

Decoding the Control Conundrum under the Takeover Regulations: Mandatory Bids Intricacies

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Abstract

The concept of control has been discussed in companies act 2013, competition act 2002 and in substantial acquisition of shares and takeovers, 2011. I shall particularly discuss the concept of control in the light of takeover regulations. The qualitative and quantitative aspect of control in the light of mandatory bids has been extensively debated by the scholars. Even the regulatory authorities face a lot of problems while resolving such difficulty. Whether the trac's recommendations in the form of 25% numerical threshold are sufficient today for reducing the heavy burden compliance? What are the loopholes with mandatory open offers? Whether the regulatory authority should rethink and reimagine the contours of control? Such questions have been raised in this paper. An inclusive approach has been adopted while giving suggestions to the issue in concern.

Keywords: Takeover code; Mandatory bid; Trac; Sat; Sebi; Control

Introduction

The promotion and maintenance of vibrant market for the purpose of corporate control is considered as one of the fundamental roles of takeover regulation [1]. It is incontrovertible that under the takeover regulations, 2011, the acquirer is required to make 26% tender offer to shareholders of the target company; in case the acquisition contained 25% voting rights or even change in control. Different jurisdictions across the world including the UK, south africa, spain and other eu members, russia and singapore have mandated making offer, though they largely rely upon the numerical threshold [2].

To substantiate my point, i shall refer to UK takeover code which defines control in terms of 30% interests or voting rights of company. Hence, exceeding 30% threshold by the acquirer would mandate him to make an open offer as per the UK takeover code. So far as the Indian condition is concerned, the conception of control has been done both qualitatively and quantitatively. The measurement of control is determined by acquiring substantial acquisition of 25% of voting rights of a target company. The purpose of mandatory bid is to provide a fair and equal treatment to all shareholders and the minority shareholders should be protected from the coercion of majority. Nonetheless, changes in the shares of the target company often left minority shareholders in lurch.

The research paper aims at highlighting the issues of control under the takeover code and what kinds of loopholes are there in mandatory bid rules. It further reflects the negligence of regulatory authorities in defining the contour of direct and indirect control. Consequently, i have taken the help of various case laws wherein the concept of direct and indirect control was unsatisfactorily explained by the regulatory authority. I have also outlined the purpose of the trac recommendations for 25% mandatory open offer which eventually seems to have failed in achieving the objectives. I have, in fact, given the suggestions as to how regulatory authority shall the clash of control into account while determining and rethinking upon the 25% criteria. Most importantly, the regulatory authority shall rethink the scope of control and the mtb in the light of leading jurisdictions.

Concept of control in India: the evolution

Promulgation of the substantial acquisition of shares and takeover regulations (referred to as takeover regulation) by the securities and exchange board of india (herein referred to as sebi) in 1992

consolidated the very provision of the mandatory open offer [3]. Since the liberalization and privatization had a profound impact on the indian economy, the necessity of an effective regulation for the purpose of control was largely felt.

given the development, growth and new challenges of financial market, the formation of justice bhagwati committee was seen as a blessing in disguise. Taking into consideration recommendations of justice bhagwati committee, the substantial acquisition of shares and takeover regulations was passed in 1997 [4]. The committee noted that the acquisition of control could take place not only through acquiring a particular percentage of shares or voting rights but the projection of control could also take the shape in terms of exercising control over the board of directors. It could easily be referred to as de facto and de jure control [5].

The numerical threshold was increased in this particular recommendation from ten percent to fifteen percent [6]. The further staggering development of takeover regulations 1997 had taken place with appointment of the takeover regulations appointment committee (referred to as trac) in the year 2009. The purpose of setting up such committee was to look into the market volatilities, to remove inconsistencies and to bring fair and equitable market treatment for all shareholders [7]. As a consequence of this, the trac suggested that the obligation of making a mandatory open offer should be indispensable in case of both direct and indirect control.

In addition to this, the committee further opined that the acquisition of twenty five percent shares or voting rights would tantamount to the fact that the acquirer is entitled to take de facto control over the company thereby making the obligatory requirement of mandatory open offer. The substantial acquisition of shares and takeover regulations 2011 is the by-product of recommendations of abovementioned trac committee [8]. In this regard, the regulations 3, 4 and 12 are pretty relevant for

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issuing a mandatory open offer in terms of voting rights and de facto control respectively, if it meets the criteria of 25% of the acquisition [9].

The fundamental object behind the enactment of mandatory bids under the takeover regulation 2011 was to prevent the catastrophic effect of a 'change without permission' in control. It was also aimed to prevent the bidder from taking advantage of the power of the single person to whipsaw the others [10]. Thus, maintaining the principle of equality among shareholders is one of the primary concerns of insertion of mtb [11]. Astonishingly enough, there is no uniform pattern for the definition of acquisition of control across different jurisdictions. The reflection of control might be in the form of voting rights or majority of members of board of the company. This was as one of the main reasons as to why sebi thought of the brightline test for decoding the conception of control [12].

Role of judiciary in defining the concept of control

It is indisputable to state that investors demand veto rights to protect their interests at the time of purchasing the shares in a particular company which contains in the shareholder's agreement or charter document of the company [13]. The question before the judicial authority arises as to whether the negative control conferred under the same rights could constitute control under the ambit of regulation 2(1) (c) of the takeover regulations, 2011 [14]. To substantiate this issue, i shall hereby refer the relevant case in this regard. In *Subhkam Ventures Pvt Ltd vs. Sebi* while defining the conception of control under the 1997 takeover regulation, the sebi held that specific affirmative voting rights or veto rights acquired by the acquirer by shareholders agreement would amount to control over the target company [15].

On the other hand, the securities appellate tribunal (sat) discarded the contour of control by saying that the positive control amounts to control whereas the negative control in terms of veto rights could not be classified as control. Notwithstanding the fact that in the case of *Rhodia SA v. Sebi* the sat held that the veto rights on structural and strategic changes enabled the acquirer to acquire control over the target company [16]. The sat further delineated that it is not essential to have control over the day to day functioning of the target company for the purpose of exercising veto rights.

On a contrary note, the *Jet-Etihad* case is quite different wherein the sebi opined that the imposition of open offer obligation is not essential having accessed the cooperative commercial arrangements and seeking some required changes in the terms [17]. Furthermore, it was elucidated that the agreement in concern has no role to play for *Etihad* for the sake of acquiring control over the managements and affairs or policy decisions of *Jet*. In other words, for the purpose of establishing control, the right to appoint two directors out of twelve is not sufficient in so far as all major policy decisions would be required to be taken by both the *Jet Airways* and *Etihad* [18].

Arcelormittal India Private Limited vs. Satish Kumar Gupta & Ors the apex court explained the definition of control as per the companies act which is in consonance with the definition of control under the takeover code and further categorized the same into two parts namely de facto and de jure control [19-20]. The de jure control implies the fact that it is a right for the purpose of appointment of majority of directors whereas the de facto control enables a person positively, directly or indirectly to influence the management or policy decision of a company.

Interestingly, the supreme court agreed upon the reasoning of the sat in the *Subhkam Ventures* case and opined that control fundamentally means the positive control. However, the power to block special resolution cannot be termed as control. Given the crux of

the abovementioned judgments, it is important to understand that the judicial authorities have to be careful and vigilant while adjudicating the issues of any change in control that the ability to adversely affect the business in any way [21].

Control under the takeover regulation 2011: the conundrum

Since i have earlier dealt with the evolution of the conception of control in the light of various committee reports and recommendations, i have also outlined the role of the judicial authorities as to how they performed their role of interpretation while determining the contour of control. Furthermore, i have encapsulated the ways in which the particular authority shall adjudicate the disputes in concern. Now, i shall extensively elaborate the implications of control that was hardly touched upon by the regulatory authority. What kinds of ambiguities and inconsistencies are there in terms of numerical thresholds along with control face to face with significant influences?

The expression "control" essentially enables a person to exercise right for the appointment of majority of directors to have control individually or in concert over management or policy decisions either directly or indirectly which undisputedly includes shareholding and management rights or shareholders agreements and voting agreements. One should understand the principle that there is no application if the director or the officer of the target company has control just because of his position [22-23].

It goes without saying that indian companies have been playing a bigger role for cross-border takeover markets [24]. In fact, indian companies are playing a pivotal role so far as acquiring targets and assets overseas through outbound deals are concerned [25]. Moreover, lots of takeover activities are taking place in the indian market, takeover regulations are have strictly or constantly been tested and regulated [26].

The mtb which contains the proposition of equal treatment of all shareholders acting as an elixir for the protection of minority shareholders, it does contain the numerical threshold of 25% along with the subjective definition of control [27]. Additionally, if the above two conditions are satisfied, the acquirer would initiate the mtb. Ironically, the root cause of deviation of indian takeover code from rest of the jurisdictions is that it contains low numerical threshold and broader subjective definition of control.

Mandatory bid rule: the ambiguities

It is pertinent to mention that the purpose of mtb was to provide protection to minority investors and to grant fair and equitable benefits to them. On the contrary, it contains some ambiguities as well. One of the disadvantages of mtb is that it not only prevents the occurrence of value-increasing takeover but it also makes the takeover an expensive venture. Once an acquirer exceeds the 25% threshold, the mandatory bid rule comes into play [28]. Consequently, there is an increase in the costs of such acquisition which ultimately results in high expenditure [29]. Another form of ambiguities is that sometimes the creeping acquisition works as a gateway for the acquirer in terms of getting benefits thereby to strengthen control over the company [30]. Surprisingly enough, if the regulation 3 (2) of the takeover code, 2011 comes into play, it may work as a deprivation of equal treatment of shareholders which eventually could act as a setback over the very objective of the takeover code. Hence, a possible solution lies upon the act that creeping acquisition threshold must be decreased thereby preventing the promoters from taking undue advantages [31]. One of the loopholes of the code is that it does not clearly reflect the actual meaning of the term control since the term "control the management

and policies” is a subjective proposition whereas the “right to appoint directors” is an objective proposition [32]. It goes beyond any reasonable doubt that when it comes to the issue of takeover regulation and the mtb, conception of control has been quite complicated particularly in India. The blend of qualitative and quantitative concept of control has been a herculean task to be resolved.

Conclusion

It is, therefore, essential for regulators to exercise larger freedom while examining and introspecting the perspective of control taking into considerations the facts and circumstances of cases. A crystal clear and concise definition pertaining to conception of control shall be provided while ensuring protection of minority investors and providing minority shareholders fair and equitable benefits. Hence, a more balanced approach would be desirable given the encouragement of acquisition of equity stakes. Moreover, in determining the control, special attention shall be paid towards the ability of acquirers as to whether such thing could essentially influence company’s board of directors. Moreover, regulatory authority shall rethink the concept of control and increase numerical threshold in the pattern of certain leading jurisdictions like that of uk takeover code. Further, it is imperative to resolve the intricacies imbibed in mandatory bids considering inclusive growth and development of our country.

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