

M&A Hotline

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SEBI DISTINGUISHES A MARKET PURCHASE FROM A NEGOTIATED PURCHASE UNDER TAKEOVER CODE

Recently, the Securities and Exchange Board of India ("SEBI") issued an informal guidance to R Systems International Limited ("Target Company") under the SEBI (Informal Guidance) Scheme 2003 with respect to applicability of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "Takeover Code") to acquisitions made through market purchases. This is a significant clarification from SEBI on whether an acquirer, in case of market purchases, can consummate the acquisition of shares of a target company (which triggered the open offer) before expiry of the open offer period.

BACKGROUND

Mr. Bhavook Tripathi ("Acquirer"), who held 23.82% of the shares of the Target Company wanted to increase his shareholding in the Target Company through market purchases. In this regard, the Acquirer prior to placing an order with a stock broker issued a public announcement ("PA") on December 15, 2011 so as to comply with the requirements under the Takeover Code. After the PA, he was successful in buying 7.18% of the shares of the Target Company from the open market before issue of a detailed public statement as required under the Takeover Code. The Acquirer issued the public statement on December 22, 2011 in which he stated that he was holding 31% of the shares of the Target Company post the acquisition of aforesaid shares from the open market.

TARGET COMPANY'S CONTENTIONS

The Target Company contended in the application that:

- The Acquirer acquired the aforesaid shares in violation of Regulation 22(1)1 of the Takeover Code which provides that an acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period.
- The language of Regulation 22(1) is very broad and covers all types of acquisition of shares and not just those which are contemplated under an agreement executed by an acquirer.
- The intention behind Regulation 22(1) was to prohibit the completion of acquisition of shares (whether through market purchase or through an agreement) which triggered the making of an open offer prior to the consideration having been received by the shareholders who have tendered their shares pursuant to the open offer. If the intention was to restrict the scope of Regulation 22(1) only to the acquisition of shares pursuant an agreement, the same should have been reflected clearly in the regulation.
- Regulation 22(2)² is an exception to Regulation 22(1) in case of acquisition of shares pursuant to an agreement. This exception permits an acquirer to complete the acquisition contemplated under such agreement after 21 days from the date of detailed public statement subject to deposit of an amount equal to 100% of the consideration payable under the open offer assuming full acceptance of the open offer.
- The non obstante clause "Notwithstanding anything contained in regulation 22(1)", as provided in Regulation 22(2) cannot narrow down the scope of Regulation 22(1). In case of any ambiguity in the interpretation of Regulation 22(1) against the non obstante clause in Regulation 22(2), Regulation 22(1) must be read in a manner so as to control the non obstante clause in Regulation 22(2) and not the other way round. In support of this argument, two cases were also cited in the application wherein views of Justice Bhagawati and Justice Patanjali Shastri on 'non-obstante clause' were also referred which appears to substantiate Target Company's interpretation of the aforesaid two regulations.

SEBI'S RESPONSE

SEBI, after considering the submissions of the Target Company, expressed its views on this issue as follows:

- Regulation 13(2)(a) of the Takeover Code stipulates that in case of market purchases which would lead to increase in the voting rights of the acquirer beyond the stipulated threshold, the PA has to be made prior to placing of the order with a stock broker.
- Regulation 22(1) relates to an acquisition of shares pursuant to an agreement and is not applicable in cases of transactions involving the market purchases. The expression "such agreement" in Regulation 22(2) endorses the above stated interpretation. Regulation 22(2) provides for an exception to Regulation 22(1) by permitting the acquirer to complete the acquisition contemplated in the agreement which triggered an open offer subject to the fulfillment of the conditions stated therein.
- Regulation 22(2) provides for an exception to Regulation 22(1) by permitting the acquirer to complete the

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acquisition contemplated in the agreement which triggered an open offer subject to the fulfillment of the conditions stated therein.

ANALYSIS

SEBI notified the Takeover Code on September 23, 2011 replacing the old takeover code based on the report of Takeover Regulations Advisory Committee ("**TRAC**"). SEBI accepted draft of the new takeover regulations ("**TRAC Draft**") submitted by the TRAC with certain modifications. One of the modifications was with respect to Regulation 22(1) of Takeover Code.

Regulation 22(1) of the TRAC Draft which read as follows:

"The acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company under any agreement attracting the obligation to make an open offer for acquiring shares, until the expiry of offer period"

On perusal of the Regulation 22(1) and 22(2) of the TRAC Draft, it is evident that intention of the TRAC was to apply these regulations only to the acquisition of shares or voting rights in or control over the target company pursuant to an agreement and not pursuant to market purchases. Further, it may be noted that SEBI modified Regulation 22(1) under the Takeover Code by removing the reference to the term "agreement" though such reference is there in Regulation 22(2) of the Takeover Code.

If SEBI's intention was to deliberately remove reference to the term "agreement" under Regulation 22(1), then SEBI should have taken a contrary view based on the plain reading of the regulation. However, based on the informal guidance, it is evident that SEBI is in consonance with the TRAC's recommendation with respect to the scope of Regulation 22(1) though the same is not properly reflected in the Takeover Code. Even Regulation 22(16) of takeover code of 1997 provided that an acquirer, pursuant to an agreement, cannot consummate the primary transaction which triggered the open offer till the public shareholders who have tendered their shares in the open offer have been paid their consideration.

From a practical standpoint, SEBI's view on this issue seems tenable since typically in case of market purchase, an acquirer purchases shares from open market from other shareholders of the target company without entering into any private arrangement with any shareholder. The purpose of deferring the primary acquisition pursuant to an agreement till the completion of open offer period was to safeguard the interest of public shareholders who tender their shares in the open offer against any potential default by the acquirer in purchasing such tendered shares after having completed the primary acquisition of shares under private arrangement which triggered the open offer.

While the intention of SEBI is clear from this informal guidance that only purchases pursuant to an agreement are covered by Regulation 22(1), it would be prudent for SEBI to amend the Takeover Code to avoid any possible interpretation issues and disputes over the same cause of action in future.

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You can direct your queries or comments to the authors

¹Regulation 22(1) of the Takeover Code

The acquirer shall not complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period:

Provided that in case of an offer made under sub-regulation (1) of regulation 20, pursuant to a preferential allotment, the offer shall be completed within the period as provided under sub-regulation (1) of regulation 74 of Securities and Exchange Board of India (Issue of Capital and Disclosure) Regulations, 2009.

²Regulation 22(2) of the Takeover Code:

Notwithstanding anything contained in sub-regulation (1), subject to the acquirer depositing in the escrow account under regulation 17, cash of an amount equal to one hundred per cent of the consideration payable under the open offer assuming full acceptance of the open offer, the parties to such agreement may after the expiry of twenty-one working days from the date of detailed public statement, act upon the agreement and the acquirer may complete the acquisition of shares or voting rights in, or control over the target company as contemplated.

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