

# Competition Law Hotline

March 08, 2011

## ACQUIRERS BEWARE: INDIAN MERGER CONTROL REGULATIONS NOTIFIED!

In the backdrop of corporate India gaining momentum and mergers, acquisitions and corporate restructuring being the order of the day, the Government of India has finally decided that time is ripe to give full effect to the merger control provisions. On March 4, 2011, the Government of India, Ministry of Corporate Affairs notified the much debated and dreaded provisions of the Competition Act, 2002 ("**Act**") relating to "combinations" namely Sections 5 and 6. Although notified as of March 4, 2011, these provisions are to take effect from June 1, 2011 ("**Effective Date**") giving all those subject to the same, a period of 3 months to tie loose ends and complete unfinished transactions before getting entangled in the web of the Act.

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

- (1) the acquisition of control, shares or voting rights or assets by a person;
- (2) the acquisition of control of an enterprise where the acquirer already has direct or indirect control of another engaged in identical business; and
- (3) a merger or amalgamation between or among enterprises, that cross the financial thresholds set out in Section 5.

Section 6 makes void any combination which causes or is likely to cause an appreciable adverse effect ("**AAE**") on competition within India. In furtherance of this determination, Section 6 of the Act requires every acquirer to notify the Competition Commission of India ("**CCI**") of a combination and seek its approval prior to effectuating the same in the manner set out therein. The term 'AAE' has not been defined under the Act. However, Section 20(4) of the Act states that while determining whether a combination has an AAE, CCI shall have due regard to certain factors which are merely subjective and do not provide clear determining factors as to what would constitute an AAE.

The procedures to be followed pursuant to Section 6 of the Act are the subject matter of a separate draft regulations issued by the CCI on March 2, 2011 ("**New Draft Regulations**")<sup>1</sup>. The CCI had, in 2008, proposed draft combination regulations which were however never brought into force ("**2008 Regulations**").

In this hotline, we have summarized the key amendments proposed in the New Draft Regulations and analysed the implications arising out of the notification of Sections 5 and 6 of the Act on potential M&A transactions.

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1.	<b>Provisions relating to 'Combinations' to apply prospectively:</b>	<p>The New Draft Regulations provide that the combinations which have '<i>taken effect</i>' prior to the combination provisions being effective in India will be exempt from the filing requirement.</p> <p>The proposed provision creates ambiguity as it does not explicitly state when exactly a combination 'takes effect' and this is therefore subject to interpretation. Of importance are transactions which are subject to completion by tranches – where one tranche has been closed, but the second tranche is due completion post the Effective Date and whether such transactions will also need to comply with the requirement of the New Draft Regulations.</p> <p>More importantly is the catch all provision of Section 20 of the Act which grants the CCI a retrospective power to "look back" into transactions that have taken effect one year prior thereto. Therefore, despite the Effective Date, there is an ambiguity as to whether CCI will still have the power to look into transaction completed prior to the Effective Date in pursuance of Section 20 of the Act.</p>	
2.	<b>Pre- merger consultation:</b>	<p>Any enterprise which proposes to enter into a combination may request in writing to the designated authority, for an informal and verbal consultation about filing, under the New Draft Regulations, with the officials of the CCI.</p> <p>It should however be noted that such informal and verbal consultation with the CCI will not be binding on the CCI.</p> <p>The introduction of pre merger consultation provisions on the line of advance ruling procedure is a welcome move as parties to the combination can freely seek clarifications from the CCI before triggering the filing requirements. This will further help parties in presetting the statutory time period and avoiding any forfeiture of filing fee.</p>	
3.	<b>Waiting period:</b>	<p>As per the provisions of the Act, CCI shall pass a final order or issue a direction within 210 days from the date of filing or else the combination shall be deemed to have been approved.</p> <p>However, as per the provisions of the New Draft Regulations, CCI shall endeavour to pass a final order or issue a direction within 180 days from the date of filing.</p> <p>Whilst the New Draft Regulations indicate that CCI shall <i>endeavor</i> to come to a final decision within 180 days, the statutory time limit i.e. waiting period continues to remain 210 days and consequently the 180 day time period is optical in nature and not binding on the CCI.</p>	
4.	<b>Prima facie opinion:</b>	<p>The New Draft Regulations mandate CCI to form a <i>prima facie</i> opinion on whether a combination has caused or is likely to cause an AAE on competition within the relevant market in India, within 30 days of filing.</p> <p>The 30 day time period for forming a <i>prima facie</i> opinion by CCI is likely to speed up the procedure for obtaining approval in case of simple / routine transactions doing away with the need to wait for the outer limit of 210 days to expire.</p>	
5.	<b>Filing requirements:</b>	<p>The 2008 Regulations prescribed categories of transactions not likely to have an AAE on competition. On a plain reading of Section 6 of the Act, it was unclear as to whether a combination that did not result in an AAE, had to be notified to the CCI.</p> <p>The New Draft Regulations do not differentiate between transactions likely to have an AAE and those that do not. Instead separate forms (Form I) have been prescribed for those transactions that were in 2008 Regulations deemed not to have an AAE. For other transactions, Form II has been prescribed.</p> <p>A separate form needs to be filed without fee where the acquirer is a public financial institution, foreign institutional investor, bank or venture capital fund.</p> <p>Although it could be deduced that transactions forming the subject matter of Form I would be looked at with less scrutiny, there is no clarity as to whether such transactions will be considered on a fast track basis and processed quickly.</p> <p>Further, the requirement of filing for possibly each and every transaction may hinder or impede fresh investment or consolidation activity in an industry.</p> <p>In continuation with the spirit of the Act, public financial institution, foreign institutional investor, bank or venture capital fund will now be required to make reporting under prescribed forms and are exempt from seeking CCI approval.</p>	

S. No	Proposed Amendments	Effect
1.	<p>Under the New Draft Regulations, it is application of the procedure to make filing / provide information to CCI. The New Draft Regulations provide that the combinations which have 'taken effect' prior to the combination provisions being effective in India will be exempt from the filing requirement.</p>	<p>The obligation of the acquirer to provide detailed information about the target to CCI, may at times lead to disagreement between the acquirer and the seller about the quantum of confidential information which can be shared with combination 'takes effect' and this is therefore subject to interpretation. Of importance are the provisions which state that under the form the acquirer is required to state with reasons if the proposed combination is not likely to cause an AAE in India thereby shifting the onus of proof on the acquirer. Also, it needs to be noted that estimates under HHI (Herfindahl-Hirschman Index) on international and commonly accepted measure of market concentration also needs to be provided along with the filings.</p>
6.	<p><b>Publication of details of combination:</b></p> <p>Where the CCI is of the prima facie opinion that the combination has caused or is likely to cause AAE on competition within the relevant markets in India, it shall direct the parties to publish the details of the combination within 10 working days in all India editions of four leading daily newspapers including at least two business newspapers, for an informal and verbal consultation about filing, under the New Draft Regulations, with the officials of the CCI.</p> <p>It should however be noted that such informal and verbal consultation with the CCI will not be binding on the CCI.</p>	<p>CCI has been given discretion to process combination of Section 29 of the Act, cause an AAE on competition, making the information relating to the combination public. Although, it may be said that the CCI may, through this publication, gain information about its adverse effects, if any, from the market, the implications of such a publication to the target seller and the acquirer may be deleterious in the context of the financial market. It may be noted that this publication will have to be made without the parties being offered an opportunity of being heard as required under Section 29 of the Act thereby diluting this protection.</p>
7.	<p><b>Modification:</b></p> <p>During the scrutiny of the notice filed by the parties to the combination, if the CCI is of the opinion that certain modifications need to be carried out in the combination and parties accept such modification, it may appoint independent agencies to oversee the modification and file a report.</p>	<p>Parties to a combination may have to report to a third party independent agency. This could delay the execution of the combination transaction. Further, no parameters have been laid down as to how the independent agency may utilize its supervisory powers.</p>
8.	<p><b>Filing Fees:</b></p> <p>Under the New Draft Regulations, the filing fee to be paid alongwith the forms range between INR 1 million (approx. USD 22,222) to INR 4 million (approx. USD 88,888).</p>	<p>The filing fee prescribed under the New Draft Regulations seems exorbitant considering that almost all combination will be subject to the filing requirement.</p>
9.	<p><b>Confidentiality:</b></p> <p>The New Draft Regulations also entitle the parties to the combination to seek confidentiality of the information filed.</p>	<p>As per the filing requirements, the information filed with the CCI with the relevant forms include diligence reports, surveys, details of shareholders etc. Although, confidentiality may be claimed with respect to the sharing of information with the public, there is no such restriction for the sharing of information if required by other regulatory / sectoral authorities under applicable law. Further, the CCI has also been given the powers to approach other statutory authorities concerned with such a combination to seek inputs therefrom in connection with the transaction which may further lead to sharing of confidential information so filed.</p>

## New prescribed thresholds:

The new prescribed thresholds for the joint assets/turnover are presented in the form of a table below:

Type of Combination	For Parties in India	For Parties world-wide	For the Group* in India	For the Group world-wide
Acquisition, Dominant Position, Mergers and Amalgamations	Assets  INR 15 billion (approx USD 333	Assets  USD 750 million or Turnover USD	Assets  INR 60 billion (approx USD 1.3	Assets  USD 3 billion or Turnover

million) or	2,250 million	billion) or Turnover	USD 9 billion;
Turnover INR 45		INR 180 billion	
billion (approx	AND	(approx USD 4	AND
USD 1 billion)	In India	billion)	In India
	Assets		Assets
	INR 7.5 billion (USD		INR 7.5 billion
	approx 167 million)		(approx USD
	or Turnover		167 million) or
	INR 22.5 billion		Turnover
	(approx USD 500		INR 22.5 billion
	million)		(approx USD
			500 million)

*\* The definition of the “group” had been modified to increase the % shareholding from 26% to 50% for the purposes of compliance with Section 5 of the Act.*

#### ANALYSIS:

**Enterprise value** – The triggers of the Act relating to combinations are linked to the combined value of the turnover/asset of the acquirer and the target and not the transaction value.

Vide its notification on March 4, 2011 the Government of India has exempted the acquisitions of small enterprises whose turnover is less than INR 7.5 billion (approx USD 167 million) or whose assets value is less than INR 2.5 billion (approx USD 56 million) from the definition of combination as defined under Section 5 of the Act. However, it is still ambiguous as to whether these values are to be computed on a standalone basis for the target or on a consolidated basis for the target along with its subsidiaries.

**Structuring a transaction** - Structuring of a merger or an acquisition involving Indian assets would now have to be done more meticulously and the parties would now have to contemplate the implications of various future scenarios. 210 days being a long time for the deemed approval, by the time approval is granted, it is possible that the whole dynamics of the transaction, be it pricing, or commercials may change, affecting the viability of the transaction. Further, even if the transaction is concluded, since the terms “acquirer” and “acquisition” have not been defined, a subsequent acquisition through a default mechanism such as the exercise of call options / put options / enforcement of security etc. may again trigger the provisions of the Act. Also, since the CCI has the right to call upon the diligence reports from the acquirer, the acquirer may face lack of co-operation from the sellers in sharing of confidential information about the target.

**No provision for seeking exemption** – The current provisions relating to combinations under the Act and the New Draft Regulations do not provide for seeking an exemption or waiver from the applicability of the said provisions. It should be noted that a ‘prima facie opinion’ may be formed by the CCI solely on the basis of the information submitted by the acquirer at the time of filing the relevant forms as no hearing at this stage is prescribed. Acquirers may therefore need to weigh the pros and cons of sharing information with the CCI and the risk that the company/acquirer may be subject to upon the regulator having access to such information.

#### CONCLUSION:

The landscape of domestic and cross border M&A activity in India will now see radical changes with the proposed merger control provisions soon coming into effect. Though proposed amendments such as pre merger consultation and so called reduced time line are a welcome change for the investor community, the inherent loop holes or lacunae in the proposed provisions continue to hound the market players.

CCI now has the herculean task of ensuring that the Indian merger control provisions do not in any manner hamper the domestic and cross border M&A activity in India. The recent precedent of Chinese competition regulator being battered by the international community for blocking Coca Cola’s takeover of leading Chinese juice maker Huiyaun could act as a good example for the CCI on how to handle big ticket M&A deals from a competition law perspective since the same could make or mar its reputation as a competition regulator.

This leaves the nascent regulator with a tough balancing act - on one hand to be regarded as a serious upholder of competitive markets and on the other hand to ensure that the proposed merger control provisions are conducive such that the global acquirers continue to subscribe to India’s success story.

#### - Team Competition Law

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1 Draft the Competition Commission of India (Procedure in regard to the transaction of business relating to combination) issued on March 2, 2011

\* For reference USD 1 = INR 45

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