and (iii) an extension of the *de-minimus exemption* for a period of 5 years from the date of publication of the 2017 Notification.

BACKGROUND

Unless specifically exempted, the Competition Act requires every 'combination' to be notified to the CCI in the manner set out in the Competition Act read along with the CCI (Procedure in regard to the transaction of business relating to combinations) Regulation, 2011 ("**Combination Regulations**") and seek its approval prior to effectuating the same. The CCI in turn is required to make a determination as to whether such a combination is likely to result in causing an *'appreciable adverse effect on competition'* for Section 6 of the Competition Act makes void any combination which causes or is likely to cause an appreciable adverse effect on competition within India.

In terms of Section 5 of the Competition Act, a 'combination' involves:

i. the acquisition of control, shares, voting rights or assets of an enterprise by a person;
ii. the acquisition of control of an enterprise where the acquirer already has direct or indirect control of another engaged in identical business; or
iii. a merger or amalgamation between or among enterprises;

that cross the financial thresholds set out in Section 5.

The financial thresholds for a combination are determined with reference to (i) the combined asset value and the turnover of the acquirer and the target, in the event of an acquisition and the combined resultant company, in the event of an amalgamation or merger, and (ii) the combined asset value and the turnover of the "group" to which the target / resultant company will belong pursuant to the proposed acquisition / merger.

The CCI has under the Combination Regulations specified a list of transactions that would not ordinarily require notification before the CCI. The Competition Act also permits the Central Government to exempt certain enterprises or classes of enterprises from the application of the Competition Act in public interest. In furtherance of this provision the Central Government had under a notification dated March 4, 2011 ("**2011 Notification**") exempted enterprises *whose control, shares, voting rights or assets were being acquired*, that had assets not exceeding INR 2.5 billion in value or turnover not exceeding INR 7.5 billion in India, from the provisions of section 5 of the Competition Act for a period of 5 years. The 2011 Notification was superseded by the notification dated March 4, 2016 ("2016 Notification") whereby the threshold for the asset value to be exempt was increased from INR 2.5 billion to INR 3.5 billion and the threshold for the turnover was increased from INR 7.5 billion to INR 10 billion for an additional period of 5 years (as analysed by us previously here).

2017 NOTIFICATION

The 2017 Notification has enhanced the 2016 Notification and the de-minimus exemption in terms of scope as well as term. While there is no increase in the thresholds for the asset value and turnover, the 2017 Notification intends to cover more situations in relation to small enterprises and transactions. We have analyzed the changes brought about by the 2017 Notification in detail below.

Key changes under the 2017 Notification

A. *Extension of the De-minimis Threshold:*

The 2011 Notification and the 2016 Notification provided great relief to corporate India for without such an exemption every small acquisition by global players or large corporates would likely need prior approval of the CCI, thereby

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increasing deal uncertainty, timelines and costs. However one key concern that continued to prevail despite the de-minimus exemption was that it was interpreted to apply to a select types of combinations and not all types of combinations. The words "enterprise *whose control, shares, voting rights or assets were being acquired"* was interpreted by the CCI to mean that only combinations that were in the form of acquisitions were entitled to the benefit of this exemption. Therefore only if the acquirer was acquiring shares or voting rights or control or assets of a small enterprise (i.e. an entity whose assets or turnover fell below the prescribed thresholds), would the exemption apply. Should a combination take the form of an 'amalgamation' or 'merger', such combination would not be accorded the benefit of the exemption. Hence transactions which involved a merger of small enterprise as opposed to an acquisition of such an enterprise were denied the benefit of the 2011 Notification and 2016 Notification, as the case may be.

The 2017 Notification seeks to rectify this anomaly. The 2017 Notification now exempts enterprises being party to any form of combination described under Section 5 of the Competition Act – acquisitions and mergers / amalgamations alike, where the value of assets being acquired, taken control of, merged or amalgamated is not more than 3.5 billion in India or turnover is not more than INR 10 billion from the provisions of Section 5 of the Competition Act ("**2017 De-minimus Financial Thresholds**").

Additionally, the 2017 Notification extends the period of exemption in such cases for a period of 5 years from the date of publication of the notification (that is March 27, 2017) and hence extends the exemption for an additional period of one year compared to the 2016 Notification.

B. *When a portion of the business is being acquired:*

Section 5 of the Competition Act provides for a standard manner in which the asset value and turnover value of the parties to the combination need to be computed when determining whether the financial thresholds prescribed under the Competition Act have been crossed. This determination is combination agnostic. Consequently, whether the transaction involved the acquisition of assets constituting less than 1% of the asset value of the company or whether the transaction involved the acquisition of 100% of those assets, the entire asset value of the enterprise who was selling the assets would be taken into consideration for determining the financial thresholds under the Competition Act.

The 2017 Notification now relaxes these thresholds. The 2017 Notification specifically states that where a portion of an enterprise or division or business is being acquired, taken control of, merged or amalgamated with another enterprise, the value of assets of the said portion will be the relevant assets and turnover to be taken into account for the purpose of calculating the thresholds under Section 5 of the Competition Act. This results in the entire enterprise value being disregarded in cases where it is the commercial intent for the acquirer to acquire only a portion of an enterprise.

This relaxation provides great relief to small transactions as any large company that divested even a fraction of its business needed the approval of the CCI thus far.

C. *Calculations and more*

The 2017 Notification has also provided for the manner of determination of the value of assets and turnover when a portion of an enterprise or division or business is being acquired. In these circumstances the 2017 Notification states that:

i. The value of assets will be the book value of assets for the financial year immediately preceding the financial year in which the date of the combination falls as per the:
   - audited books of accounts of the enterprise; or
   - statutory auditor's report if the financial statements of the enterprise have *not yet become due to be filed*

ii. as reduced by depreciation and the value of assets shall include various forms of intellectual property including goodwill, brand value etc, if any.

iii. The turnover will be the turnover of the said portion or division or business of the enterprise *as certified by the statutory auditor on basis of the last available audited accounts of the company*.

This determination would only apply when a portion of an enterprise or division or business is being acquired and not in situations where an investment is made into an enterprise. The intent appears to be to disregard assets or turnover of an enterprise that the acquirer will have no exposure to.

The scope of the terms "not yet become due to be filed" is unclear. Taking the guidance of the Companies Act, 2013, the financial statements of a company for a financial year are required to be approved by the shareholders in its annual general meeting in the year following that financial year, which can be held latest by September 30 and these financial statements are required to be filed with the registrar of companies within 30 days from the date of the shareholder meeting. On this basis, in case the relevant date for the combination falls prior to the month of October in a particular financial year, it can be said that the financial statements of the enterprise "have not yet become due to be filed" and hence reliance would be placed on the statutory auditors report for the financial year 2016-17 which would provide for the value of the assets of the enterprise. However, no format of the statutory auditor's report has been provided and it is unclear on what basis (unaudited financial statements for instance) and whether in fact the report of the auditor is to be prepared for determining the value of the assets in such financial year.

Determination of turnover however does seem to require this process and the last 'available' audited accounts of the company can be used to make a determination.

D. *Rescission of 2016 Notification:*

The 2017 Notification rescinds the 2016 Notification on a prospective basis, that is, it does not affect the transactions which were previously covered under the 2016 Notification. Therefore transactions that triggered the provisions of the Competition Act prior to 2017 Notification coming into effect, whether such filings were made or not, may not be granted the benefit of the 2017 Notifications.

E. *On a combined reading of matters discussed in A, B and C above*

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There are great reliefs that the 2017 Notification brings about for corporate India undertaking commercial transactions and this will significantly improve the bandwidth of the CCI weeding out transactions that wouldn't normally warrant the attention of an anti-trust regulator. On a combined reading of the changes discussed in A, B and C above, it would appear that:

i. The 2017 Notification extends the benefit of this exemption to all forms of combinations under Section 5 of the Competition Act where assets or turnover being acquired are less than the 2017 De-minimus Financial Thresholds.

ii. In transactions that involve assets acquisitions or slump sale and business acquisitions, the assets being acquired would be relevant for the computation of the financial thresholds under Section 5 of the Competition Act. The value of the assets or business must be determined as per the methodology discussed in C above and is independent of the transaction value.

iii. If the value of the assets or the business (as per the methodology discussed above) being acquired is less than the 2017 De-minimus Financial Thresholds, such a combination will be exempt from the provisions of Section 5 of the Competition Act.

iv. Regulation 5(9) of the Combination Regulation provides that in case of combinations that involve a series of inter-related steps/transactions, where assets are being transferred to an enterprise for the purpose of such enterprise entering into an agreement relating to an acquisition/merger/amalgamation with another person or enterprise, the value of assets and turnover of the transferor enterprise shall be attributed to the value of assets and turnover of the transferee enterprise for the purpose of calculation of thresholds under Section 5 of the Act. Given the new methodology of computation, Regulation 5(9) has been watered down. Now, only the value of the portion of the enterprise or division or business in terms of assets and turnover may be considered along with the asset and turnover of the acquiring or merging or amalgamating enterprise for the purposes of Section 5 of the Competition Act.

However the 2017 Notification is not free from ambiguities. The language of the exemption uses the words "value of assets" and "value of turnover" being acquired in a non-uniform manner giving rise to the concerns such as:

i. If only assets are being acquired, how will turnover be calculated in relation to those assets?

ii. Similarly, transactions that involve only an acquisition of a stream of revenue, for instance, the assignment of exclusive contracts, how will asset value be calculated?

iii. Since the 2017 Notification is an "or" test i.e. the exemption would be granted if the assets value is less than the 2017 De-minimus Financial Thresholds OR the turnover value is less than the 2017 De-minimus Financial Thresholds, will the transactions that involve only an asset acquisition or only a revenue stream being acquired always get the benefit of the 2017 Notification?

iv. Methodology of how to calculate the value of assets and turnover where audited accounts for the previous financial year are not available in combinations that involve acquisition of a portion of the division or business continues is unclear.

v. In situations where assets like self-generated intellectual property are being transferred, where there is no corresponding 'book value' in the financial accounts of a company, how will the asset value be computed?

CONCLUSION

The Central Government through the 2017 Notification has taken a further step in relaxing and reducing the requirement for making a merger control filing which is congruent with the Government's narrative of ease of doing business in India. We expect the CCI to come out with a clarification in relation to the ambiguities pointed out here soon.

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You can direct your queries or comments to the authors