
M&A LAB

Zandu - Emami Deal Dissected

Dissected by –
Team M&A

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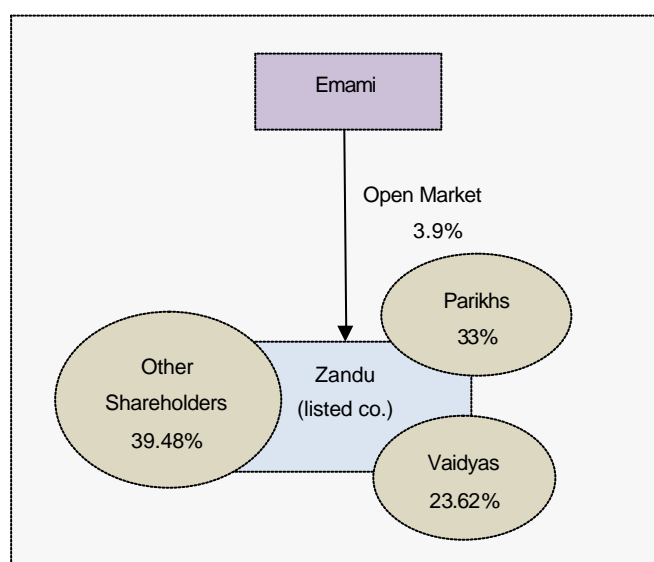


BACKGROUND

In May 2008, Emami Limited (“**Emami**”), an Indian public limited company, entered into share purchase agreements (“**Agreements**”) with Devkumar Vaidya and family, the co-promoters of Zandu Pharmaceuticals Works Limited (“**Zandu**”) and persons acting in concert (collectively **Vaidyas**), to acquire 23.62% stake in Zandu. Prior to this acquisition, Emami was already holding 3.9% equity stake in Zandu which was acquired through open market purchases.

The deal was not a runaway victory for Emami as it went into dispute with the Parikh family, the other co-promoters of Zandu (the “**Parikhs**”) alleging violation of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (“**Takeover Code**”), Securities and Exchange Board of India (Prohibition of Insider Trading) Regulation, 1992 (“**Insider Trading Regulations**”) and the Companies Act, 1956 (“**Act**”). Further, the Parikhs moved the Bombay High Court alleging *inter alia* their right of first refusal in respect of the 23.62% stake that the Vaidyas sold to Emami. In pursuance of this dispute Zandu did not register Emami as the owner of the acquired shares in its books.

STRUCTURE



KEY IMPLICATIONS AND ANALYSIS UNDER INDIAN LAWS

SECURITIES LAW ISSUES

Takeover Code

Emami acquired 23.62% stake from the Vaidyas in two tranches, on May 28, 2008 (10.92%) and May 29, 2008 (12.70%). Pursuant to the acquisition of 12.70% shares of Zandu in the second tranche, Emami made public announcement of its open offer under the Takeover Code¹ on June 1, 2008 to acquire additional 20% of the shareholding of Zandu in accordance with Regulation 14 of the Takeover Code.

¹ The objective of Takeover Code is to ensure that the incumbent management of the target company is aware of the substantial acquisition of shares or voting rights and the small investors are given an exit option under the new dispensation by way of an open offer to buy them out. Regulation 14 of the Takeover Code accordingly requires an acquirer of shares, whose aggregate shareholding or voting right in any listed company exceeds the threshold limit provided under the Takeover Code, to make a public

Zandu and the Parikhs alleged before the Bombay High Court and later the Company Law Board (“CLB”) that Emami was in violation of Regulation 10² of the Takeover Code on the basis that Regulation 14(1) of the Takeover Code does not necessarily contemplate the existence of a written agreement to acquire shares, voting rights or control of a listed company for triggering the obligation of making an open offer by the acquirer. Regulation 14 requires that the public announcement of open offer (triggered under Regulation 10) be made even in case of a decision to acquire shares, voting rights or control of a listed company. Accordingly, the Parikhs contended that the open offer requirement was triggered not on May 29, 2008 when the second tranche shares were acquired and the 15% threshold under Regulation 10 was hit, but much prior to the aforesaid acquisition as the decision to acquire the 23.62% shares of Zandu was taken before May 28, 2008 and May 29, 2008, and that the two tranche acquisitions were part of one single transaction.

Emami on the other hand contended that the parties may have negotiated to acquire the shares for a long time but only when they crystallize and enter into a proper contract of either transfer or payment of a consideration that the Takeover Code gets attracted. Further, Emami contended that the shares were acquired from eight parties and even though they were related to each other, each acquisition was an independent transaction. Accordingly on May 29, 2008 when the second tranche was acquired the Takeover Code was triggered.

Team M&A View

In view of Regulation 14, it is evident that a written agreement is not the only trigger for open offer, and a mere “decision” to acquire alone may be enough to trigger an open offer. However, in the absence of a written contract, the time and fact of “decision” to acquire would be subjective and would *inter alia* depend upon the conduct of the parties concerned.

It is pertinent to understand that, one may have begun negotiations and talks for acquisition much before an agreement is executed, however, what actually constitutes a definitive “decision” is arguable. One may have decided to acquire shares subject to negotiations, however, the failure between the concerned parties to reach a common ground may not lead to a consummation of the deal, thereby, frustrating the very trigger for making an open offer.

Insider Trading

The Parikhs contended that Devkumar Vaidya was a senior employee of Zandu for more than 15 years and was designated as the Management Executive of Zandu. Also, he was an invitee to all the board of directors meetings since September 2005. Further, Devkumar Vaidya was present in the board meeting in which they discussed the approval of accounts and future sales plan as well as review of the financial position for the year 2007-2008. Therefore the Parikhs alleged that Devkumar Vaidya was an “insider”³

announcement of open offer not later than four working days of entering into an agreement for acquisition of shares or voting rights or deciding to acquire shares or voting rights exceeding the threshold limit

² No acquirer shall acquire shares or voting rights which (taken together with shares or voting rights, if any, held by him or by persons acting in concert with him), entitle such acquirer to exercise 15% or more of the voting rights in a company, unless such acquirer makes a public announcement to acquire shares of such company in accordance with the regulations.

³ Under Regulation 2(e) of the Insider Trading Regulations, an Insider, means any person who is, or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access to unpublished

under the Insider Trading Regulations as he was in possession of unpublished price sensitive information (“UPSI”) and hence, was barred from dealing in securities of Zandu without obtaining clearance and approval from Zandu. Thus, Devkumar Vaidya was in violation of Zandu’s code of conduct framed in accordance with the Insider Trading Regulation and Regulations 3⁴ and 3A⁵ of the Insider Trading Regulations.

It was contended on behalf of Devkumar Vaidya that as per the Clause 41 of the Listing Agreement, within 15 minutes of finalization and approval of the accounts by the board of directors the same is to be communicated to the concerned stock exchange. Therefore, the information relating to the accounts and financials of Zandu was in public domain and not UPSI. Also, it was contended that Devkumar Vaidya was not involved with Zandu’s management from 2005 due to friction and misunderstanding between the Parikhs and Vaidyas and hence was not in possession of any UPSI.

Team M&A View

In respect of the violation alleged under the Insider Trading Regulations, one may argue that the intent of the Insider Trading Regulations is to prohibit a person from deriving undue advantage from dealing in securities of a listed entity due to access to any UPSI which such person is privy to by virtue of his position in the concerned listed entity or otherwise. In the instant case, as long as it can be proved that person dealing in securities of Zandu was not driven by the UPSI such dealing should qualify as a bonafide dealing of security. Further, as per the Listing Agreement, since the disclosure to stock exchange was made within 15 minutes of the Board Meeting, the information available with Devkumar Vaidya no longer remained a UPSI.

However, it is pertinent to note here that under the Insider Trading Regulations, every listed company is required to frame an internal code of conduct for its directors and designated employees⁶ for dealing in securities of the company in consonance with the Model Code of Conduct provided under Schedule II of the Insider Trading Regulations. Under the Model Code of Conduct, all directors/officers/designated employees of the company who intend to deal in the securities of the company (above a minimum threshold limit to be decided by the company) should obtain pre-clearance as per the pre-dealing procedure that may be provided. *Prima facie*, this code of conduct is applicable irrespective of whether the directors and designated employees are in possession of UPSI or not. Accordingly, it might be pertinent to understand whether Devkumar Vaidya adhered to the Code of Conduct for Zandu to determine any violations under such Code.

price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information

⁴ Regulation 3 of the Insider Trading Regulations prohibits dealing, communication or counseling on matters relating to insider trading

⁵ Regulation 3A prohibits dealing in the securities of another company or associate of that other company while in possession of any unpublished price sensitive information

⁶ the term ‘designated employee’ includes:

- i. officers comprising the top three tiers of the company management; and
- ii. the employees designated by the company to whom the trading restrictions are applicable, keeping in mind the objectives of the code of conduct.

CORPORATE LAW ISSUES

Right of First Refusal

The Parikhs approached the Bombay High Court claiming they had the right of first refusal on the shares held by Vaidyas in Zandu and therefore the Vaidyas were obligated to offer the shares to the Parikhs before transferring to Emami. In pursuance of this dispute Zandu did not register Emami as the owner of the acquired shares in its books. However, the Parikhs could not substantiate the claim. Also, the Chairman of Zandu, Mr. Y.P. Trivedi stated that he was not aware of existence of any such agreement between the Vaidyas and Parikhs.

Team M&A View

The Parikhs right of first refusal on the shares held by Vaidyas could not be substantiated and proved. However, one pertinent issue that arises is the impact that the right of first refusal could have had on the transfer had the right of first refusal been proved? Section 111A of the Act states that shares of a public company are freely transferable. Even if transfer restrictions are incorporated in the Articles of Association of Zandu or by way of any contractual arrangement, the enforceability of the transfer restrictions vis-a-vis Zandu might become doubtful on account of Section 111A of the Act. Further, there have been judicial precedents both in favour and against the enforceability of such transfer restrictions in an Indian public company and hence the enforceability of such transfer restrictions in case of an Indian public company still remains untested.

Suspension of voting rights

The Parikhs regarded the acquisition as threat to Zandu's management and an attempt to oust the Parikhs and therefore sought injunction for restraining Emami from exercising voting rights over the Zandu shares purchased from the Vaidyas.

Emami claimed that its intention was not to overthrow or hinder the current management of Zandu and to clarify its intention committed that it shall not exercise voting rights over the 12.70% shares that it acquired in the second tranche which had triggered the open offer requirement.

In view of the aforesaid commitment of Emami and in view of the Parikhs controlling 33% stake in Zandu, CLB did not see any eminent danger to the management of Zandu and denied suspension of the voting rights as requested by Parikhs and Zandu. CLB also uplifted the principle that corporate democracy should prevail and that shareholders voting rights should be suspended only on rare occasions.

Team M&A View

A pertinent issue remains as to whether a shareholder can contractually waive certain right which has been provided by law. Section 9 of the Act makes any agreement void which is *ultra vires* the Act, therefore, any agreement by Emami to waive its voting rights may not be enforceable by Zandu against Emami if Emami proposes to exercise such rights in future, however, such agreement to waive voting rights may be contractually enforceable by Parikhs vis-a-vis Emami.

Inter-Corporate Loans and Investment

Parikhs alleged before the CLB that the acquisition of shares by Emami exceeded the limits prescribed under Section 372A of the Act and hence the acquisition was in violation of Section 372A of the Act. Under Section 372A(1)(c) of the Act, a company is prohibited from directly or indirectly acquiring, by way of subscription, purchase or otherwise the securities of any other body corporate, exceeding 60% of its paid-up share capital and free reserves, or 100% of its free reserves, whichever is more. Accordingly, Zandu and Parikhs submitted that since the acquisition is in violation of Section 372A of the Act, the name of Emami as holder of the shares in Zandu should be struck down from Zandu's register of members.

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Section 372A(1) of the Act contemplates that a special resolution passed in a general meeting be required by a company for acquisition of shares of any other body corporate, exceeding 60% of the acquiring company's paid-up share capital and free reserves, or 100% of its free reserves, whichever is more. Accordingly, if such special resolution was not passed by Emami, there would have been a violation under the Act by Emami.

Restriction on acquisition of certain shares

The Parikhs alleged violation under Section 108A and Section 108G of the Act, as Emami did not obtain prior approval of the Central Government for acquisition of shares of Zandu. Section 108A of the Act requires that prior approval of Central Government should be obtained for acquiring shares in a public company, in the event that the total nominal value of equity shares intended to be acquired exceeds 25% of the paid-up equity share capital of such target company. It was further alleged by Parikhs that acquisition of shares by Emami would have given rise to issues relating to abuse of dominance under Section 108G of the Act since the combined share of Emami and Zandu in sales of product category "Rubefacient" for the years 2004, 2005 and 2006 was 25.44%, 25.3% and 26.33% respectively and thus prior approval of Central Government was imperative.

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The Central Government has power under section 108D to direct the companies not to give effect to the transfer of shares if in the opinion of the Central Government the transfer is resulting in a change in controlling interest which is prejudicial to the company or against public interest. Accordingly, CLB took a stand that the issue should first be adjudicated by the Central Government before CLB takes any actions.

Acquisition of Zandu Shares: A Case of Hostile Takeover

Zandu and the Parikhs alleged that the hostile acquisition of Zandu shares by Emami was an attempt to overthrow the management of Zandu, which at the time of acquisition of shares rested in the hands of the Parikhs. Accordingly, attempts were made by the Parikhs and Zandu to resist the aforesaid takeover, which is evidenced by the following takeover defenses:

- Zandu attempted to make preferential allotment of additional 5% shares to the Parikhs to keep the control in the hands of Parikhs. Accordingly, allotment of preference shares was included in the agenda for the board of directors meeting scheduled for June 6, 2008. However, the agenda was

withdrawn due to opposition from the independent directors of Zandu and legal notice served by Emami.

- Zandu had taken out a supplementary agenda in the form of a notice from a shareholder to appoint 5 additional members on the board of directors of Zandu for its Annual General Meeting scheduled for September 24, 2008. However, this move was successfully opposed by Emami.
- Zandu had initially approached SEBI for violation of Takeover Code pursuant to acquisition of shares by Emami and moved on to approach CLB without waiting for the outcome of petition filed before SEBI.

Team M&A View

In spite of Zandu's attempt to thwart the hostile takeover attempt from Emami, Emami succeeded in refraining Zandu by taking timely legal actions against Zandu. In our view, the Takeover Code provides an equal opportunity to an acquirer to make hostile acquisitions and to the promoters and the target company to defend such hostile acquisitions.

Jurisdiction Issue

Emami argued that the issues raised under the present dispute were with respect to acquisition of shares which is governed by the Takeover Code and that the entire matter fell under the ambit of Regulation 44(d)⁷ of the Takeover Code where under SEBI has the authority to cause a target company to suspend voting rights on the shares acquired by any person or withhold the target company from transferring shares in favour of an acquirer.

After hearing all the parties, the CLB observed that the allegations of violation of Takeover Code and Insider Trading Regulations were to be decided by SEBI and similarly most of the allegations made by the Parikhs under the Act including those relating to investment beyond the limits prescribed under the Act and creation of a dominant undertaking were to be investigated and confirmed as violation by the Central Government. Further, as some of the allegations were of criminal nature and might have entailed penal consequences, the CLB observed that a Criminal Court should decide on the issue relating to such violations.

CLB thus held that it had no jurisdiction over the subject matters and directed the matter to SEBI and Central Government which were the appropriate authorities to decide the matters.

Team M&A View

CLB rightly dismissed the petition as the subject matter of the dispute exceeded its jurisdiction. The Section 15Y and Section 20A of the Securities and Exchange Board of India Act, 1992, grants exclusive

⁷ Without prejudice to its rights to initiate action under Chapter VIA and section 24 of the Act, the Board may, in the interest of the securities market or for protection of interest of investors, issue such directions as it deems fit including:

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.....

(d) directing the target company or the depository not to give effect to transfer or further freeze the transfer of any such shares and not to permit the acquirer cancel or any such shares and not to permit the acquirer or any nominee or any proxy of the acquirer to exercise any voting or other rights attached to such shares acquired in violation of regulation 10, 11, 12.

powers to SEBI to deal with the matters relating to the Takeover Code and it cannot be exercised by anybody else. In this regard, the CLB relied upon the Bombay High Court Judgment in the matter of *Kesha Appliances P. Ltd. & Others v. Royal Holdings Services Ltd. & Others*⁸, wherein it was observed that, once the provisions of the Takeover Code are invoked, then the entire jurisdiction by virtue of the provisions of Section 15Y and Section 20A is exclusively conferred on SEBI.

FINAL OUTCOME

Pursuant to the settlement efforts initiated by the CLB vide its order dated September 22, 2008, the Parikhs agreed to sell 18.18% shareholding in Zandu to Emami. Accordingly, Emami acquired, through a share purchase agreement dated October 15, 2008 (the day on which the open offer closed) 18.18% of the shareholding of Zandu at a price of Rs 15,000 (Rupees Fifteen Thousand only) per share and also paid a non-compete fee to Parikhs of Rs 1,500 (Rupees Fifteen hundred only) per equity share. Also Emami acquired through open market purchases stake in Zandu on October 15, 2008.

Pursuant to the aforesaid acquisition from the Parikhs and the purchases from open market along with the acquisition of shares in the open offer, Emami secured 70.34% stake in Zandu in the following manner.

i.	From Parikhs	18.18% @ Rs. 16,500 per share
ii.	From Vaidyas	23.62% @ Rs. 6,900 per share
iii.	From Public Shareholders	28.54% <ul style="list-style-type: none"> • 3.9% through secondary market; • 20% @ Rs. 16,500 per share; and • 4.64% @ Rs. 14,440 per share (approx)

Pursuant to the compromise between Emami and Parikhs, Emami has also invited members of the Parikhs to join its restructured board as independent directors. The wrestle to acquire control of herbal health care firm Zandu, by personal-care products maker Emami, was thus laid to rest after the Parikhs agreed to sell their stake to Emami and after the consummation of the public offer, largely because of the support of the Parikh family.

CHRONOLOGY OF KEY EVENTS

To conclude, the chronology of key events is summarized as under:

Date	Event summarized
September 7, 2007 to May 9, 2008	Emami acquired a minor stake in Zandu of 3.9% through open market purchases
May 28, 2008 and May 29, 2008	Emami acquired 23.62% stake from the Vaidyas in two tranches on May 28, 2008 (10.92%) and May 29, 2008 (12.70%) thereby increasing its stake in Zandu to 27.52% from its earlier holding of 3.9%
June 1, 2008	Emami announced open offer to buy 20% additional shares from shareholders of Zandu
June 5, 2008	The Board of Directors of Zandu sent a notice to the Bombay Stock Exchange stating its board would meet to discuss a preferential allotment to the promoters and directors of Zandu

⁸ 2006 (1) Bom.C.R.545

June 6, 2008	The Emami group issued legal notice to Zandu's board with respect to the proposed preferential allotment. The preferential allotment proposal was dropped pursuant to the aforesaid legal notice and opposition by the independent directors of Zandu
August 7, 2008	The Bombay High Court directed CLB to decide on Zandu's application alleging violation of Takeover Code, Insider Trading Regulations and the Act
August 26, 2008	The CLB dismissed the petition and referred the matter back to Bombay High Court on grounds that it did not have jurisdiction over the subject matter
September 12, 2008	Open offer cleared by SEBI
September 15, 2008	Emami revised the initial offer price from Rs. 7,315 to Rs. 15,000. Further, the open offer was made more attractive by revising the open offer price from Rs 15,000 per share to Rs 16,500 per share
September 26, 2008	Opening of open offer
October 15, 2008	Closing of open offer

This analysis should not be construed as a legal opinion. Although every effort has been made to provide accurate information in this analysis, we cannot represent or guarantee that the content of this analysis is appropriate for your situation and hence this information is not a substitute for professional advice. The facts and figures mentioned in this analysis have been obtained from publicly available sources and Nishith Desai Associates does not vouch for the accuracy of the same. It may not be relied upon by any person for any other purpose, nor is it to be quoted or referred to in any public document or shown to, or filed with any government authority, agency or other official body without our consent. We are relying upon relevant provisions of the Indian laws, and the regulations thereunder, and the judicial and administrative interpretations thereof, which are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could have an effect on our interpretation of the relevant provisions contained in this analysis.

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