

M&A Hotline

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SEBI PLUGS LOOPHOLES IN TAKEOVER CODE

Considering the ambiguities in the interpretation of certain provisions of the Securities and Exchange Board of India ("SEBI") (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "**Takeover Code**"), SEBI recently introduced certain important amendments to the Takeover Code. We have discussed herein below some of the important amendments.

MARKET PURCHASE KEPT AT PAR WITH NEGOTIATED PURCHASE

One of the important amendments is insertion of new Regulation 22(2A) to the Takeover Code. This amendment seems to have been introduced to plug the loophole with respect to the issue dealt in SEBI's informal guidance issued to R Systems International Limited ("**Target Company**") on July 09, 2012 and the Securities Appellate Tribunal ("**SAT**") order dated September 07, 2012.

In the aforesaid matter, Mr. Bhavook Tripathi had acquired shares of the Target Company through market purchases without complying with provisions of Regulations 22(1) and 22(2). In this respect, SEBI vide its informal guidance clarified that Regulation 22(1)¹ of the Takeover Code is applicable only to acquisition of shares pursuant to an agreement and not to market purchase. We had analyzed the aforesaid informal guidance issued to Target Company in our hotline "**SEBI distinguishes a market purchase from a negotiated purchase under the Takeover Code**" dated August 09, 2012.

Considering certain complaints against Mr. Bhavook Tripathi from Target Company and others especially with respect to certain pre-understanding between him and certain sellers regarding purchase of shares of Target Company and also allegation regarding violation of certain provisions of the Takeover Code, SEBI directed Mr. Bhavook Tripathi to comply with Regulations 22(1) and 22(2)² of the Takeover Code. Against this direction, Mr. Bhavook filed an appeal before SAT.

SAT in its order dated September 07, 2012, inter alia directed SEBI to provide the relevant information/documents in connection with certain pre-understanding with a seller. Post the SAT order, Mr. Bhavook through formal communication refuted all the allegations and also without accepting the existence of pre-understanding with a seller agreed to deposit in the escrow account 100% of the open offer consideration. Based on this undertaking, SEBI responded that it may not initiate any actions against Mr. Bhavook with respect to violation of Regulations 22(1) and 22(2) of the Takeover Code.

Analysis: Prior to this amendment and referring to the informal guidance, earlier SEBI was distinguishing between market purchase and negotiated purchase. However, based on the observations made and the issues analyzed in the above case SEBI realized that market purchase could be pre-negotiated without a written agreement and thereby acquirer could avoid the compliance of Regulations 22(1) and 22(2). In order to plug this loophole, SEBI has now imposed certain restrictions in case of acquisition of shares through market purchases and in this regard has inserted a new Regulation 22(2A) in the Takeover Code as follows:

"An acquirer may acquire shares either through preferential issue or stock exchange settlement process other than bulk or block deal subject to fulfillment of the following:

1. Such shares are kept in an escrow account;
2. The acquirer not exercising any voting rights over such shares kept in the escrow account.

Provided that such shares may be transferred to the account of the acquirer, subject to the acquirer complying with requirements specified in Regulation 22(2)."

With the insertion of sub-regulation (2A), acquirers can now acquire the shares via preferential issue or stock exchange settlement process subject to the compliance of the conditions mentioned therein.

TIMING FOR MAKING A PUBLIC ANNOUNCEMENT

Regulation 13 of the Takeover Code provides for the timing of making a public announcement for different modes of acquisition of shares of a target company. SEBI has made certain changes in respect of timing of making a public announcement in case of

1. preferential allotment of shares; and
2. acquisition of shares of a target company by more than one mode of acquisition of shares.

Preferential allotment of shares

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In case acquisition of shares is under preferential issue which triggers an open offer requirement an acquirer is required to make a public announcement on the date on which a special resolution is passed by the target company under Section 81(1A) of the Companies Act, 1956 for the acquisition of shares or voting rights in or control over the target company³.

Amendment has been made to Regulation 13(2) pursuant to which an acquirer is required to make a public announcement on the date when the board of directors of the target company authorizes such preferential allotment of shares as opposed to the earlier case wherein the announcement was to be made on date on which a special resolution is passed.

Analysis: The rationale for this amendment is that the day Board approves the preferential allotment, the market comes to know about the same and the share price becomes volatile on account of the knowledge about the preferential allotment in spite of the fact that the shareholders have not approved the preferential allotment. To plug this loophole resulting in volatility in share price, SEBI has changed the date for making a public announcement from date of passing of shareholders resolution to date of passing of Board resolution.

More than one mode of acquisition of shares

Currently, Takeover Codes provides for the timing of making a public announcement for the different modes of acquisition of shares. However, Takeover Code is silent about timing of making a public announcement in case an acquirer intends to acquire shares of a target company by way of more than one mode of acquisition of shares as provided under Regulation 13 of the Takeover Code.

In order to address the aforesaid issue, a new Regulation 13(2A) has been inserted⁴. With this amendment, in case of more than one mode of acquisition of shares either by way of an agreement and the one or more modes of acquisition of shares as provided under Regulation 13(2) of the Takeover Code or only through one or more modes of acquisition as provided under Regulation 13(2) of the Takeover Code, an acquirer is required to make a public announcement on the date of first such acquisition giving the details of the proposed subsequent acquisition.

Analysis: The above change is welcome since there was always an ambiguity on the timing for making a public announcement in a situation where the acquirer was proposing to acquire the shares through a combination of purchase from an existing shareholder and purchase through preferential allotment since the timing for making a public announcement was different in case of secondary purchase and preferential allotment, This change will bring the much needed clarity with respect to such cases where more than one mode of acquisition is used by the acquirer to purchase the shares of the target company.

WITHDRAWAL OF OPEN OFFER NOT ALLOWED IN CASE OF UNSUCCESSFUL PREFERENTIAL ISSUE

As per the Takeover Code, an open offer cannot be withdrawn once the public announcement is made except in certain cases specified in Regulation 23. One of such cases is when any condition stipulated under the agreement triggering the open offer for effecting such agreement has not been met for reasons outside the control of the acquirer provided such conditions were specifically disclosed in the letter of offer and detailed public statement⁵.

SEBI has now clarified by adding a proviso to clause (C) to sub-regulation (1) of Regulation 23 of the Takeover Code that an acquirer shall not be permitted to withdraw an open offer made pursuant to the public announcement made as per Regulation 13(2)(g) even if the proposed acquisition through a preferential issue is unsuccessful.

Analysis: The above amendment has been introduced to address the issue of share price volatility between the date of Board resolution and date of shareholders resolution as discussed earlier. Post this amendment, the acquirer will have to be doubly sure about the success of the shareholders' special resolution for approving the preferential issue failing which the acquirer will be obligated to make an open offer even in absence of any preferential allotment of shares by the target company.

SCOPE OF DISCLOSURE NORMS WIDENED

As per the provisions of the Takeover Code, an acquirer who along with persons acting in concert ("PAC") holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, shall disclose every acquisition or disposal of shares of such target company representing two per cent or more of the shares or voting rights in such target company in such form as may be specified (Regulation 29 (2)).

SEBI has now replaced the present Regulation 29(2) with the new sub-regulation which is more clarificatory in nature and also the same as provided in Regulation 13(3) of the SEBI (Prohibition of Insider Trading) Regulations, 1992. As per the new Regulation 29(2), an acquirer along with PAC if he holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company shall disclose the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below five per cent, if there has been change in such holdings from the last disclosure and such change exceeds two per cent of total shareholding or voting rights in the target company.

Analysis: Some of the acquirers holding more than 5% were taking benefit of the ambiguity under erstwhile Regulation 29(2) and not making disclosures in cases where the shareholding fell below 5% after the sale and such sale did not warrant disclosures under Regulation 29(2). On account of the same, it became difficult to track the cases where disclosure was made under Regulation 29(1) and the shareholding fell below 5% on account of sale being less than 2%. Post amendment it has been clarified that even if the change makes the acquirer's holding fall below 5%, he is obligated to make the disclosure if such change is of 2% or more from the last disclosed shareholding.

CALCULATION OF TIME LIMIT FOR DISPOSAL OF SHARES IN CASE OF BUY-BACK OF SHARES

As per Regulation 10(3) of the Takeover Code, a shareholder is not required to make an open offer in case his voting rights in a company increases beyond the threshold limit pursuant to buy-back of shares provided such shareholder reduces his shareholding such that his voting rights fall to below the threshold within ninety days from the date on which the voting rights so increase.

With this amendment, time limit of ninety days to reduce the shareholding is calculated from the date of closure of the

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buy-back offer rather than the date on which the voting rights so increase as provided in sub-regulation (3) of Regulation 10 of the Takeover Code.

Analysis: The intent behind introducing this change seems to be in line with the basic principle of Takeover Code for trigger of open offer i.e. at the time of acquisition of shares or agreeing to acquire the shares, whichever is earlier. The date of closure of buy-back offer precedes the date of increase in voting rights post buy-back since post the date of closure of buy-back offer, payment of buy-back consideration is required to be made and the shares tendered are required to be bought back. The date of closure of buy-back is the date by when the event of crossing the threshold for trigger of open offer becomes certain and hence the timeline of 90 days post this amendment will happen from the date of closure of the buy-back offer instead of date of increase in voting rights.

CONCLUSION

Any new law always brings along with it new set of ambiguities. With the Takeover Code being more than 18 months old, SEBIs had to come out with these changes based on the feedback from market participants and lessons from the open offers already made. It's important that SEBI continues to introduce such amendments so that the stakeholders are able to plan their actions beforehand rather than get bogged down by the ambiguities in interpreting the Takeover Code.

- Vishwanath Kolhar, Alap Yadav, and Nishchal Joshipura
You can direct your queries or comments to the authors

¹ Regulation 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:
² Regulation 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.
³ Regulation 13(2)
⁴ (2A) Notwithstanding anything contained in sub-regulation (2), a public announcement referred to in regulation 3 and regulation 4 for a proposed acquisition of shares or voting rights in or control over the target company through a combination of,- (i) an agreement and any one or more modes of acquisition referred to in sub-regulation (2) of regulation 13, or (ii) any one or more modes of acquisition referred in clause (a) to (i) of sub-regulation (2) of regulation 13, shall be made on the date of first such acquisition, provided the acquirer discloses in the public announcement the details of the proposed subsequent acquisition.
⁵ Regulation 23(1) (c)

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