M&A Interactive

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THE TV INTERVIEW THAT COST ZUARI RS 3 CRORES!

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The growing anti-trust jurisprudence in India being developed by the Competition Commission of India (“**CCI**”) definitely requires deal makers to rethink their strategy in conjuring M&A deals. Hasty reliance on what has become ‘good to have customary rights’ may attract onerous obligations and will need careful consideration in light of recent anti-trust developments. The notification of sections 5 and 6 of the Competition Act, 2002 (“**Act**”) and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (“**Regulations**”, the Act and the Regulation are, for the sake of brevity, hereinafter referred to as the “**Merger Control Regime**”) was expected to be a game changer for M&As in India and was met with a lot of skepticism.

The central theme in the initial years revolved around the question of the potential delay in deal consummation that would ensue from the implementation of the Merger Control Regime. Amidst the cynicism, the Regulations with the various exemptions they contained provided a breather to the industry especially in relation to non-strategic acquisitions which would have otherwise met with an unwarranted anti-trust scrutiny. However, 4 years since the advent of the Merger Control Regime a different situation arises – having proven its capability in terms of speedy decision making, the CCI has allayed concerns of delays in the approval process but the Regulations and their various exemptions pose an unsolved mystery. In trying to decipher the Merger Control Regime in the early stages a lot was taken for granted under the aegis of how things worked prior to the Merger Control Regime and, naturally references were drawn from how other market regulators like the Securities and Exchange Board of India had acted in similar situations. However the recent orders of the CCI indicates an independent line of thought emerging from the CCI which may very well be different from how other regulators have interpreted the same concepts in the past, adding fresh considerations for deal makers.

The orders of the CCI levying heavy fines on both the architects of the hostile bid of Mangalore Fertilizers and Chemicals Limited (“**MFCL**”) is one such example which emphasizes the considerable impact and the conundrum of the Merger Control Regime that deal makers will have to grapple with. The genesis of the MFCL controversy dates back to the vulnerable position of *Vijay Mallya* and the *UB Group* (promoters of MFCL) as a result of the collapse of Kingfisher Airlines which provided an opportunity to *Deepak Fertilizers* (which has always been in the fray to acquire MFCL) to build a significant position in MFCL by purchasing the shares of MFCL through bulk and block deals. The shares of MFCL were easily available in the market at a steep discount because of the liquidity created by the invocation of pledge by the lenders of *UB Group*.

Mindful of the lurking danger, *Vijay Mallya* brought in a white knight in the form of *Saroj Poddar/Adventz Group* and between April, 2013 and July, 2013 the Adventz Group acquired approximately 16% stake in MFCL through various open market purchases. In July, 2013 Deepak Fertilizer acquired 24.46% in MCFL through a combination of bulk and block deals. Thereafter almost after a year in April, 2014 *Deepak Fertilizers* acquired another 0.8% triggering a mandatory open offer under the takeover code for the acquisition of another 26% of the voting capital MFCL from the public shareholders. In defense of the hostile bid by *Deepak Fertilizers*, the promoters of MFCL (Vijay Mallya and UB Group) entered to an agreement with the *Adventz Group* to jointly launch an open offer to acquire 26% of MFCL from the public shareholders.

While, CCI approved both the offers of *Deepak Fertilizers* and the *UB/Adventz Group* without an adverse finding, it levied a heavy penalty on both the groups for consummating parts of the transaction i.e. the open market purchases without the prior approval of the CCI (internationally in the anti-trust context it also referred to as *gun jumping*). The CCI held that the 16% acquisition made by the *Adventz Group* through open market purchases in four tranches was in violation of the Act since such acquisitions were strategic in nature and with *intent* to acquire control over the MFCL. In arriving at this conclusion, the CCI relied on a televised interview of *Saroj Poddar* where he had said that the open market purchases were made after consulting *Vijay Mallya* and with intent to enter into a joint venture with the *UB Group* at a future date.

The CCI further held that the acquisition of 24.46% and 0.8% shares of MFCL by *Deepak Fertilizers* through open market purchases was in violation of Act and was an act of gun jumping. The CCI relied on the filings made by *Deepak Fertilizers* with the stock exchanges wherein it had said that the acquisition was made because MFCL was a “*very strategic and good fit with company (Deepak Fertilizers)*”.

In both the cases CCI discarded the contention of the *Adventz Group* and *Deepak Fertilizers* that the respective acquisitions were exempt under the Regulations. The Regulations exempts a combination (which meets the financial

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asset and turnover thresholds prescribed under the Act) involving an acquisition of shares from the prior approval of CCI if (a) solely made as an investment or (b) is in the ordinary course of business and (i) does not result in an acquisition of more than 25% of the shares or voting rights of the target company and (ii) does not give the acquirer control over the target company ("**Exemption**"). In this case, CCI found based on the evidences discussed above that the open market purchases of 16% and 24% (and subsequent 0.8%) by the *Adventz Group* and *Deepak Fertilizers* respectively were strategic in nature and were not acquisitions *solely as investment*.

The Exemption is commonly availed by private equity players and other acquirers acquiring minority positions. While the CCI has in its decisions analysed one of the limbs of the Exemption i.e. control, in this instance for the first time CCI has examined the scope of the word '*solely made as an investment*' in the Exemption. The CCI has observed that the *phrase 'solely made as an investment'* indicates *'passive investment'* and any investment in a target enterprise which is done with a strategic intent cannot be treated as *'solely made as an investment'.* Since an investment that is not made '*solely an investment'* or in the '*ordinary course of business'* does not qualify for the Exemption even if no control or less than 25% of the shares or voting rights are being acquired, interpreting these terms is critical for examining when the acquirers can rely on the Exemption. Given that the Exemption permits for acquisition of shares up to 25% of the shares or voting rights of the target company, it is questionable whether such a large threshold can ever be acquired without a plausible 'strategic intent'. However it appears that the conduct of the acquirer will play a decisive role in the determination of the nature of investment with the CCI even possibly relying on TV interviews as evidence.

While the finding of the CCI may seem draconian in the Indian context, in fact it appears to be in line with the global position on the issue. For e.g. the US anti-trust law has a similar exemption for acquisition of shares that are made '*solely for investment purposes'.* In the US context the exemption has been interpreted very narrowly and the intention of the parties are looked at in order to ascertain whether the acquisition of shares was '*solely made as an investment'* or a strategic one. Typically, any acquisition which gives the acquirer the right to (a) nominate a director on the board or (b) propose any corporate action which requires shareholder approval is considered *prima facie* strategic under the US anti-trust law. Even if the acquisition is made with intent to solicit proxies or appoint directors of the board, such acquisitions are considered strategic. In fact, at times acquisition of a miniscule stake in a competitor could be deemed a strategic acquisition under US anti-trust laws.

Clearly, the recent rulings will change the M&A game plan in India. For instance, several companies acquire miniscule shares in some of their competitors (sometimes less than 5% since public disclosure is required of a shareholder who acquires more than 5% in a listed entity). Henceforth such acquisitions will have to be carefully examined from an anti-trust perspective. Further, the strategy in the case of hostile bids has to be carefully examined since building positions with the intent to acquire control at a future date may not be possible without a CCI approval. However the two constituencies on whom the recent orders is likely to have a significant impact are activist shareholders/hedge funds and private equity investors. Hedge funds who intend to acquire shares and solicit proxies may be viewed as 'activist shareholders' not being able to avail the Exemption prescribed unless they are registered as FPIs. Similarly private equity investors who typically have exhaustive rights in the target company may not be able to avail the Exemption.

While the CCI's action against *Deepak Fertilizers* and the *Adventz Group* may have legal justifications, there are a number of fundamental questions that CCI will have to provide greater clarity on such as (1) what if the intent is *solely for investment* when the acquisition is made and thereafter the intent changes, will the initial investment be deemed strategic?, (2) how will open market purchases for strategic reasons be made without disclosing the same to the market prior to the purchase given that will almost always be the case if all such open market purchases require prior CCI approval? Perhaps, the day is not far when CCI will come out with the much awaited merger control guidelines and provide guidance on some of these questions.

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