

M&A Hotline

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BUYBACK OF SHARES: DOES IT TRIGGER AN OPEN OFFER?

Securities and Exchange Board of India ("SEBI") in its recent orders in the matters of OCL India Limited¹ and Ajanta Pharma Limited² has cleared the ambiguities clouding the issue of trigger of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 1997, (the "Takeover Code") pursuant to a buy-back of shares by a listed company resulting in passive increase in shareholding or voting rights in the company.

I. OCL India Limited ("OCL")

FACTS

OCL had effected a buy-back of 11,83,708 equity shares in 2003. Consequent to the said buy-back, the voting rights of its promoters, who had not participated in the buy-back, increased from 62.56% to 75%. Though this increase in voting rights triggered the open offer requirement under Regulation 11(1) of the Takeover Code (as it stood at the time of the buy-back in 2003 which allowed an acquirer, holding between 15% and 75% of shares or voting rights, to increase the shareholding by 5% in one financial year without trigger of an open offer), the 'acquirers' failed to make an open offer to acquire at least 20% of the voting capital of OCL from its then existing public shareholders, mandatory under the Takeover Code.³ In light of this breach, SEBI issued a show cause notice dated July 17, 2007 to the promoters of OCL *inter alia* alleging that they are liable for penal action under the Takeover Code and the SEBI Act, 1992.

ISSUE UNDER CONSIDERATION

Whether the increase in voting rights of the promoters incidental to the buy-back would trigger the open offer obligation under the Takeover Code or not?

FINDINGS

SEBI categorically stated that any increase in voting rights beyond the prescribed thresholds pursuant to a buy-back would trigger an open offer obligation under the Takeover Code. In the instant case the voting rights of the promoters of OCL increased from 62.56% to 75%, i.e. an increase of 12.44% which triggered the open offer obligation under Regulation 11(1) of the Takeover Code.

(I) ACQUISITION OF SHARES NOT A PRE-REQUISITE FOR TRIGGER

The promoters of OCL took a defence that the increase in shareholding or voting right pursuant to a buy-back was not an 'acquisition' of shares or voting rights through an act of the shareholder, but was merely incidental to the buy-back and that such an increase in shareholding or voting rights without an actual acquisition of shares will not trigger Regulation 11(1). SEBI observed that acquisition of shares is not necessary for trigger of open offer obligation under Regulation 11(1) and that the mode of acquisition was not relevant for such trigger. The two trigger events are mutually exclusive and hence increase in voting rights without acquisition of shares can trigger the open offer obligation.

(II) EXEMPTION IS NOT AUTOMATIC

The Takeover Code does not provide any automatic exemption from open offer obligation triggered on account of a passive increase in shareholding or voting rights incidental to a buy-back. Further, an exemption is not a matter of right of the acquirers but a discretionary exemption granted by SEBI on a case to case basis. In the instant case, the acquirers did not move any exemption application and hence were in violation of the Takeover Code.

(iii) Open offer not beneficial to the shareholders

SEBI finally concluded that the promoters of OCL had acted in contravention of the Takeover Code by not making an open offer to provide exit opportunity to the public shareholders. However, SEBI did not direct the promoters to make the open offer on the ground that the open offer price calculated as per the earlier market price was much lower than the prevailing market price.⁴ Consequently, no shareholder would have opted for the exit option and the open offer would have been rendered unsuccessful. Accordingly, SEBI directed adjudication proceedings against the promoters of OCL.

II. Ajanta Pharma Ltd. ("Ajanta")

FACTS

The acquirers belonged to the promoter group of Ajanta and held 66.82% of the paid up capital of Ajanta. Ajanta

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proposed to buy back certain shares pursuant to which the shareholding of the acquirers would have increased from 66.82% to 73.92%, i.e. 7.10%, given that the acquirers were not participating in the buy-back. This passive increase in shareholding and the corresponding increase in voting rights of the acquirers would trigger Regulation 11(2) of the Takeover Code, mandatorily requiring the promoters to make an open offer. Hence, Ajanta moved an exemption application on behalf of the acquirers before SEBI seeking exemption from the open offer obligation.

ISSUE UNDER CONSIDERATION

Whether the acquirers forming part of the promoter group are eligible for exemption from the open offer obligation on the grounds mentioned in the application or not?

FINDINGS

(i) Exemption required only for acquisition up to 2.1%

SEBI concluded that the passive increase in shareholding and voting rights from 66.82% to 73.92%, pursuant to the buy-back, triggers Regulation 11(2) of the Takeover Code, but clarified that the entire increase by 7.10% does not constitute the trigger event. Under Regulation 11(2), any acquisition of shares or voting rights by an acquirer already holding 55% or more but less than 75% of the shares or voting rights in a target company mandates a compulsory open offer.

In this context, it is pertinent to note that the second proviso to Regulation 11(2) which came into effect on October 30, 2008, exempts an acquirer from open offer obligation under Regulation 11(2) in case of an increase in shareholding or voting rights upto 5% if such increase is pursuant to a buy-back of shares by the target company;

SEBI, vide circular dated August 06, 2009, has clarified that the 5% limit under proviso to Regulation 11(2) can be availed only once in the lifetime of the company and is not renewed each financial year as in the case of Regulation 11(1).

In the light of the second proviso to Regulation 11(2) and the clarification issued, SEBI concluded that the acquirers forming part of the promoter group of Ajanta are automatically exempt from the open offer obligation under Regulation 11(2) for acquisition up to 5%. However, the acquirers required a specific exemption from SEBI for the remaining 2.10% which alone constituted the trigger event.

(ii) Promoters are eligible for exemption

SEBI exempted the acquirers from the obligation of making an open offer pursuant to the passive increase in shareholding and the corresponding increase in voting rights (i.e. the increase of 2.10% beyond the 5% exemption). The exemption was given on the basis of the following considerations:

- There would be no proactive acquisition of shares or voting rights by the acquirers and the increase would be only incidental to the proposed buy-back.
- The increase in voting rights would not bring about any change in control of Ajanta as the promoter group already held 66.82% of the equity share capital and were thus in control.
- The buy-back was expected to contribute to the overall enhancement of the shareholder value and result in an increase in the return on equity of Ajanta.
- The company had assured that the proposed buy-back would be carried out in compliance with all the legal norms and requirements.
- The Takeover Panel observed that the passive increase in shareholding would not be detrimental to the interests of the public shareholders.

On these grounds SEBI granted exemption to the promoters of Ajanta from the open offer requirement under Regulation 11(2) for the acquisition of 2.1% voting rights pursuant to the proposed buy-back.

CONCLUSION

SEBI has clarified that there is no automatic exemption available to the acquirers from trigger of Takeover Code pursuant to a buy-back except as provided in the proviso to Regulation 11(2) or on specific exemption granted on application by SEBI. The precedents evidently reflect that SEBI has been flexible enough to grant exemption to the acquirers on exemption applications when the acquisition is incidental to the buy-back and there is no change in control of the company. In light of this trend, it is advisable to consolidate the law on trigger of Takeover Code pursuant to buy-back and specifically incorporate it in the Takeover Code rather than keeping it discretionary at SEBI's volition. The Takeover Regulations Advisory Committee constituted to review the Takeover Code should also critically review the Takeover Code vis-a-vis buy-back of shares to clear the ambiguities surrounding this issue.

- **Arun Scaria, Sadia Ashraf & Nishchal Joshipura**

¹ <http://www.sebi.gov.in/cmorder/ocl.pdf>

² <http://www.sebi.gov.in/cmorder/ajpharma.pdf>

³ Regulation 10, Regulation 14(1), Regulation 21

⁴ Regulation 20(4)

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