

Permissible Combinations—Legal Perspective

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This article deals with the competition law aspects of mergers and acquisitions which are broadly referred to as "Combinations" under the Competition Act, 2002 (Act). The Article analyses the issues and concerns regarding the manner in which Combinations are sought to be regulated. The Draft Competition Commission (Combinations) Regulations are also discussed to understand the types of Combinations that may be permissible. In addition, the article also examines the broad classification of Combinations per international practices to further understand the type of Combinations that are likely to fall beyond the rigors of the Act. In analysing the law on Combinations, the article seeks to highlight certain concerns that need to be resolved and grey areas which require further deliberation by the legislature before such law is brought into full force and effect.

Introduction

In the aftermath of the recent economic crisis, mergers and acquisitions (M&A) in the market are once again on the rise. This is primarily due to affordable valuations of target companies and increasing liquidity of potential acquirers. More importantly, market players are looking to consolidate resources to beat growing competition.

Regulation of Combinations

Currently, the regulatory framework which governs M&A transactions such as the Companies Act, 1956 and regulations passed by the Securities and Exchange Board of India (applicable to listed companies), primarily regulate and administer the arrangement between companies and their respective shareholders/creditors etc. However, there was no legislation addressing the impact of such M&A transactions on the market and the consumer community at large. In order to secure the interests of

the consumers and market players, the Competition Act, 2002 (Act) was introduced with the objective of sustaining competition in the market, ensuring freedom of trade and safeguarding the interests of the consumers at large. Under Sections 5 and 6, the Act governs M&A transactions by regulating certain types of "Combinations". While the term "Combination" has not been defined under the Act, the said term is broadly used to encompass an acquisition, merger or amalgamation that cross the threshold limits prescribed under Section 5 of the Act.

It is important to note that the sections regulating Combinations have not been notified and are yet to attain the force of law.

Concerns

The concerns associated with the manner in which the Act seeks to regulate Combinations are manifold.

Firstly (and has been significantly publicised), is the mandatory notification process stipulating a waiting period of 210 days within which the Competition Commission of India (CCI)¹ is required to grant its approval. Though competition laws of certain international jurisdictions such as the United States provide for mandatory notification of combinations, the waiting period is significantly shorter (30 days). However, in India, the lengthy 210 day waiting period may impact time lines in the closing of mergers and acquisitions, and the costs involved in waiting out this time period. This will impact the industries which are considering rapid expansion by way of M&A, for instance pharmaceutical and automotive industries and the like.

Secondly, the threshold limits prescribed [based on assets/turnover of the combining parties (or the group) within and outside India] which on the face of it appear high, may still impose limitations on enterprises in terms of expansion of their existing market base. Capital intensive sectors like infrastructure, petroleum refinery, etc. due to their nature of business require significant asset creation. However, merely on account of their asset size, they may unnecessarily be brought within the rigors of the Act. Further, under the Act, once an enterprise crosses a prescribed threshold, any M&A thereafter; however insignificant, in terms of market size or impact on competition, would still be captured within the purview of the Act.

Another significant concern is that the validity of a Combination may subsequently be questioned and rendered void by the CCI on grounds of

anti-competitiveness. This is despite the fact that the CCI has granted its approval for the Combination sought to be rendered void.² The process of reversing a Combination appears ambiguous creating legal and tax uncertainties in addition to being detrimental to the interest of the enterprises concerned. As a result, such enterprises would have to be cautious before undertaking any Combination which triggers the specified thresholds, as the transaction may subsequently be rendered void by the CCI. However, it may be noted that the power of the CCI to initiate an inquiry into a Combination and render it void has been restricted to a period of one year from the date on which the Combination has taken effect.

Types of Combinations—General Principles

Broadly, Combinations may be horizontal, vertical or conglomerate as described below. While such classification is not set out under the Act, in several jurisdictions, the permissibility of a Combination often depends on the type of Combination sought to be implemented. This is primarily because the effects of a Combination would depend on the type of Combination and the manner in which it is consummated. Thus, it may be relevant to understand the types of Combinations that may be undertaken.

Horizontal Combinations

Involves combination between two or more entities involved in the same line of industrial process. By virtue of such horizontal arrangements, competition between the products of the merging firms is eliminated and the merged entity

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- 1 The CCI is the Apex Body vested with the responsibility of enforcing the provisions of the Act.
 - 2 Section 29 of the Act confers the CCI with the authority to investigate any combination (even after it has been undertaken) and render it void if it is of the belief that such a combination has an appreciable adverse effect on competition.

establishes a powerful market presence. Some other consequent benefits of such an arrangement is advantage of economies of scale and economies of scope. Horizontal merger gives the merged entity "increase in market power", thereby impacting the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise negatively influence parameters of competition. For instance, a potential merger of Bharti Airtel with Vodafone Essar Limited, both being the dominant players in the space of telecom, would undoubtedly influence the rate of per person telecom usage thereby affecting competition in India.

Vertical Combinations

It pertains to the arrangement between entities that operate at different but complementary levels in the chain of production and/or distribution of the same final product. A vertical merger allows the merged entity to internalise any pre-existing double mark-ups resulting from both parties setting their prices independently (as existing prior to the merger) and further allow the parties to better coordinate the production and distribution process, and therefore saving inventories costs. A vertical merger may have anticompetitive effects if it enables the vertically integrated merged entity to constrain a rival's ability to compete either by foreclosing it from an upstream or downstream market or by raising its costs in a way that permits the merged entity to exercise market power. The anti-competitive behaviour of the merged entity can increase rivals' costs. Such arrangements also help an entity move towards enhanced independence and self-sufficiency.

Conglomerate Combinations

It pertains to a merger between two entities engaged in unrelated industries.

A merger of such a nature helps entities to venture into varied businesses without having to incur large start-up costs normally associated with a new business. In majority of circumstances, a conglomerate merger will not lead to any anti-competitive issues; however, there could be other competitive issues in case of a merger between two or more companies which are active in closely related markets (for instance arrangements involving suppliers of complementary products or of products belonging to the same category that are generally purchased by the same set of customers for the same end use).

Unlike Horizontal Combinations, Vertical or Conglomerate Combinations are generally less likely to impede competition as such non-horizontal mergers generally do not entail any loss of direct competition in the same market. Thus, such non-horizontal Combinations are per se not illegal or prohibited. However, if they create a dominant enterprise which subsequently abuses, its dominance, or is likely to cause an appreciable adverse effect within the relevant market in India, the same may be subject to scrutiny and be prohibited by the CCI.

Permissible Combinations – The Act and Draft Regulations

The basic objective of the Act in regulating Combinations is to restrict Combinations that have an "appreciable adverse effect" on competition in the market. The guiding factors towards determining whether a Combination is likely to have such "appreciable adverse effect" on competition is listed in Section 20(4) of the Act. Thus, all other Combinations (not having such effect) should be permissible.

With the intent to dispel ambiguities pertaining to Combinations and provide for Combinations that may be permissible, the CCI promulgated a draft

of the Competition Commission (Combinations) Regulations (Draft Regulations). The Draft Regulations carve out 13 transactions from the purview of the Combinations that are expected to cause an appreciable adverse effect on competition in India. Some of the key transactions that have been carved out are as follows:

- any acquisition of shares or voting rights of a company of not more than 15 per cent of the total shares or voting rights of the company;³
- any acquisition of assets that are not directly related to the business of the acquirer; however, this exemption would not apply where assets of the company that are being acquired represent the entire business operation in a particular location or relate to a particular product or service of such company;⁴
- an acquisition of, or acquiring of control of or an M&A transaction, where the domestic nexus for foreign parties engaged in a combination (i.e. with thresholds of Rs. 500 crores (approx USD 111 Million) of assets or Rs. 1,500 crores (approx. USD 333 Million) of turnover), does not comprise of assets of Rs. 200 crores (approx. USD 44.4 Million) or a turnover of Rs. 600 crores (approx. USD 133 Million), of each of at least two of the parties to such combination;
- any acquisition of shares or voting rights of a company where the acquirer already holds more than 50 per cent of the shares or voting rights of such company prior to the acquisition;
- any acquisition pursuant to a bonus or rights' issue or sub-

division of shares, but not including any acquisition resulting out of relinquishment of rights;

- an acquisition of control or shares or voting rights or assets resulting from gift or intestate or testamentary succession or transfer by a settler to an irrevocable trust;
- an acquisition of current assets in the ordinary course of business;
- an acquisition where the acquiring party is a foreign state;
- an acquisition of shares or voting rights by a person acting as a securities underwriter, in the ordinary course of business and in the process of underwriting;
- an acquisition of shares or voting rights pursuant to a bonus or rights' issue or sub-division of shares;
- an acquisition pursuant to an order of CCI;
- an acquisition by the Central Government or a State Government;
- any acquisition, acquiring of control, merger or amalgamation, which is specifically exempt under any other statute made by the Parliament.

Strangely, the Draft Regulations simply list 13 transactions that are regarded as not having an appreciable adverse effect on competition in India. However, the Draft Regulations do not exempt such transactions from the mandatory notification requirements prescribed under the Amendment Act. Consequently, enterprises that propose to undertake any of these transactions would nonetheless have to approach the CCI for its approval and sit through the waiting period. However, the Draft

3 The acquisitions, should be acquisitions which are made solely as an investment or in the ordinary course of business and which do not lead to control of the company by such acquirer.

4 *ibid*

Regulations nonetheless provide some comfort in terms of having an indication of Combinations that would be permitted. It is important to note that the Draft Regulations as released by the CCI for comments is no longer available on its website. It is possible that the Draft Regulations are undergoing further changes before they are once again made available for comments.

Conclusion

The Draft Regulations bring out the much required framework to provide for the manner in which Combinations are sought to be regulated by the CCI. However, there still remain certain concerns that need to be resolved and grey areas which require further

deliberation by the legislature.

In the event that the provisions of the Act with respect to Combinations and the Draft Regulations are notified and enforced in their present form, one of the possible outcomes could be an appreciable retardation of investment and M&A activity in India.

Therefore, it is hoped that the law on Combinations be brought into full force and effect only after all ambiguities and concerns are adequately addressed, and that Combinations are regulated in a manner that is not a hindrance to the economic growth and development of India.

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