CHAPTER-III
LEGAL AND REGULATORY FRAMEWORK FOR TAKEOVERS AND ACQUISITIONS IN INDIA

“No rule, no regulation, indeed no law, which deals with dynamically evolving economic situations and circumstances and seeks to resolve constantly varying economic interests and problems in a fast growing economy, can possibly hope to have a permanent not even a long ending life”

Justice Bhagwati Committee

3.1. Introductory

These lines were used by Justice Bhagwati Committee to refer to the constantly changing law on takeovers in India which we will come to known as we go through this chapter. In the previous chapter, we have dealt in details the provisions of law relating to amalgamation or merger. In this chapter, we propose to deal with the law, practice and procedure relating to takeover or acquisition by a company of another company. We already know the meaning of the term ‘takeover’, ‘acquisition’, ‘takeover bid’, ‘kinds of takeover’ (as discussed in chapter 1). As we know the basic concepts, let us proceed further.

Takeover of companies is a well-accepted and established strategy for corporate growth through inorganic route. Its appeal as an instrument of corporate growth has usually been the result of an admixture of corporate ethos of a country, shareholding pattern of companies, existence of cross holdings in companies, cultural conditions and the regulatory environment. The corporate world exists within the competition and by the competition which, paradoxically, give rise, on the one hand, to threats and cross-fire, trade rivalry and collision, antagonism and impugnation resulting into sickness and closure of corporate enterprise and on the other hand, business enterprises flourish and expand with cooperation and concert, collusion and combination, federation and

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2 J.C. Verma, Corporate Mergers Amalgamations and Takeovers, Bharat Law House, New Delhi, 2009, p. 598.
confederation in ‘esprit de corpe’. Hostility and friendliness is the nature of man who manages the corporate enterprise. Mergers and takeovers are motivated under the dominance of these pressures and influences and are accordingly classified as friendly and hostile takeovers.\(^3\)

As we already said, that takeover of companies is a well-accepted and established strategy of corporate growth the world over. This is so since the processes of substantial acquisition of shares and takeovers ensure rational allocation and optimal utilisation of resources. However, for these objectives to be achieved it is necessary that these processes take place in orderly manner with fairness, transparency and equity. It is also necessary that in the process, shareholders’ interests especially, the public shareholders interest are not compromised.\(^4\)

Involvement of social interests in the economic activities implies application of law with a view to regulate the activity to ensure safeguard of general public interests. In India, takeover or acquisition of a company is regulated by:

- Provisions of Companies Act
- Listing Agreement
- SEBI Takeover Code 2011

Therefore, before planning a takeover of a listed company, any acquirer should understand the compliance requirements under the Regulations and also the requirements under the Listing Agreement and the Companies Act.

### 3.2. History of Takeover Law in India

Basically, in layman terms, takeover is nothing but the acquisition of shares of one company by another company. It is necessary to trace, very briefly, the history of legislation which regulated the corporate acquisitions generally, its effect on the investors and the efforts made by the government to protect the latter. The laws relating to takeover were not very organised until the year 1994 when the Takeover Code was drafted. Calling it unorganised would rather be an understatement because laws relating

\(^3\) Ibid.
to takeovers in India until 1994 hardly existed. Except for certain provisions of the Companies Act, 1956 (section 372, regarding intercorporate loans by companies and section 395, regarding acquisition of the shares of dissentient shareholders), there was hardly anything solid enough to be called as organised takeover laws.\(^5\)

As there was no comprehensive piece of legislation that governed the takeover bids, the first attempt to regulate the takeovers was made by the government by incorporating Clause 40 in the Listing Agreement of stock exchanges. Thus, government used the medium of stock exchanges where a public limited company’s shares were listed as a means to regulate takeovers and substantial acquisition of shares and thus protect the interests of minority shareholders.

Mention should also be made of the Capital Issues Control Act, 1947 an Act ‘to provide control over issues of capital. This piece of legislation protected the Indian Investors from subscribing to shares which are over-priced, through the pricing method adopted for public issues of shares by the controller of capital issues.\(^6\) Another aspect of the Indian corporate sector, which affected takeover, is the role of public sector banks and public financial and development institutions. Due to historical reasons, these banks and institutions, which are primarily under the ownership and control of the government, acquired large shareholding in private sector companies. These institutions played a developmental role in the formative days of the Indian corporate sector. Just like their counterpart the world over, these institutions have a definite role in the takeover game.\(^7\)

### 3.3. The Provisions of the Companies Act, 1956/Companies Act, 2013

In addition to the provisions of SEBI Takeover Code, 2011, the Board of Directors of a company will need to comply with provisions of section 372A of Companies Act, 1956 (section 186 of the Companies Act 2013) while considering a takeover.

Section 372A(1) of 1956 Act/Section 186 (2) of the 2013 Act says that a company can directly or indirectly make any loan to any other body corporate, give any guarantee or

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\(^7\) Id., p. 871
provide security in connection with a loan made by any other person to or to any other person, by any body corporate, and acquire by way of subscription, purchase or otherwise, the securities of any other body corporate for a value not exceeding 60 percent of its paid-up share capital and free reserves or 100 percent of its free reserves, whichever is more. Proviso to section 372A(1) of the 1956 Act/Section 186 (3) of the 2013 Act says that if the giving of any loan or guarantee or providing any security or the acquisition under sub-section (2) exceeds 60 percent of its paid-up share capital and free reserves or 100 percent of its free reserves, prior approval by means of a special resolution passed at a general meeting is mandatory.

Section 186(4) has added a new provision which makes it mandatory for the company to disclose to the members in the financial statement the full particulars of the loan given, investment made or guarantee given or security provided and the purpose for which they are going to be utilised. Section 372-A(2) of the 1956 Act/Section 230(5) of the 2013 Act says that no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned is obtained in the case of subsistence of term loan.

It further provides that prior approval of a public financial institution is not necessary where the aggregate of the loans, investments and guarantee/security given or provided alongwith loans, investment and guarantee/security to be given does not exceed the limit specified above and moreover there is no default in repayment of loan installment or payment of interest as per the terms and conditions of the said loan to the public financial institution.  

**3.3.1. Internal Rate**

Benchmark interest rate for making inter-corporate loans changed by the Companies Act 2013. Under the 1956 Act it was RBI’s bank rate and now under the 2013 Act, it is the interest rate of dated government security.

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8 Proviso to Section 372-A(2) of the Companies Act, 1956/Proviso to section 230(5) of the Companies Act, 2013.
3.3.2. Effect of Default

By virtue of section 230(8), no company which is in default in the repayment of any deposits or interest thereon, shall give any loan guarantee or provide any security or make an acquisition till such default is subsisting.\(^9\)

3.3.3. Maintenance of Register

Every company giving loan or guarantee or providing security or making an acquisition shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed.\(^10\) The register shall be kept at the registered office of the company and it shall be open for inspection and extracts may be taken thereof by any member and he can have copy of the register on payment of prescribed fees.\(^11\)

3.3.4. Exemptions in Case of Certain Companies

The acquisitions by following companies are exempted from the provision of section 186 (except sub-section 1).

1. Acquisitions made by Non-Banking Financial Company (NBFC) registered under Chapter III B of the RBI Act, 1934 and whose principal business is acquisition of securities. Exemption of NBFC shall be in respect of investment and lending activities.

2. Acquisition made by a company whose principal business is the acquisition of securities.

3. Acquisition of shares allotted in pursuance of section 62(1)(a) i.e. right shares.

3.3.5. Government Guidelines

The Central government has been authorised to prescribe the necessary guidelines which shall be applicable under these provisions.\(^12\) Thus, companies are required to comply with such guidelines also, as and when they may be prescribed, in addition to the compliance of the provisions of this section.

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\(^10\) Section 186(9) of the Companies Act, 2013.

\(^11\) Section 186(10) of the Companies Act, 2013.

\(^12\) Section 372-A (7) of the Companies Act, 1956/Section 186(12) of the Companies Act, 2013.
3.3.6. Default

If the company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than Rs. 25000 but which may extend upto Rs. 5,00,000 and officer in default shall be punishable with imprisonment for a term which may extend upto two years and fine which shall not be less than Rs. 25,000 but which may extend upto Rs. 1,00,000. These penalty provisions have also been modified by 2013 Act. A major change introduced is under 1956 Act, one could escape punishment of imprisonment by fully repaying the inter-corporate loan or reduction of punishment by part payment of loan.

3.3.7. Restriction on Multi-Layered Structures

In the Companies Act, 1956, there are no provisions regarding restrictions on multi-layered structures. Accordingly, several multi-layered structures have been set up for holding investments in operating entities to suit business or commercial needs. However, the New Act has imposed a restriction of two layers for investment companies. Section 186(1) says that a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies. But this provision shall not affect:

1. A company from acquiring any other company incorporated in a country outside India if such company has investment subsidiaries beyond two layers as per the laws of such country.

2. A subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

In the view of the researcher, the rationale behind this change is to limit diversion of funds and to check avoidance of tax through the webs of complex corporate structures.

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13 Section 186(13) of the Companies Act, 2013.
15 Explanation to section 186 of the Companies Act defines ‘Investment Company’ as a company whose principal business is the acquisition of shares, debentures or other securities.
16 Proviso to section 186(1) of the Companies Act, 2013.
3.4. The Provisions of Listing Agreement (In Case of Listed Companies)

Every company desirous of getting itself listed on a stock exchange has to sign an agreement with the exchange. This is known as the listing agreement. Of the various clauses contained in the listing agreement, clauses 40A and 40B are relevant from the point of view of our subject. The first attempts at regulating takeovers were made in a limited way by incorporating a clause, viz. clause 40, in the listing agreement, which provided for making a public offer to the shareholders of a company by any person who sought to acquire 25 percent or more of the voting rights of the company. This allowed for the passive participation of shareholders of the company that is being taken over, in the takeover process. However, in the Indian context, where companies could be controlled by acquiring much less than 25 percent, the basic purpose of the clause could be and was being defeated by acquiring shares just below the threshold limit of 25 percent and still acquiring control over the company. Besides, it was noted that it was possible to acquire control over a company in the Indian context with even holding 10 percent directly. Hence, in 1990, even before SEBI became a statutory body, the government in consultation with SEBI, replaced the clause 40 by clauses 40A and 40B by lowering the threshold acquisition level for making a public offer by the acquirer from 25 percent to 10 percent. Further, it was provided that, notwithstanding there being no change in the shareholding, a change of management of a company will trigger the need to make a public offer to acquire shares. It also stipulated a minimum price at which an offer should be made and requiring a shareholder to disclose his shareholding at level of 5 percent or above to serve as an advance notice to the target company about the possible takeover threat. It also stipulated that in case of an acquisition of shares exceeding 10 percent of the voting capital of any company as above, the person so acquiring the shares shall make an open offer to acquire at least 20 percent shares from the public through an open offer. Since these clauses have now been substantially amended, we will not be discussing them in detail here.

17 Prasad G. Godbole, 2009, p.156.
20 Original Clause 40A of the Listing Agreement.
21 Original Clause 40B of the Listing Agreement.
These changes helped in making the process of acquisition of shares and takeovers transparent, provided for protection of investors interest in greater measure and introduced an element of equity between the various parties concerned by increasing the disclosure requirement. But the clauses suffered from several deficiencies – particularly in their limited applicability and weak enforceability. The amended clauses were unable to provide a comprehensive regulatory framework governing takeovers. Nonetheless, they made a positive beginning.\textsuperscript{22}

After acquiring statutory powers pursuant to the enactment of the SEBI Act in 1992, SEBI came out with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994. Clause 40 A and 40B of the Listing Agreement also remained in force. The Regulations retained the basic framework of clauses 40A and 40B,\textsuperscript{23} though they did make a significant departure from clause 40A and 40B by dropping ‘change in management’ simpliciter as a ground for making a public offer.

The Justice Bhagwati Committee recommended that these clauses have become redundant and hence be replaced by more appropriate one, it was only in 2006 that new clause 40A and 40B were enacted. They became effective from 1 May 2006. The important provisions of these clauses are discussed here as under.

In order to ensure availability of floating stock on a continuous basis and to being about greater transparency in respect of disclosure of shareholding pattern of companies, SEBI has decided to bring the following changes to the clause 40A and 40B of the continuous listing agreements.\textsuperscript{24}

\textbf{3.4.1. Minimum Level of Public Shareholding (Clause 40A)}

1. According to this clause, all listed companies, will be required to ensure minimum level of public shareholding at 25 percent of the total number of issued shares of a class or kind for the purpose of continuous listing.\textsuperscript{25} But there are two important exceptions to this:

\begin{itemize}
  \item Sub-clause(i) to clause 40A of the Listing Agreement.
\end{itemize}

\begin{itemize}
  \item J.C. Verma, 2009, p. 603.
  \item Initial disclosure at the level of 5 percent, threshold limit of 10 percent for public offer to acquire minimum percentage of shares at a minimum offer price and making of a public announcement by the acquirer followed by a letter of offer.
  \item Circular No. SEBI/CFD/DIL/LA/2006/13/4, Dated 13 April 2006, retrieved from www.nse-india.com/corporates/content/eq-listcompanies.htm, accessed on 8 September 2012 at 4.00 pm.
\end{itemize}
(a) Companies, which, at the time of initial listing had offered less than 25 percent but not less than 10 percent of the total number of issued shares of a class or kind, in terms of rule 19(2)(b) of Securities Contract (Regulation) Rules 1957 (SCRR) or companies desiring to list their shares by making an initial public offering of at least 10 percent in terms of rule 19(2)(b) of SCRR.\(^\text{26}\)

(b) The second exception is in the case of companies, which have, irrespective of the percentage of their shares with public at the time of initial listing, reached a size of two crore or more in terms of number of listed shares and Rs. 1000 crore or more in terms of market capitalisation.\(^\text{27}\)

The companies in the above two cases will be required to maintain the minimum level of public shareholding at 10 percent of the total number of issued shares of a class or kind for the purpose of continuous listing.

2. The companies which are not complying with the above clause as on 1 May 2006, will have to comply with it within a period, not exceeding two years as granted by the Specified Stock Exchange (SSE). This period can be further extended (not exceeding one year) by SSE after verifying the adequacy of the steps taken by the company to increase the public shareholding and the genuineness of the reasons submitted by the company.\(^\text{28}\)

3. Similarly, in respect of companies whose public shareholding falls below the minimum level pursuant to:

(a) The issuance or transfer of shares due to supervening extraordinary events such as;

- Compliance with directions of any regulatory or statutory authority, directions of a court or tribunal;
- In compliance with the Takeover Code.

(b) Reorganisation of capital by a scheme of arrangement;

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\(^{26}\) Sub-clause (ii) to clause 40A of the Listing Agreement.

\(^{27}\) Sub-clause (iii) to clause 40A of the Listing Agreement.

\(^{28}\) Sub-clause (iv) to clause 40A of the Listing Agreement.
The stock exchange may provide additional time of one year (extendable up to two years by SSE after verifying adequacy of steps taken by the company to increase the public shareholding and genuineness of the reasons submitted by the company)\textsuperscript{29} to the company to comply with the minimum requirements.\textsuperscript{30}

4. Where the public shareholding in the company, in respect of any class or kind of shares has reduced below the stipulated minimum the company shall not further dilute the same except on account of supervening extraordinary events.\textsuperscript{31}

5. The company shall not issue shares to promoters or entities belonging to its promoter group except on account of supervening extraordinary events or make any offer for buy-back of its shares or buy its shares for making sponsored issuance of depository receipts etc., if it results in reducing the public shareholding below the minimum level of 25 percent or 10 percent as the case may be.\textsuperscript{32}

6. Nothing contained in the above clauses,\textsuperscript{33} shall apply to government companies (as defined under section 617 of the Companies Act, 1956), infrastructure companies as defined in clause 1.2.1 (xv) of the SEBI (Disclosure and Investor Protection) Guidelines, 2000, or the companies referred to the Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 or to the National Company Law Tribunal under section 424A of the Companies Act.

7. Sub clause (viii) provides that: The company agrees that in event of its public shareholding reduces below the stipulated minimum level, it shall immediately take steps to increase the same above the stipulated minimum by any of the following methods:

(a) Issuance of shares to public through prospectus.

(b) Offer for sale of shares held by promoters to public through prospectus.

\textsuperscript{29} Sub-clause (vii) to clause 40A of the Listing Agreement.

\textsuperscript{30} Proviso to sub-clause (vii) to clause 40A of the Listing Agreement.

\textsuperscript{31} Sub-clause (v) to clause 40A of the Listing Agreement.

\textsuperscript{32} Sub-clause (vi) to clause 40A of the Listing Agreement.

\textsuperscript{33} Sub-clause (i) to (vii) of clause 40A of the Listing Agreement.
(c) Sale of shares held by promoters through the secondary market.

(d) Any other method which does not adversely affect the interest of minority shareholders.\textsuperscript{34}

Last but not the least, where a company fails to comply with the above provisions, it shares shall be liable to be delisted in terms of the SEBI Delisting Guidelines and it shall also be liable for penal actions under the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992.\textsuperscript{35}

\textbf{3.4.2. Take over Offer (Clause 40B)}

This clause says that it is a condition for a continued listing that whenever a takeover offer is made or there is a change in the management of a company, the person who secures the control of the management and the company whose shares have been acquired shall comply with the relevant provisions of the SEBI’s Takeover Code.

But the amended clauses are still unable to provide a comprehensive regulatory framework governing takeovers due to their limited applicability and weak enforceability.

1. This clause could be made binding only on listed companies and could not be effectively enforced against an acquirer unless the acquirer itself was a listed company as listing agreement is a sought of contract between a company and the stock exchange.

2. The penalty for non-compliance was one common to all violations of a listing agreement, namely delisting of the company’s shares, which in fact may turnout to be more detrimental to the interests of the investors sought to be protected.

Despite all its weaknesses, the listing agreement made a good beginning.

\textbf{3.5. SEBI Takeover Code 2011}

In 1991, the Indian Government, under the then Prime Minister Late Mr. P.V. Narasimha Rao, undertook the initiative in favour of economic reforms, consisting essentially of

\textsuperscript{34} Proviso to sub-clause (viii) of clause 40 A provides that for the purpose of adopting methods specified in sub-clauses (c) and (d) above, the company agrees to take prior approval of the SSE which may impose certain conditions as it deems fit.

\textsuperscript{35} Sub-clause (ix) to clause 40 A of the Listing Agreement.
liberalisation and de-regulation and thereby changed the economic policy of India, which used to be a closed economy till then. The Monopolies and Restrictive Trade Practices Act 1969 was amended and this resulted in the opening up of the economy and dismantling of the regulatory system to facilitate industrial development.

Prior to the coming into force of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994, transferability of substantial shares of listed companies was governed by Clause 40 of the then listing agreement. As already explained, that since there were some lacunas in the then clause 40, in 1990, clause 40 was amended and was substituted by new clauses 40A and 40B, which lowered the threshold limit from 25 percent to 10 percent. Since these clauses had their own shortcomings, as discussed earlier the SEBI pursuant to the powers vested in it under section 30 of the SEBI Act, 1992 came out with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations in 1994, which came into force on 4 November 1994.

It was a maiden attempt in India to regulate in an organised manner ‘takeover’ of a quoted company. They were however found to be inadequate. Within two years of working of regulations, a need was felt to improve the regulations to make them more comprehensive. Therefore, government constituted a committee under the chairmanship of Hon’ble Justice P.N. Bhagwati, former Chief Justice of Supreme Court of India to:

1. Examine the areas of deficiency in the existing regulations.
2. To suggest amendments in the regulations with a view to strengthening the regulations and to make them more fair, transparent and unambiguous and also to protect the interest of investors and of all parties concerned in the acquisition process.

The Bhagwati Committee while suggesting amendments to the regulations, recognised that the process of takeovers is complex and is closely interlinked to the dynamics of

Before making its recommendations, the Committee took into account a set of ten general principles which should be taken as the guiding factors in circumstances which are not explicitly covered by the regulations, and in the event of any ambiguity or doubt as to their interpretation.

Based on the recommendations made by the Bhagwati Committees, the fresh set of regulations were notified with effect from 20-02-1997 entitled SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997 (hereinafter referred to as ‘the Takeover Code 1997’ or sometimes simply as ‘the 1997 Code’). This notified Code superseded the earlier Code notified in November 1994. They were subsequently framed with the object of harmonising economic growth with investor protection.

The economic environment was changing rapidly which required suitable adjustment in the regulations to keep pace with changing social and economic matrix and the emerging global scenario. Hence these regulations have to be reviewed from time to time. Major amendments to these regulations were made in 1998 and 2001. No doubt, the Takeover Code of 1997, helped set basic rules for mergers and acquisitions in the nascent market scenario for such transactions. But, the rules left scope for interpretation leading to many disputes, including Gujarat Ambuja Cements purchase of nearly 15 percent in rival ACC. This lead to reconstitution of Bhagwati Committee in 2001.

The takeover regulations underwent substantial and major changes with effect from 9-9-2002 based on the second report of the reconvened committee under the chairmanship of Justice P.N. Bhagwati. The reconvened committee made its recommendations virtually covering every aspect of the Code including the takeover panel, consolidation of holdings, creeping acquisitions, preferential allotment, minimum offer price etc.

Based on these recommendations, a fresh set of amendments were made in the year 2002 to the takeover regulations. The regulations again underwent changes in December 2004. These amendments were not based on any recommendations of any external

41 For details on the ten general principles, see, N.R. Sridharan and P.H. Arvind Pandian, 2010, pp. 605-606; also see J.C. Verma, 2009, p. 713.
committee. These changes reflect SEBI’s determination to protect small investors and regulate the security market. Overall, the Takeover Code was amended 23 times in 13 years and created more confusion than clarifying the regulatory status of the law and the SEBI.\(^{45}\)

3.5.1. Constitution of TRAC

India is one among the fastest developing countries with a highly impressive growth story. But to sustain this level of growth there need to be a favourable environment conducive to development. Significant alterations have been due from long time. However, owing to the rigidity of Indian legal system, the processes have been outstretched. The business and the number of corporate organisations have increased manifold over the years.\(^{46}\) India has witnessed intense activities in corporate restructuring in past few years. The number of takeovers of listed companies has increased from an average of 69 a year during the period between 1997 and 2005 to an average of 99 a year during the period between 2006 and 2010.\(^{47}\) Taking into consideration the growing level of M&A activity in India, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the 1997 Code and to bring it in line with the current understanding of the international market. In this dynamic era, one cannot think of sticking to age-old legal regime.

According, SEBI, vide its order dated 4 September 2009 constituted the Takeover Regulations Advisory Committee (TRAC) with the mandate to examine and review the 1997 Code and to suggest suitable amendments, as deemed fit. The committee was constituted under the chairmanship of former presiding officer, Securities Appellate Tribunal to bridge the gap between the decade long regulations and a rapidly evolving M&A market. TRAC submitted its report to the SEBI on 19 July 2010 with a new set of takeover regulations taking into consideration various decisions of the courts in India

\(^{45}\) C.S. Balasubramaniam, 2011, p. 98.


and rulings of Securities Appellate Tribunal, and international best practices. The committee’s report has been prepared taking into account a plethora of important factors having a strong bearing on the performance of the India capital markets, which have witnessed changes since the Takeover Code was enacted in 1997. On the basis of its market research and prevailing best practices in other jurisdictions, the committee has suggested numerous improvements to the Takeover Code. The effect of these changes has been to bring the amended Code substantially in line with international takeover regulations in some respects. The 139 page report of the Achuthan committee has proposed sweeping changes to the Takeover Regulations 1997.

Based on the recommendations of the committee and feedback from interest groups and general public on such recommendations, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (hereinafter referred to as the ‘Takeover Code 2011’ or sometimes simply ‘2011 Code’) were notified.

The SEBI has accepted several recommendations of the TRAC committee in the 2011 Code. It has made some amendments to the changes proposed by the TRAC. With several changes in the domestic tax and regulatory framework, such as the Direct Taxes Code, Goods and Services Tax, Competition (Amendment) Bill etc., on the anvil, without much certainty on most fronts, corporate India has one less regulation to be uncertain about after the onset of this 2011 Code, i.e. the Takeover Code. The new Takeover Code is expected to provide impetus to capital markets and industry in general.

3.5.2. Necessity, Purpose and Object of the Code

M&As are the powerful ways to achieve corporate growth, but because of their complex nature, protection of interest of all the parties, curbing of the malpractices and to facilitate the orderly development, these activities are regulated by a Takeover Code in most part of the world. In India after liberalisation, government started to regulate these


activities by introducing a Takeover Code. The Code is based on the principle of transparency, fairness and equal opportunity to all. The impact of the SEBI's initiative on the Takeover Code in the interest of investors seems to be visible as according to a report by SEBI in 2001, introduction of Takeover Code has resulted in a benefit of Rs. 4250 crores to the shareholders of various companies.\(^50\)

The necessity for a Code to regulate corporate takeovers need not be over emphasised. It was enacted to protect businesses from hostile takeovers as from time immemorial there have been predators with huge, disposable wealth ready to grab successful business entities at the weakest moments and generally at the cost of the promoters, investors as well as the retail investors. The takeover regulations have been framed with a view to provide transparency in transfers arising out of substantial acquisition of shares and takeovers. The object is to bring about fairness in such transactions as also to protect the interests of the investors in securities. The provisions in the Code are intended to protect the interests of small shareholders so that in substantial acquisition of shares they get a fair price for the shares transferred by them.\(^51\) Now we will analyse various judgements of Supreme Court, various High Courts, SAT etc. which have emphasised the object and purpose of the Code.

In *Sultania (GL) v. SEBI*,\(^52\) the Supreme Court held that the entire scheme of the Code is designed to protect the interests of the investors, particularly the smaller ones who run the risk of getting an unfair deal in such transactions. As emphasised by the Bombay High Court in *K.K. Modi v. SAT*:\(^53\)

> “The Regulations have been framed with a view to protect the interests of investors in securities, and to promote development of and to regulate the securities market and for matters connected therewith or incidental thereto. The regulations deal inter alia with substantial acquisition of shares in companies by an acquirer. They do not, in any manner, inhibit the right of the owner of shares to sell his shares to a willing purchaser. In fact, the law leans in favour of free transferability of shares.”

\(^{50}\) Mahesh Kumar Tambi, “Indian Takeover Code in Search of Excellence: A Case Study Approach”, retrieved from [http://ideas.repec.org/p/wpa/wvwpma/0504021.html](http://ideas.repec.org/p/wpa/wvwpma/0504021.html), accessed on 8 September 2012 at 2.18 p.m.

\(^{51}\) J.C. Verma, 2009, p. 713.

\(^{52}\) (2007) 76 SCL 473 (SC).

\(^{53}\) (2002) 35 SCL 230 (Bom.).
The object and purpose of the 2011 Code can very well be elucidated by the judgement of the Securities Appellate Tribunal, Mumbai in *Kishore Chhabana v. Chairman, SEBI*. The Tribunal held the purpose of the Code to be remedial and regulatory and to:

- To ensure that the incumbent management of the target company is aware of the substantial acquisition.
- To ensure that in the process of substantial acquisition the security market is not distorted.
- To ensure that the small investors are offered a choice either to remain or to exit profitably.

### 3.5.3. Objectives of the 2011 Code

The fundamental objectives of the 2011 Code (as per the TRAC report) are:

1. To provide a transparent legal framework for facilitating takeover activities.
2. To protect the interests of investors in securities and the securities market, taking into account that both the acquirer and the other shareholders or investors need a fair, equitable and transparent framework to protect their interest.
3. To balance the various, and at times, conflicting objectives and interests of various stakeholders in the context of substantial acquisition of shares in, and takeovers of, listed companies.
4. To provide each shareholder an opportunity to exit his investment in the target company when a substantial acquisition of share in, or takeover of a target company takes place, on terms that are not inferior to the terms on which substantial shareholders exit their investments.
5. To provide acquirer with a transparent legal framework to acquire shares in or control of the target company and to make an open offer.
6. To ensure that the affairs of the target company are conducted in the ordinary course when a target company is subject matter of an open offer.

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54 (2003) 46 SCL 385 (SAT-Mum.).
7. To ensure fair and accurate disclosure of all material information by persons responsible for making them to various stakeholders to enable them to take informed decisions.

8. To regulate and provide for fair and effective competition among acquirers desirous of taking over the same target company.

9. To ensure that only those acquirers who are capable of actually fulfilling their obligations under the takeover regulations make open offers.

Now, we shall discuss the important provisions of Takeover Code 2011 which regulates takeovers and acquisitions in India by referring to the corresponding provisions of 1997 Code wherever necessary. A critical analysis of provisions may also be carried out wherever necessary. Important judgements will also be quoted at appropriate places.

3.5.4. Acquisition

Regulation 2(1)(b) defines ‘acquisition’ to mean:

- Directly or indirectly;
- Acquiring or agreeing to acquire;
- Shares or voting rights in, or control over, a target company.

The 2011 Code in its regulation 1 (3) explicitly states that it shall apply to direct or indirect acquisition of shares or voting rights in or control over any target company. Shares has been defined in the 2011 Code as including equity share capital of the target company carrying voting rights, all depository receipts carrying an entitlement to voting rights in the target company and it also includes any security which entitles the holder thereof to exercise voting rights.\(^{56}\) Further, the Takeover Code 1997 excluded preference shares from the definition of shares vide an amendment of 2002. In the case of *Weizmann Ltd v. Adjudicating officer of SEBI*,\(^{57}\) it was held by the Tribunal that the words ‘but shall not include preference shares’ were inserted in the year 2002 with effect from 9-9-2002. Prior to this insertion, preference shares, if they carried voting rights, were included for the purposes of the Takeover Code. The appellants became entitled to vote on the strength of their preference shares only in the annual general

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\(^{56}\) For definition of shares, see regulation 2(v) of Takeover Code 2011.

\(^{57}\) (2009) 96 SCL 355 (SAT-Mum.).
meeting held on 31-12-2002. Since on that date, the preference shares had been excluded from the ambit of the Takeover Code, the Code was not triggered. Therefore, the appellants were not required to make a public announcement. However, this exclusion has been removed in the Takeover Code 2011, and therefore now ‘shares’ would include, without any restriction, any security which entitles the holder to voting rights.

3.5.5. Acquirer

Clause (a) of Regulation 2 (2) defines ‘acquirer’ to mean:

- Any person;
- Who, directly or indirectly;
- Acquires, or agrees to acquire;
- Whether by himself, or through, or with persons acting in concert with him;
- Shares or voting rights in, or control over a target company.

This definition identifies the acquirer as one who acquires shares or voting rights or control in a target company, thereby making suitable distinction in the meaning of these expressions. Further the definition also focuses not only on acquiring but also on agreeing to acquire. Any person acting in concert with the acquirer is also an acquirer under the Code.58

Acquirer Includes Persons who Agree to Acquire

Not only actual acquisition but agreement to acquire is also covered. The term ‘acquirer’ as defined in regulation 2 (b) came up for consideration before the Bombay High Court in B.P. PLC v. SEBI,59 the court held that:

“After giving a deep consideration to the submissions of both the counsel and in the light of the provisions of the SEBI regulations, we find that the word ‘acquirer’ could not be interpreted to mean only a person who has already acquired shares. On the contrary, the definition of ‘acquirer’ in regulation 2(b) makes it very clear that even someone who ‘agrees to acquire shares or voting rights’ or ‘agrees to acquire control over the target company’ would come within the definition of ‘acquirer’.

59 (2001) 34 SCL 469 (Bom.).
Therefore, it is explicitly apparent and clear that the word ‘acquirer’ would not only mean that those who have already acquired shares but also those ‘who agree to acquire shares or agree to acquire control over the target company.’

The definition of acquirer reminds us of another very important and interesting concept ‘person acting in concert’. Let’s go through it.

3.5.6. Person Acting in Concert

‘Person acting in concert’ have particular relevance to public offers, for often an acquirer can acquire shares or voting rights in a company ‘in concert’ with any other person in a manner that the acquisitions made by him remain below the threshold limit, though taken together with the voting rights of persons in concert, the threshold may well be exceeded. It is, therefore, important to define ‘person acting in concert’.60 Persons acting in concert are divided into two broad categories, namely ‘direct persons’ and ‘deemed persons’. These two categories are identified in the following manner:

(1) **Direct Persons:** The first category of persons are those, who with a common objective or purpose of acquisition of shares or voting rights or exercising control over the target company pursuant to an agreement or understanding whether formal or informal, co-operate for acquisition of shares or voting rights in or exercise of control over the target company.61 The definition in the 1997 Code required that, to come within the definition of person acting in concert (PAC), the person in question should co-operate with the acquirer by acquiring or agreeing to acquire shares or voting rights in the target Company. The present definition only requires co-operation with the acquirer with common objective of acquisition of shares, it does not require co-operation by acquiring or agreeing to acquire shares or voting rights in the target Company.

(2) **Deemed Persons:** The second category of persons are those who will be ‘deemed to be persons acting in concert’ with other persons in the same category unless the

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61 Regulation 2(1)(q) of the SEBI (Substantial Acquisition of Share and Takeover) Regulations, 2011.
contrary is established. This category of ‘deemed persons’ acting in concert has thirteen sub-categories. They are:\textsuperscript{62}

(i) A company, its holding company, subsidiary company and any company under the same management.

(ii) A company, its directors, and any person entrusted with the management of the company.

(iii) Director of companies referred to in items (i) and (ii) above and associates of such directors.

(iv) Promoters and members of the promoter group.

(v) Immediate relatives.

(vi) A mutual fund, its sponsor, trustees, trustee company, and asset management company.

(vii) A collective investment scheme and its collective investment management company, trustees and trustee company.

(viii) A venture capital fund and its sponsor, trustees, trustee company and asset management company.

(ix) A foreign institutional investor and its sub-accounts.

(x) A merchant banker and its client, who is an acquirer.

(xi) A portfolio manager and its client, who is an acquirer.

(xii) Banks, financial advisors and stock brokers of the acquirer, or any company which is holding or subsidiary of the acquirer, and where the acquirer is an individual, the immediate relative of such individual. But the proviso to this sub-clause lays down an exception saying that bank whose sole role is that of providing normal commercial banking services or activities in relation to an open offer under these regulations, shall not be deemed to be a PAC.

(xiii) An investment company or fund and any person who has an interest in such investment company or fund as a shareholder or unit holder having not less than

\textsuperscript{62} \textit{Ibid.}
10 percent of the paid-up capital of the investment company or unit capital of
the fund and it also includes any other investment company or fund in which
such person or his associate holds not less than 10 percent of the paid up capital
of that investment company or unit capital of that ‘fund’. The 2011 regulations
has broadened the sub-clauses and added the term fund in addition to the
investment company but narrowed the scope of the term PAC by extending the 2
percent limit to 10 percent. Now person holding less than 10 percent will not be
included in the category of PAC.

Thus, overall, the second category of deemed persons acting in concert is quite
comprehensive and exhaustive. The definition in Regulation 2(1)(r) of the 2011 Code
differs from the definition in the regulation 2(1)(e) of the 1997 Code in the following
respects.

The 2011 Code has included following three categories to the list of PAC in addition to
minor change in sub clauses (which have already been discussed).

(i) Promoters and members of the promoter group.

(ii) Immediate relatives.63

(iii) A collective investment scheme and its collective investment management
company, trustees and trustee company.

The inclusion of ‘promoters and members of the promoter group’ as a category of
deemed PAC in the definition of PAC is to presumably overcome of the decision of the
Bombay High Court in K.K. Modi v. Securities Appellate Tribunal,64 where it was held
that the question whether a promoter is acting in concert with the acquirer is question of
fact and depends on the facts of the case. Therefore, co-promoter cannot be said to be a
PAC with the acquirer unless the evidence on record clearly establishes common
objective for the purpose of substantial acquisition of shares.

But now under the new definition of PAC in these regulations, a co-promoter of the
target company will be deemed to be PAC with acquirer who also happens to be one of

63 ‘Immediate Relative’ has been defined in Regulation 2(1)(l) of the SEBI (Substantial Acquisition of
Shares and Takeovers) Regulations, 2011.
64 (2003) 113 Com Cases 418(Bom.): also see, Shirish Finance and Investment Pvt. Ltd. v. M.
the promoters of the target company, unless the contrary is proved. In case of immediate relatives, under the 1997 Code, it had to be shown that these relatives were co-operating with the individual acquirer by acquiring or agreeing to acquire shares for a common objective, but this is not so in 2011 Code. This makes the definition of PACs in the regulations as much more simplified and rationalised definition than under the 1997 Code.

3.5.6.1. **Decisions on Persons Acting ‘in Concert’:** In *Alliance Capital Mutual Fund and Others v. SEBI*,\(^{65}\) it was held that the words ‘in the same category’ in sub-clause 2(v) of Regulation 2(1)(e) are important and they make it clear that the deeming provision would apply only in respect of persons who are referred in the same category and hence, it follows that the deeming fiction shall not extend to entities across the different categories. The order went ahead with giving the following illustration: a mutual fund referred to in category (iv) will not be deemed to be acting in concert with a foreign institutional investor mentioned in category (v). The adjudicating officer had stated in its order that the mutual fund and sub-accounts were ‘persons acting in concert’ in clause (v). The Securities Appellate Tribunal (SAT) held that since the only entities mentioned in clause (v) are the foreign institutional investors and their sub-accounts and that since a mutual fund is not mentioned in this category, acquisitions made by it cannot be clubbed with those of a foreign institutional investors and its sub-account for the purposes of regulation 7 of the Takeover Code.\(^{66}\)

*Hitachi Home and Life Solutions Inc. v. SEBI*,\(^{67}\) is another important judgement on PACs. It said that where the parties acting in concert have decided to sever their relations, it cannot be said that they are not acting in concert. Mere desire to sever the relations is not sufficient. It is only at the time of exit that the severance actually takes place. In *Northern Projects Ltd. v. Adjudicating Officer, Securities and Exchange Board of India*,\(^{68}\) the Securities Appellate Tribunal held that the relationship of PAC could come into being only by design and by the meeting of their minds leading to the shared common objective of acquiring shares of the target company. Whether they shared this

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65 (2008) 83 SCL 265 (SAT-Mum.).
66 The serial number of sub-clauses is changed as this judgement refers to the 1997 Code.
67 (2006) 65 SCL 339 (SAT-Mum.).
68 (2011) 109 SCL 471 (SAT-Mum.).
objective is a question of fact which has to be determined on the basis of the material on
record.

In Bank of Rajasthan v. Parvin Kumar Tayal and Others, the SEBI on the basis of
circumstantial evidence decided that the promoter groups- Tayal Group, Yadav Group
and Silvassa Group were PACs and the connection/relations were established on the
basis of common directors, common addresses, fund transfers and off market transfer of
shares.

3.5.6.2. Supreme Court on ‘Persons Acting in Concert’: The Supreme Court in
Technip SA v. S.M.S. Holdings (P.) Ltd., referring to report held that ‘to be acting in
concert’ with an acquirer, persons must fulfill certain ‘bright line’ tests. They must have
commonality of objectives and a community of interest and their act of acquiring the
shares or voting rights in company must serve this common objective. The commonality
of objective should be established between the acquirer and a shareholder in order to
trigger regulations 10, 11 and 12.

In Daiichi Sankyo Company Ltd v. Jayaran Thigurapathi and others/Daiichi Sankyo Co.
Ltd. v. N. Narayanan and Another, these were two appeals before the Supreme Court
from the decision of SAT in Dr. Jayaram Chigurapatti v. SEBI (Zenotech Case), the
SEBI ruled that Ranbaxy was deemed to be PAC with Daiichi when acquiring shares of
This judgement created widespread discontent as regarding the meaning and content of
the term PAC. The SAT held that when Ranbaxy became subsidiary of Daiichi in
October 2008, it became deemed to be PAC according to regulation 2(e)(2). The
judgement of SAT created a widespread discontent as to how can Ranbaxy have
commonality of objective and a community of interest with Daiichi before 20 October
2008 –the date when it became Daiichi’s subsidiary, as Zenotech shares were purchased

69 Adjudication Order No. BM/AO/8-125/2013 as quoted in “SEBI’s Order on Persons Acting in
Concert”, Common Directors and Corporate Address of Alleged Companies Triggering the
70 (2005) 60 SCL 249 (SC).
71 (2010) 3 Comp LJ 297 (SC): For a detailed analysis of the judgement and related issues, see, Vivek
Ranjan, “Daiichi Sankyo Co’s Case – Indirect Acquisitions, Determination of Open Offers Price and
72 Appeal No. 137 of 2009 as analysed in Murturza Bohra, “Impact of Zenotech Case on Indirect
in January 2008. So, the appeals from the erroneous decision of SAT came before the Apex Court. The Supreme Court reversed the findings of SAT and held that the purchase of Zenotech shares by Ranbaxy in January 2008 cannot be said to be by a ‘person acting in concert’ with Daiichi. The Apex Court held that deeming fiction under sub-regulation (2) can only operate prospectively and not retrospectively. That deeming provision would give rise to the presumption. Only from the date two or more persons come together in one of the prescribed relationships and not from any earlier date. The Daiichi and Ranbaxy were PAC from the date Ranbaxy became subsidiary of Daiichi on 20 October 2008 and not before that.

The Court further held that there can be no PAC unless there is a shared common objective or purpose between two or more persons of substantial acquisition of shares etc. of the target company. The idea of ‘person acting in concert’ is not about a fortuitous relationship coming into existence by accident or chance. The relationship can come into being only by design, meeting of minds between two or more persons leading to the shared common objective or purpose of substantial acquisition of shares of the target company.

3.5.7. Dilemma Over the Term ‘Control’

The definition of control is an inclusive definition as was in the 1997 Code. The inclusive definition given in the regulations confirms the view that the expression ‘control’ defies precise definition. In terms of Regulation 2(1)(e) of the Takeover Code 2011, ‘control’ includes the right to appoint majority of the directors or to control the management or policy decisions of the target company, exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner. A director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position.

To underline and emphasise the ‘control’ is de facto control and not merely de jure control, the proviso to regulation 2(1)(e) clarifies that a director or officer of the target company would not be regarded as being in control merely by virtue of holding such
position. This proviso seems to have been inserted to overcome the decision of the SAT in *Nimish Kantilal Unadkat v. Adjudicating Officer, SEBI*.\(^{73}\) In this case based on the definitions of ‘Control’ and ‘Promoter’ in the 1997 Code the SAT held that every director of a company was a promoter and was liable to make continual disclosures under regulation 8 of the 1997 Code. It is clear from the definition that person who is in control of a company is a promoter for the purposes of the Takeover Code and control includes the control of the management or policy decisions of the company.

3.5.7.1. The Dilemma: The term ‘control’ has a very crucial position in every M&A transaction. Even M.A. Weinberg, one of the pioneers in the formation of law and practice relating to M&As has defined takeover as “a transaction or a series of transactions whereby a person acquires control over the assets of a company either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company.”\(^{74}\) Therefore, in every M&A regulation, around the world, the definition of control can be aptly called as the steering wheel. The definition of control, which lies at the heart of every M&A deal has been the subject of various litigations over the years. This concept has acquired importance as it forms the rationale for requiring prospective acquirers acquiring such ‘control’ to be bound by the open offer obligations to acquire the additional shareholding of the target company. The requirement of making an open offer under the Takeover Code is triggered not only on the acquisition of shareholding beyond prescribed thresholds,\(^{75}\) but also pursuant to change in ‘control’ (regardless of acquisition of any shares).\(^{76}\) While the former is comparatively straightforward, the latter has always raised various uncertainties, especially in the light of the broad and inclusive definition of ‘control’.\(^{77}\) We have already discussed under the heading of the term ‘control’, its meaning as prescribed in the Takeover Code, 2011. This definition opens the door to the concept of negative

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\(^{73}\) (2010) 98 SCL 133 (SAT-Mum.).

\(^{74}\) M.A. Weinberg et al., *Weinberg and Blank on Take-overs and Mergers*, Sweet and Maxwell, London, 1979, p. 3, para 103.

\(^{75}\) As under Regulation 3(1) and 3(2) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{76}\) As under Regulation 4 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

control that is often exercised by veto rights common in most investor agreements. It was expected that SEBI will remove the ambiguity connected with the definition of control in the new regulations but SEBI has retained the previous definition of 1997 Code. Rather, it has refused to accept the Takeover Committee’s suggestion on definition of the ‘control’ to include word ‘ability’ along with the word ‘right’ in this definition. But SEBI says that it is a subjective matter and interpretation can vary. Thus SEBI has refused to clarify the confusion caused by implications of negative control in the matter.

Given the rather unpredictable view of the SEBI regarding governance rights of the investors vis-à-vis interpretation of the term ‘control’, the Securities Appellate Tribunal (SAT) judgement in Subhkam Ventures (India) (Pvt.) Ltd’s Case becomes significant for its refined interpretation of the term ‘control’ under the Takeover Regulations. In the case of Subhkam Ventures (India) Private Limited v. SEBI, in, the applicability of regulation 12 of the Takeover Regulations in relation to the open offer made by a venture capital investor, Subhkam Ventures (India) (Pvt.) Ltd. to the shareholders of its portfolio company, MSK Projects (India) Ltd., was the main bone of contention between the SEBI and Subhkam Ventures while Subhkam Ventures made an open offer pursuant to regulation 10 of the Takeover Regulations, the SEBI had taken the view, that it should make an open offer pursuant to regulation 10 and 12 of the 1997 Code as there was a change in control of MSK pursuant to certain clauses in the shareholders agreement between Subhkam and MSK.

According to SEBI, such rights of Subkham Ventures under the shareholders agreement like right to appoint a nominee on the board of directors of the target company, affirmative voting rights etc., constituted an acquisition of ‘control’ of the target company thereby inviting the provisions of regulation 12 of the erstwhile Takeover Code. Thus SEBI brought ‘negative control’ within the purview of ‘control’ under the erstwhile Takeover Code. This raised serious concern among the private equity fund and venture capitalists community as these rights are commonly granted to investors.


79 (2010) 99 SCL 159 (SAT-Mum.).
under investment agreements entered into by them with target companies to protect their investment in the target company.\textsuperscript{80}

On appeal by SEBI, SAT overturned the decision of SEBI by saying that control is a positive power and not a negative power. Control, according to the definition is a proactive and not a reactive power. It is a power by which acquirer can command the target company to do what he wants it to do. Control really means creating or controlling a situation by taking the initiative. Power by which an acquirer can only prevent a company from doing what the latter wants to do is by itself is not control. In that event, the acquirer is only reacting rather than taking the initiative. It is a positive power and not a negative power. The test really is whether the acquirer is in the driving seat, and then alone would he be in control of the company. The question to be asked in each case would be whether the acquirer is the driving force behind the company and whether he is the one providing motion to the organisation. If yes, he is in control but not otherwise. In short, control means effective control.\textsuperscript{81}

SEBI, feeling aggrieved by the decision of the SAT, appealed to the Supreme Court. The entire private equity industry keenly awaited the decision of the Supreme Court on the point to settle the question of ‘control’ for once and for all and to clarify the point of law on the issue. But a three Judge Bench of the Supreme Court headed by Chief Justice of India (CJI) S.H. Kapadia in its order dated 16 November 2011 in \textit{Subhkam Ventures (I) (P.) Ltd.} Case,\textsuperscript{82} held that keeping in view the above changed circumstances (i.e. parties have decided to settle the matter by mutual consent), court has decided to dispose of the appeal in terms of the position agreed between parties. The Supreme Court decided to keep the question of law open and also further clarified that the impugned order passed by the SAT will not be treated as a precedent.

\textbf{3.5.7.2. Implications of the Order of SAT and the Supreme Court:} Before the decision of SAT in Shubhkam case, the private equity investors usually agreed to water down the

\textsuperscript{80} For details see, “Updates on Corporate Law and FDI”, retrieved from \url{http://dsklegal.com/pdf/2012/dsklegalknowledgecentreupdate.pdf}, accessed on 9 October 2012 at 10.10 am.

\textsuperscript{81} Para 6 of the judgement in \textit{Subhkam Ventures (India) (P.) Ltd. v. SEBI}.

capital protection and governance rights in shareholders agreements in PIPE deals to avoid being hailed as ‘controlling’ the listed company. As an investor considered to have ‘control’ in a listed company will not only trigger the open offer requirements under regulation 4 of the 2011 Code, but also the eventual exit of such investors from the listed companies may be protracted due to the lock-in restrictions imposed on the transferability of shares held by person ‘controlling’ the listed companies under the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 (‘ICDR Regulations’). But this ruling of SAT gave an impetus to the private equity funds, venture capitals and other similar venture capitalists from being able to obtain customary contractual rights while undertaking PIPE transactions without the fear of inviting unintended consequences of becoming controllers of the target company.

On one hand, the SAT order had earlier provided relief to the investor community that customarily seeks protective provisions in contractual documentation. On the other hand, the Supreme Court has disturbed the equilibrium by effectively nullifying the broader implication of the SAT order. It has brought ambiguity and confusion in the matter which the SAT has tried to remove. This is the reason for the cautious approach adopted by investors while entering into agreements due to lack of clarity on this issue. Every M&A transaction has to navigate the concept of control circumspectly. Even Etihad Airways’ acquisition of 24% stake in Jet Airways was approved by the Securities and Exchange Board of India only after the Abu Dhabi carrier agreed to drop some conditions, including the nomination of three directors to the board, eventually settling for two. It also gave up the right to select members of the senior management. Such an ambiguity in definition of control has dampening impact on M&As and therefore should be removed by SEBI at the earliest by providing a ‘bright line’ rule on control.

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86 Reena Zachariah, “Deal St Abuzz, Sebi to Clear Air on Control”, The Economic Times, 29 July 2014, p. 1
3.5.8. Substantial Acquisition of Shares, Voting Rights or Control

Chapter II of the Takeover Code deals with various issues connected to the substantial acquisition. It talks about threshold for triggering of the Takeover Code, creeping acquisition limit, how and when a public announcement should be made by the acquirer to acquire the shares of such company in accordance with the regulations. It would not be an exaggeration if it is said that the essence of takeover regulations is contained in this chapter.

In terms of regulation 3, no acquirer shall acquire shares or voting rights which (taken together with shares or voting rights if any held by him or by persons acting in concert with him) entitle such acquirer to exercise 25 percent or more of the voting rights in a company, unless such acquirer makes a public announcement to acquire shares of such company in accordance with the regulations. Failure to comply with the regulations disentitles the person to exercise voting rights of more than 25 percent.\(^8^7\)

The new Takeover Code has reset the trigger for open offer at 25 percent whereas the threshold limit prescribed by the earlier Code, i.e. 1997 Code was at 15 percent. Initially, it was 10 percent but vide amendment in 1998; the threshold limit has been changed from 10 to 15 percent. It was noted that the threshold limit “varied from country to country, depended on the corporate shareholding pattern prevailing in the country.” The Committee felt that under Indian conditions hardly any person as investor would invest in more than 10 percent in any company unless he has an intention of taking over the company at some point of time and the committee therefore decided to retain the threshold limit of 10 percent. Regulation 3(1) corresponds to regulation 10 of the Takeover Code 1997.

3.5.8.1. Rationale for such an Amendment: Any person, singly or together with PAC (together referred to as acquirer), can acquire up to 24.99 percent shares or voting rights in a listed company in India as compared to 14.99 percent in the previous Code. According to TRAC report,\(^8^8\) the existing threshold of 15 percent had been fixed in an

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\(^8^7\) J.C. Verma, 2009, p. 776.

environment where the shareholding pattern in corporate India was such that it was possible to control listed companies with holdings as low as 15 percent, and therefore the threshold was considered to be a substantial voting power.

The Committee also reviewed the recent trends in shareholding pattern of the companies listed on the national stock exchanges, and took into consideration the public comments received in this regard. A significant change in the shareholding pattern in listed companies has been observed over the last few years. The mean and median of promoter shareholdings in the listed companies are currently at 48.9 percent and 50.5 percent of the total equity capital of the company respectively, and the number of companies declared to be controlled by promoters holding 15 percent or less is less than 8.4 percent.\textsuperscript{89}

The Committee concluded that the existing trigger threshold of 15 percent has outlived its contextual relevance and would require an upward revision. The Committee also observed that there are only about 6.1 percent companies listed on the BSE where promoter shareholding is between 15 percent and 25 percent. Hence the Committee concluded in favour of increasing the initial trigger threshold.\textsuperscript{90}

The Committee observed that in the UK, the first trigger point is at 30 percent. Initial trigger points in other jurisdictions such as Singapore, Hong Kong, EU and South Africa were also found to be in the range of 30 percent to 35 percent. These trigger levels were set primarily based on the level at which a potential acquirer can exercise de facto positive control over a company, viz. the level at which the potential acquirer is likely to be able to get a majority of votes cast in a general meeting of shareholders.\textsuperscript{91}

It was observed that despite the increase in the mean level of promoter shareholding, there are a number of prominent companies in India, which are controlled by shareholders holding between 25 percent and 30 percent of the voting capital of the company. The Committee is of the view that this trend suggests that 25 percent is the level at which promoters would be capable of exercising de facto control. Further, in India, the Companies Act recognises any holding in excess of 25 percent as the

\begin{footnotesize}
\begin{enumerate}
\item Id., p. 2.143, para 2.2.
\item Para 2.3 of the TRAC Report.
\item Para 2.5 of the TRAC Report.
\end{enumerate}
\end{footnotesize}
threshold at which special resolutions can be blocked. Taking into account both the ability of promoters to exercise de facto control at 25 percent and the law governing special resolutions, 30 percent threshold would be too high.92

The Committee felt that 25 percent shareholding would be an appropriate level at which a new incumbent shareholder could reasonably expect to exercise positive control in the current environment. Thus the Committee concluded that since a holding level of 25 percent permits the exercise of de facto control over a company, this could be fixed as the appropriate open offer trigger threshold in the Indian context.93

3.5.8.2. Important Decision of SAT on Regulation 3(1): Having gone through the regulation 3(1) in detail, some of the important decisions of SAT on it are discussed hereunder. In Sharad Doshi v. The Adjudicating Officer,94 SAT succinctly captured the essence of the regulations in the following words:

“Regulating substantial acquisition of shares and takeover of companies for protecting the interest of investors is one of the functions of SEBI, under the SEBI Act. The Takeover Regulations demand transparency in the transactions and also for following principles of equity and fairness for the benefit of shareholders at large. Regulation 9 of 1994 regulations (which corresponds to regulation 10 of 1997 Code and regulation 34 (1) of 2011 Code) provides for public announcement to acquire shares of the company at a minimum offer price from the other shareholders, is one of the core provisions in the takeover regulations for protecting the interest of the investors. SEBI Act provides for penalty for non-disclosures and prosecution of offenders.”

The object of regulation 10 (now regulation 3(1) of the 2011 Code) as explained by Andhra Pradesh High Court in K. Sreenivasa Rao v. Regional Director, SEBI and Others,95 is to alert others about the possible transfer of control to third parties and to take steps against it. Similarly in the latest decision of SAT in Arun Kumar v. Securities and Exchange Board of India,96 appellant was holding shares in a company carrying voting rights which constituted 12.84 percent of total paid–up capital of company. Later

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92 Para 2.6 of the TRAC Report.
93 Para 2.7 of the TRAC Report.
95 (2002) 112 Com Cases 327.
96 (2009) 91 SCL 340 (SAT-Mum.).
on, he was allotted and issued warrants which could be converted into equity shares. Appellant exercised his option and got his warrants converted into equity shares due to which his voting rights rose to 20.76 percent of paid up capital of company and regulation 10 [now regulation 3(1)] got triggered. The regulation 10 did not get triggered when warrants were issued, as warrants did not confer any voting rights. Regulation 10 became applicable for first time when warrants were converted into equity shares which took appellant’s voting rights beyond threshold limit.

In *Pramod Jain v. SEBI*,\(^97\) it was held that it cannot be said that the Takeover Code is triggered on a mere agreement to acquire shares without that agreement being acted upon. If the parties resile from the agreement, there cannot be any compulsion in law that can force the alleged acquirer to make public announcement to acquire shares of the target company.

### 3.5.8.3. Violation of Regulation 10 of the Takeover Code 1997 (Now Regulation 3(1) of the Takeover Code 2011):

In the latest judgement of *Northern Project Ltd. v. Adjudicating Officer, Securities and Exchange Board of India*,\(^98\) the SAT held that acquisition of fifteen percent or more of shares or voting rights of any company by acquirer alongwith persons acting in concert triggers the threshold limit and acquirer has to make a public announcement. The brief facts of the case are that the borrower company had pledged its shares in target company as a collateral security for loan taken by it from lender company. However, borrower defaulted in repayment of loan as a result whereof lender invoked pledge and got 15 lakh pledged shares of target company transferred in its demat account. The lender further sold the shares to five purchaser companies including appellant. Since the total acquisition of five purchasers plus the nine shares in account of lender was in excess of 15 percent of share capital/voting rights in target company, this triggers the open offer. SEBI initiated adjudication proceedings against them for violating regulation 10 as according to it they were persons acting in concert and had violated regulation 10 in not making a public announcement. On the other hand, appellants contended that they did not act in concert with each other. But the Adjudicating Officer found them guilty of violating regulation

\(^97\) (2005) 60 SCL 484.

\(^98\) (2011) 109 SCL 471 (SAT-Mum.).
10 and as according to him they were ‘persons acting in concert’, imposed penalty upon them. But on appeal, SAT reversed the order of Adjudicating Officer and held the appellant neither shared a common objective with other purchasers while acquiring shares of target company nor was it a company under same management and therefore, appellant could not be said to be a person acting in concert with other purchasers and individually they acquired less than fifteen percent, so threshold limit was not triggered.

In *Vashi Construction (P.) Ltd. v. Securities and Exchange Board of India*, all seven allottees (appellants) acted in concert with each other for acquiring a huge number of shares of company (PCL) through preferential allotment but failed to come up with public announcement to acquire said shares as per requirements of regulation 10. The Adjudicating Officer found them guilty of violating provisions of regulation 10 and imposed penalty on them jointly and severally. The SAT upheld the order of SEBI and held that acts of appellant were undoubtedly prejudicial to healthy growth of market and therefore, SEBI rightly exercised its jurisdiction and passed its order after due application of mind.

3.5.8.4. **Analysis of the Amendment:** The increase in threshold from 15 percent to 25 percent has been in accordance with the global trend, and international best practices. This increase would give potential acquirers more leeway to acquire a stake in a company without attracting takeover regulations. It is perceived that the increase in the threshold will be beneficial to private equity funds and institutional investors who had to earlier restrict their stake upto 14.99 percent. Now investors, including private equity funds and minority foreign investors, will be able to increase their shareholding in target companies upto 24.99 percent and will have greater say in the management of the target companies. This is advocated as good from the point of view of corporate governance as the interests of private equity players are aligned with that of the minority shareholders. With all investors now being able to hold larger stakes in any listed company, it is a logical corollary that there will be an increase in private equity

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99 (2013) 119 SCL 332 (SAT-Mum.).

100 In Indonesia, initial threshold is 50 percent, France 33 percent, Hongkong, UK and Singapore 30 percent each and Australia 20 percent.

investment in Indian companies and companies will find it easier to raise capital without triggering open offer requirements.\textsuperscript{102} It is a novel step towards liberalisation, as it will pave the way for increased investment and thereby pave the way for economic development. The promoters will get the required additional funds for their expansion and diversification. Thus it will provide great impetus to that category of investors who wish to make investment, but are not interested in takeovers.\textsuperscript{103} The effect of these changes is readily noticeable. For example, the insurer and hospital firm Max India, in which private firm Warburg Pincus holds 14.7 percent; supply chain manager Redington India, where more than 10 percent is held by Standard Chartered Private Equity, have already seen an increase in their private investors stakes.\textsuperscript{104} But there are two exceptions to overreaching positive acceptance of the revised trigger limit.

\textbf{(1) Blocking of the Special Resolution:} Since the new Takeover Code has reset the threshold limit to 25 percent, the acquirer can increase their stake upto 24.99 percent and thus able to block passing of the special resolution in the target companies without any difficulty.\textsuperscript{105}

A special resolution requires $3/4^{\text{th}}$ majority of shareholders in a general meeting. In day-to-day management of the affairs of the company, certain resolutions are required to be passed only through special resolution which includes several important corporate actions like alteration of the provisions of the memorandum, change in objects and name of the company, reduction of share capital etc. Promoters may, however, be concerned by the mischief that may be caused by the ‘predators’ holding just less than 25 percent and will be able to exercise significant voting rights on account of the multiplier effect caused by the absenteeism at the general meeting.\textsuperscript{106} Because invariably in most of the shareholders meetings, minority shareholders from the public


\textsuperscript{106} C.S. Balasubramaniam, 2011, p. 100.
may not attend the meeting. In this way any one who hold 24.99 percent of the company’s shareholding wields the power to stop special resolutions, i.e. he acquires negative control. Raising the threshold for triggering an open offer to the level that grants negative control is likely to have major implications.  

(2) Fear of Hostile Takeovers: Another exemption to overreaching positive acceptance of the revised trigger limit is the fear of hostile takeovers. The increase of the takeover limit has brought with it the fear of increased hostile takeovers in the Indian market. Although a majority of companies listed on the stock exchange would be unaffected by the raising of the trigger limit, there are some companies which may find themselves the subject of hostile takeovers. Companies where promoters have low shareholding and high public float in the capital structure will be facing difficulty in keeping themselves free from the clutches of hostile acquirers. Most listed companies on an average have promoter shareholding to the tune of 51 percent, as stated by Mr. U.K. Sinha, Chairman of SEBI, and these companies are outside the realm of hostile takeover. The Committee’s Report, however, reveals that out of 4054 companies, promoter stakes in 584 companies are below 25 percent, of these, promoter stakes in 340 companies are below 15 percent. It is thus possible now for private investors to discreetly acquire 25 percent of a company’s shareholding through multiple secondary market transactions, and then make a minimum offer bid of 26 percent to acquire de facto control over a company. The fear of a hostile takeover is even more prominent in the sluggish markets in the status quo, with company’s share trading at low values.

3.5.9. Creeping Acquisition under the New Takeover Code

The creeping acquisition route is meant to facilitate consolidation by persons already in control or holding substantial numbers of shares. In a competitive environment, it sometimes become necessary for person in control of the company to consolidate their

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109 Ibid.
holdings either *suo moto* or to build defences against takeover threats. The provision of creeping acquisition was included in the 1997 Code as the Bhagwati Committee recognised the need to harmonise consolidation of holdings by persons already holding substantial shares with the need to protect the interest of shareholders in a competitive, free market environment.\textsuperscript{111}

Regulation 3(2) of the Takeover Code deals with creeping acquisition trigger and corresponds to regulation 11 of the 1997 Code. According to this provision, acquisition of any voting shares in a listed company in excess of 25 percent is permitted without a public announcement on the condition that the acquisition is limited to 5 percent in one financial year. This is called creeping acquisition. Total shareholding by creeping acquisition can go up to 75 percent of share capital beyond which a public announcement is necessary for further acquisition of shares. 75 percent is the maximum permissible non-public shareholding. If the acquirer acquires 5 percent or more additional voting rights in a financial year, he will have to make an open offer i.e. acquisition of voting rights exceeding 5 percent in any financial year triggers open offer obligation. The open offer obligation would also apply to acquisition of shares by any person from other persons acting in concert with him such that the individual shareholding of the person acquiring shares equals or exceeds the stipulated threshold of 5 percent although the aggregate shareholding along with persons acting in concert may remain unchanged.\textsuperscript{112}

For computing the said 5 percent creeping acquisition limit:\textsuperscript{113}

1. Gross acquisitions alone will be considered regardless of any intermittent fall in shareholding or voting rights whether owing to disposal of shares held or dilution of voting rights on fresh issue of shares by the target company.

2. In case of acquisition of shares by way of issue of new shares by the target company, the difference between the pre and post allotment percentage of voting rights will be regarded as the quantum of additional acquisition.


\textsuperscript{112} Regulation 3(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\textsuperscript{113} Explanation Appended to Regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
In the 1997 Code, this explanation was not included in the regulation, so it always created a confusion that calculation of the 5 percent shares, is on the basis of gross acquisition or not. This question was brought in appeal before the Securities Appellate Tribunal in *Kosha Investments Ltd. v. SEBI*.\(^{114}\) SEBI contended that it would not net off the sales made by an acquirer during a financial year so that if on a gross basis, the acquirer’s purchases of shares in the year exceeds 5 percent, he would be considered as having triggered an open offer. This contention was claimed to have its backing in the Bhagwati Committee Report. In the second Bhagwati Committee Report,\(^{115}\) it was put forth that the percentage level referred to should be computed on a gross purchase basis at any point of time to decide whether the regulations are attracted. However, in the *Kosha Investments’ Case*, it was concluded that even after netting the shares sold by the acquirer, it had acquired more than 5 percent in the same financial year.

So lack of express provision, created confusion. Therefore, SEBI vide circular dated 6 August 2009 clarified that the 5 percent is to be calculated by aggregating all purchases without netting the aggregate sales. But in 2011, to expressly clarify the matters, the calculation of 5 percent was clearly stated in the regulations.

### 3.5.9.1. Analysis of the ‘Creeping Acquisition’ Provision:

This provision on ‘Creeping Acquisition’ in 2011 Code creates an embargo against exceeding the 75 percent limit and is for the benefit of the existing shareholders, because it is in larger interest of the public that any acquisition be limited and not allowed to proceed beyond certain limits without public knowledge. The existing shareholders should have adequate information available so as to exercise the option of exiting from the membership of the company if they so choose to.\(^{116}\) If the acquirer acquires in excess of 5 percent in any financial year, he has to make a public announcement of offer. Public announcement are considered essential for safeguarding the interest of the shareholders.\(^{117}\) Thus the main aim of the provision is to protect the interest of shareholders.

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\(^{114}\) SAT order dated 8 August 2005, Appeal No. 64 of 2004.


\(^{117}\) *Id.*, p. 58.
This provision is also beneficial to promoters who can increase their shareholding in the company without necessarily purchasing shares from the stock market. It also helps them to further consolidate their holdings and improve the degree of control without making an open offer. Regulation 3(2) in the New Takeover Code has simplified the regulation 11 of the 1997 Code.

The Takeover Code 1997 recognised creeping acquisition at two levels—from 15 percent to 55 percent and from 55 percent to the maximum permissible limit of non-public shareholding i.e. 75 percent. Acquirer holding shares within 15 percent to 55 percent were allowed to purchase additional shares or voting rights of up to 5 percent in each financial year without having the need to make a public announcement of an open offer. However, where the holding is above 55 percent but less than 75 percent, a one-time allowance to increase their shareholding by 5 percent through market purchase or pursuant to a buyback by the target company, without having to make an open offer has been permitted since 28 October 2008 provided that post-acquisition holding of acquirer does not go beyond 75 percent. On the other hand, the 2011 Code provides creeping acquisition at one level i.e. 25-75 percent. Thus, the 2011 Code has done with multiple trigger points of open offer for the creeping acquisition route. Thus, it has made the position simpler. No doubt, the new Takeover Code helps the promoters to consolidate their shareholdings up to the maximum permissible level of 75 percent which was difficult under the earlier Code but on the other hand, the opportunity given to the promoters to consolidate their holding up to 75 percent may have a negative impact on the market price of the shares because of the reduction in the public float. Further, it may impact the trading volume of the scripts due to reduced public float of 25 percent.

3.5.9.2. Judicial Expression on Creeping Acquisition Limit: In the landmark judgement of Swedish Match AB v. SEBI, the Supreme Court has laid down four pre-conditions for attracting regulation 11 of the 1997 Code (corresponding to Regulation 3(2) of the 2011 Code). They are:

1. An acquirer had acquired shares in concert with another.

2. Such acquisition was more than 15 percent but less than 55 percent of the shares or voting rights in a company.

3. In the event the acquirer intends to acquire such additional shares or voting rights which would allow him to exercise more than 5 percent of the voting rights within a period of 12 months, public announcement is required to be made thereof.

4. Such an acquisition of additional shares contemplates three different situations i.e. the acquisition may be by the acquirer himself or through or with the person acting in concert with the person with whom they had acquired shares earlier in concert with each other.

The SAT relied upon the above decision in *Phiroze Sethna Pvt. Ltd. & Others v. Adjudicating Officer*, and held that the definition of the term ‘acquirer’ covers not only completed acquisition but also agreement to acquire. SAT, while absolving the petition, laid down the pre-conditions for regulation 11[now regulation 3(2) of 2011 Code], to be attracted:

1. The acquirer should have made acquisition of shares or voting rights in the target company during earlier financial years to the extent of more than 15 percent, but less than 75 percent.

2. The acquisition of additional shares or voting rights that triggers regulation 11(1), during the relevant financial year, should provide the acquirer more than 5 percent of voting rights.

3. The same acquirer should be involved in the acquisitions of both the initial shares as well as additional shares, and

4. Such acquisitions should be either by the acquirer himself or with the persons acting in concert with him.

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122 (2008) 83 SCL 330 (SAT-Mum.).

123 15 percent has been substituted with 25 percent in Takeover Code, 2011.

124 Regulation 11(1) of the Takeover Code 1997 corresponds to regulation 3(2) of the Takeover Code, 2011.
In Pravin Punit Agarwal and Others v. Adjudicating Officer, SEBI, the adjudicating officer passed an order that the appellants had violated Regulation 11 by not making a public announcement and levied a penalty of Rs. 5 lakhs on the appellants. SAT held that mensrea was not an essential element for imposing penalty for breach of civil obligations. However, while deciding the quantum of penalty, the adjudicating officer shall take into account the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; the amount of loss caused to an investor or group of investors as a result of the default and also the repetitive nature of the default. In view of these reasons, SAT slashed the penalty to Rs. 3 lakhs.

In Liquid Holdings Pvt. Ltd. v. Securities and Exchange Board of India, appellants i.e. the promoters of target company M, took loans from two banks and shares of the appellant in the target company had been pledged by way of collateral security. M defaulted in repayment of loans, as a result of which banks invoked pledges created in their favour. Pledged shares were transferred from demat account of appellants to demat account of banks. Bank came to be recorded as beneficial owner of shares and as a member of that company. Subsequently, loan accounts were settled and all debts liquidated and shares were transferred bank to appellants. Since shares that were transferred back to appellant promoters were in excess of limits prescribed by regulation 11(1) of 1997 regulations, they must have made public announcement to acquire shares of target company in accordance with the 1997 regulations, the tribunal held that penalty was rightly imposed on them for violating regulations 7 and 11.

In Raghu Hari Dalmia v. SEBI, when percentage increase in shareholding is in excess of limits prescribed under regulations 11(1), but increase is due to buy back of securities, the tribunal held that such a passive increase in proportion of voting rights of promoters would not attract regulation 11(1). In the recent judgement of Nikhil Mansukhani v. SEBI, the Tribunal held that the it is for the SEBI to show that two groups were acting in concert, the adjudicating officer has not recorded any finding as to how the

125 (2008) 82 SCL 271 (SAT-Mum.).  
126 The Apex Court in Chairman, SEBI v. Shriram Mutual Fund and Another AIR 2006 SC 2287 held that mensrea was not an essential element for imposing penalty for breach of civil obligations.  
127 (2011) 106 SCL 463 (SAT-Mum.).  
128 (2011) 110 SCL 634 (SAT-Mum.).  
129 (2012) 113 SCL 469 (SAT-Mum.).
three acquirers of the shares were persons acting in concert. Only when they are shown to be acting in concert with sufficient material, then only it can be decided that whether regulation 11 is violated or not.

**Applicability of the 2011 Code where Public Announcement for open offer has been made under the repealed regulations-i.e. 1997 Code**

Regulation 35(2)(c) of the 2011 Code provides that any open offer for which a public announcement has been made under the repealed regulations (1997 Code) shall be required to be continued and completed under the repealed regulations (i.e. 1997 Code). In other words, if acquirer’s acquisition takes his holdings to 15 percent or more (limit as per 1997 Code) but below the revised 25 percent limit of 2011 Code and he has already made a public announcement for an open offer as per the 1997 Code, he cannot withdraw the open offer after coming into force of the 2011 Code on the ground that his holdings are now below revised limit of 25 percent. He will have to complete the open offer as per the 1997 Code.\(^{130}\)

**3.5.9.3. Acquisition of Control over a Company:** This is contained in regulation 4 of the Code which corresponds to regulation 12 of the 1997 Code. Regulation 4 make a distinction between acquisition and control thereby proving that a control can be established through acquisition but there need not necessarily be any acquisition to establish control. According to this regulation, irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company unless such a person makes a public announcement to acquire shares. The Takeover Code 2011 does not exempt change in control, pursuant to special resolution of shareholder, from open offer obligation. This whitewash provision which was available under the 1997 Code has been omitted.

**3.5.9.4. Difference between Regulation 3 and Regulation 4:** In *Swedish Match A.B. v. SEBI*,\(^ {131}\) the SAT explained the operation of regulation 3 and 4. Regulation 3(1)/ 3(2) comes into operation irrespective of whether the acquisition has resulted in any change of control or not. The triggering point therein is acquisition of shares beyond the

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\(^{131}\) (2003) 42 SCL 627 (SAT-Mum.).
specified limit. Regulation 4 comes into play on acquisition of control whether any shares/voting rights are acquired or not.

3.5.10. Indirect Acquisition

The Takeover Code of 2011 clearly lays down the structure to deal with indirect acquisitions, an issue which was not adequately dealt with in the earlier version of the Takeover Code. Regulation 5 states that acquisition of shares or voting rights in or control over the target company that would enable a person and person acting in concert with him to exercise such percentage of voting rights or control over the target company, which if directly acquired in the target company would attract the obligation to make an open offer, shall be regarded as indirect acquisition, requiring the acquirer to make an open offer.

If the indirectly acquired target company is a predominant part of the business entity being acquired, the proposed takeover regulations would treat such indirect acquisition as a direct acquisition for all practical purposes.

3.5.11. Analysis of the Voluntary Offer Provision

Regulation 6 of the 2011 Code provides for voluntary offer. According to this regulation, the acquirer holding 25 percent or more voting rights in the target company can make a voluntary offer for acquiring shares. This is subject to fulfillment of the following conditions:

- The shareholding of the acquirer after open offer should not exceed maximum permissible non-public shareholding (i.e. 75 percent).
- The acquirer and person acting in concert with him should not have acquired shares of the target company in the preceding 52 weeks without attracting open offer obligation.
- The acquirer and person acting in concert with him who has made public announcement for voluntary offer is not entitled to acquire further shares of the target company for a period of six months after completion of offer, except as a result of another voluntary open offer or participation in a competing offer.

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132 The 1997 Code dealt with indirect acquisition only in explanation to regulation 11.
Minimum offer size under voluntary offer has been reduced to 10 percent (from 20 percent under 1997 Code) to promote consolidation of holdings in a fair and transparent manner. The voluntary offer is a way to facilitate consolidation of holdings in excess of 5 percent creeping acquisitions by the holders who are holding 25 percent or more in the target company.\textsuperscript{134} In the view of the researcher, the provisions relating to voluntary open offer have made acquisition attempts by outsiders difficult and time-consuming, by providing specific conditions, most significantly the requirement of prior holding of at least 25 percent, limits on market purchases and other restrictions. Thus, it is seen that the New Takeover Code has recognised and allowed voluntary offers and has emphasised that such offer cannot be subject to norms similar to the open offer size.\textsuperscript{135}

3.5.12. The Open Offer-Offer Size

The Takeover Code, 1997 required an acquirer obligated to make an open offer, to offer for a minimum of 20 percent of ‘voting capital of the target company’ as on expiration of 15 days after the closure of the public offer.\textsuperscript{136} The Takeover Code 2011 now mandates an acquirer to place an offer for at least 26 percent of the ‘total shares of the target company’ as on the tenth working day from the closure of the tendering period.\textsuperscript{137} If after the completion of the open offer, the shareholding of the acquirer taken together with persons acting in concert exceeds the maximum permissible non-public shareholding, the acquirer shall be required to bring down the non-public shareholding to the level specified and within the time permitted under Securities Contracts (Regulation) Rules, 1957.\textsuperscript{138} Any open offer made under these regulations shall be made to all the shareholders of the target company, other than the acquirer, persons acting in concert and parties to any underlying agreement for the sale of the shares of the target company.\textsuperscript{139}

3.5.12.1. Analysis of the Open Offer Provision: The TRAC recommended the open offer size to 100 percent from 20 percent under the Takeover Code, 1997. When TRAC

\begin{itemize}
\item \textsuperscript{134} T.V. Ganesan, 2012, p. 36.
\item \textsuperscript{135} Ibid.
\item \textsuperscript{136} Regulation 21(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
\item \textsuperscript{137} Regulation 7(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\item \textsuperscript{138} Regulation 7(4) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\item \textsuperscript{139} Regulation 7(6) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\end{itemize}
recommended 100 percent, it was strongly opposed by the corporate India stating that it would increase the acquisition cost and also because of the non-availability of acquisition finance for the takeover. This will hinder M&A transactions and large number of transactions would be affected.\textsuperscript{140} The banking laws in India restrict banks from funding acquisitions. Acquisition financing is not permitted by Indian banks. A 1983 circular issued by the RBI Department of Banking Operations and Development (DBOD) states:

“Promoters contribution towards the equity capital of a company, as a measure of prudence and in order to ensure direct stake in the venture, should come from their own resources and banks should refrain from granting loans/advances to individuals/concerns to take up shares of other companies. Thus, for acquisitions within the country, the acquirer could only arrange for the substantial sum of money required in the acquisition process through internal accruals, loans from private players, or through equity issuance, all of which are very arduous process.”\textsuperscript{141}

This creates disparity between Indian acquirers and foreign acquirers (who have better and cheaper access to capital).\textsuperscript{142} That’s why, SEBI only partially approved the proposal by increasing the offer size to 26 percent.

\paragraph*{3.5.12.2. Criticism:} The increase in size of the open offer from 20 to 26 percent along with increase in the initial threshold from 15 to 25 percent, creates a unique situation under the Takeover Code 2011. An acquirer with 15 percent shareholding and increasing it by another 20 percent through an open offer would have only a 35 percent shareholding in the target company under the Takeover Code of 1997. However, now an acquirer with a 25 percent shareholding and increasing it by another 26 percent through the open offer under the Takeover Code, 2011 can acquire 51 percent shareholding and thereby attain simple majority in the target company.\textsuperscript{143} This can

\textsuperscript{140} T.V. Ganesan, 2012, p. 35.
reduce the public float and liquidity in the market with shares being concentrated in few hands.

On the other hand, such a framework i.e. 26 percent offer size gives rise to inequity – a substantial shareholder would get superior treatment by way of a complete exit as opposed to the public shareholder who would get to exit only partially if the response to open offer is larger than the size of the open offer.\footnote{Report of Takeover Regulations Advisory Committee under Chairmanship of Mr. C. Achuthan, Dated 19.7.2010, in Anand G. Srinivasan, \textit{Law Relating to New Takeover Code} 2011, Taxmann Publication (P.) Ltd., 2011, pp. 2.130-2.186, p. 2.138, para 1.3.} Let’s take an example, promoter group having 54 percent stake in a company would be able to sell the entire stake to the acquirer at an agreed price under the shareholder’s agreement. Then the acquirer makes an open offer of 26 percent, the non-promoter shareholders holding 46 percent shares would not have the opportunity for complete exit, especially if the offer price is more than the market price of shares and as such all of them tender their shares in the open offer. In such a case, the shares tendered in the open offer would be accepted proportionately. Thus, if all the public shareholder tender their shares, then little more than half of the shares of every shareholder would be accepted under the open offer and the balance shares would be returned to them. One of the attendant consequences is that the public shareholder will be unable to exit fully and realise full premium.\footnote{Somasekhar Sundaresan, “Distorted Reform in Takeover Law”, retrieved from \url{http://www.business-standards.com/india/news/distorted-reform-in-takeover-law/444432.com}, accessed on 4 July 2012 at 7.12 pm.}

But such shareholder ought to have the ability to sell whatever they choose to sell rather than have to queue up before a rationing system where their shares would only be proportionately acquired while a substantial shareholder could sell all his shares to the incoming acquirer.\footnote{Ibid.} In this way, benefit of takeover will not be uniform. In this context, the TRAC was of the view that if a shareholder wanted to exit a target company at the offer price mandated under the Takeover Code, there ought to be no reason for the law to deny him from a complete exit. That’s why, TRAC recommended a mandatory open offer for the entire shareholding i.e. 100 percent of the voting capital of the company. Besides, the obligation will be only to make an open offer to the shareholders. There is no obligation on the shareholder to sell their shares to the
This 100 percent obligation of open offer is in accordance with the international practices be it UK City Code on Takeover or Singapore Code on Takeovers.

Rather, acquisition finance should be permitted in India. There should be more flexible norms for grant of loans for strategic investments in the Indian listed companies. In this way Indian acquirer will also have an easy access to funds to finance acquisitions as their foreign counterparts. In this way interest of investors or shareholders will be fully protected. Their interest should be given primary importance as compared to other considerations. The TRAC recommendations of 100 percent open offer should have been fully accepted as it is based on sound conceptual underpinnings, international best practices and feedback from the public.148

3.5.13. Delisting

The acquirer is not entitled to acquire or enter into any agreement to acquire shares or voting rights exceeding maximum permissible non-public shareholding (75 percent). If this happens, the acquirer has to shed the stake that is in excess of 75 percent through a public offer.149 The acquirer is required to bring down his or her shareholding to 75 percent within the time specified as per Securities Contracts (Regulation) Rules, 1957. The acquirer whose shareholding exceeds 75 percent pursuant to an open offer cannot make a voluntary delisting offer under the SEBI Delisting Regulations, for one year from the date of completion of open offer.150

But the TRAC recommended for auto-delisting. If the acquirer crosses the delisting threshold through the open offer, there should be no further requirement to make a separate delisting offer under the delisting regulations, the company can be delisted at one go. However, if the open offer results in the acquirer holding between 75 percent and 90 percent of the target company, the acquirer can either choose to delist by increasing the shareholding beyond 90 percent through subsequent acquisition of shares

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148 Id., p. 2.140, para 1.12.
150 Regulation 7(5) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
or it may acquire the shares in the current open offer on a pro rata basis so that the promoters shareholding does not exceed 75 percent.\textsuperscript{151} But SEBI rejected the proposal out-rightly much to the displeasure of acquirer who plan on ‘going private’ in India.

In addition to offering shareholders one time decent gain, the union of takeover and delisting offers as a part of the same transaction would save the acquirers from the cumbersome and expensive reverse book-building method required pursuant to the SEBI (Delisting of Equity Shares) Regulations, 2009,\textsuperscript{152} and requisite approvals under the SEBI procedures from the stock exchanges.

The new Code has made the process of delisting cumbersome and tedius. Let us take an example, if the acquirer acquires, a promoter shareholding of 65 percent or more in a target company, then he has to make an open offer of minimum 26 percent as per 2011 Code. This will take acquirer’s total stake upto 91 percent which will breach the minimum public shareholding norms. But he cannot delist the company for a period of 12 months from the date of completion of open offer as per new Takeover Code. As he has breached the minimum public shareholding norms, he has to bring down his shareholding to 75 percent within 12 months and finally in order to delist the company, he has to follow the procedure of another offer to acquire the shares under the norms of the Delisting Regulations. So, for an acquirer it has become a tedious and laborious process. This needs to be addressed accordingly.

3.5.14. Pricing of Open Offers

The objectives of regulating the determination of minimum offer price is to give public shareholders an exit on terms not inferior to the terms obtained by a substantial shareholder from the acquirer for his large shareholding. Moreover, the minimum price prevents acquirers from building a stake over a period of time without offering that price to shareholders in the offer.\textsuperscript{153}

3.5.14.1 Offer Price for Direct Acquisitions: Regulation 8(1) of the 2011 Code provides that the minimum offer price in open offers should be regulated and regulation 8(2) says that it shall be the highest of:

\textsuperscript{152} \textit{Ibid.}
\textsuperscript{153} For details, see, Anand G. Srinivasan, 2011, pp. 1.73-1.94.
(i) The highest negotiated price under the agreement that attracted the open offer.

(ii) Volume weighted average price paid or payable by the acquirer during the preceding 52 weeks.

(iii) Highest price paid by the acquirer or PAC during preceding 26 weeks.

(iv) Sixty trading days volume weighted average market price, for frequently traded shares. For infrequently traded shares, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters.

(v) The per share value of the target company, if computed in case of indirectly acquired listed company, where value of the target company exceeds 15 percent of overall transaction.

3.5.14.2. Minimum Office Price for Indirect Acquisitions: In case of indirect acquisition, in addition to all the above parameters, the highest price paid or payable by the acquirer during the period between contracting of the primary transaction and the public announcement has also to be considered.

However, if the open offer price is incapable of being determined for indirect acquisition, the offer price shall be the fair price of shares of the target company to be determined by the acquirer and the manager to the open offer taking into account valuation parameters including book value, comparable trading multiples and such other parameters as are customary for valuation of shares of such companies. Moreover, in case of indirect acquisitions of the target company, the offer price would stand increased at the rate of 10 percent per annum calculated on a pro rata basis for the period between:

1. The date on which the primary acquisition is contracted or the date of announcing the intention or decision of making the primary acquisition, whichever is earlier.

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154 Shares shall be deemed to be infrequently traded if the annualised trading turnover in the preceding six calendar months preceding prior to the month in which 'public announcement' is made is less than five percent by number of shares.

155 See, Regulation 8(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

156 Regulation 8(4) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
2. The date of actual detailed public statement in respect of the target company provided such period is more than five working days. Such revised offer price shall be payable to all shareholders who tender their shares in the open offer.\textsuperscript{157}

3.5.14.3. General Points for Calculation of Offer Price:

Determination of Price by Experts: SEBI may require at the expense of the acquirers, valuation of infrequently traded shares under sub-regulation (2)(e) or (4) to be done by an independent merchant banker or a chartered accountant of ten years standing.\textsuperscript{158} The Bench of Supreme Court in the case of \textit{G.L. Sultania and another v. SEBI},\textsuperscript{159} held that the board as the regulator is not bound to accept the offer price which is required to be incorporated in the public offer, if it suspects that the offer price does not truly represent the fair value of the shares determined in accordance with regulation 20(5) [now regulation 8(16) of the 2011 Code)] and if considered necessary the board may require valuation of such shares by an independent merchant banker. However, the board in doing so cannot object to the price offered by the acquirer unless it has reasons to suspect that the price offered has not been determined fairly taking into account the enumerated factors.

Look-back Clause in Calculation of Offer Price: Under the 1997 Takeover Code, the look-back clause requires the acquirer to take into account the highest price paid by him or by persons acting in concert, over a period of twenty-six weeks prior to the date of the public announcement. The TRAC examined the relevant provisions with respect to look-back period in other countries, which range from three months (in the case of voluntary offers in Singapore and Hong Kong) to twelve months (in case of United Kingdom). It was, therefore, felt that a look-back period longer than the currently applicable 26-week period would ensure that an acquirer does not get an opportunity to postpone the public announcement at a marginal carrying cost, just to overcome paying the public shareholder the price he has actually paid in the proximate past. Longer look-back period makes it impractical proposition for the acquirer to defer the public announcement since the carrying cost increases on delaying the open offer by every

\begin{itemize}
\item \textsuperscript{157} Regulation 8(12) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\item \textsuperscript{158} Regulation 8(16) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\item \textsuperscript{159} AIR 2007 SC 2172: (2006) 67 SCL 71.
\end{itemize}
month, just to get rid of the highest price that was paid in the past few months. In view of this, look-back period of 52 weeks has been recommended by the TRAC and incorporated in the 2011 Code.\textsuperscript{160}

**Volume Weighted Average Price:** The volume weighted average market price for 60 trading days prior to the public announcement has replaced average of the weekly high and low of the closing prices of shares for past 26 weeks or 2 weeks. The rationale behind this was that 26 weeks average is too long a period to be considered and 2 week average is too volatile a period to consider. Therefore, a middle path was recommended by TRAC which is incorporated in the present Regulations. The 2011 Regulations use the word VWAP (volume weighted average price) in lieu of the average of the weekly high and low of the closing prices under the existing regulations. Use of VWAP would ensure that the resultant price is more representative and accurate as it eliminates the outlier effects of high and low prices.\textsuperscript{161} Moreover the data for VWAP are readily available.

**Non-Compete Fees:** The 2011 Code omits the clause relating to non-compete fee (i.e. non-compete fee in excess of 25 percent of offer price to be added to offer price) and provides that any consideration paid in any form (whether as non-compete fee or as control premium) shall from part of the negotiated price.\textsuperscript{162} Thus non-compete fees must form part of negotiated price and will be used as benchmark to determine the offer price.

**3.5.15. Analysis of the Change in the Provision of Non-Compete Fees**

The non-compete fee is the price to be paid to the seller besides the usual offer price at the time of M&A deals. It is the consideration paid usually to the promoters so that they do not re-enter the same business and pose a threat to the acquired company.\textsuperscript{163} The issue of non-compete fee came to light recently in the Vedanta-Cairns deal where promoters were to get approximately Rs. 50 per share extra as non-compete fee. The justification for non-compete fees has been a sticky issue. Through 1997 Code

\textsuperscript{160} Rajesh Ralen, 2010, p. 80.
\textsuperscript{161} Id., p. 81.
expressly provided for such fees, but time and again its validity was challenged before SAT. As per regulation 20(8) of the Takeover Code 1997, non-compete payments would not be factored into the offer price, only if they did not amount to more than 25 percent of the calculated offer price. Thus, any non-compete payment totaling more than 25 percent of the calculated offer price would be added to the price shareholders would receive for each of their shares. It is evident that under the previous Code, the selling promoters would receive payments higher than those received by the public shareholders, if they entered into non-compete agreements with the acquirers.\footnote{Karan Talwar and Nivedita Saksea, “Anti-acquirer and Pro-shareholder? An Analysis of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011”, retrieved from http://www.niylslawreview.org/-/karan-talwar-and-nivedita.saksena.pdf, accessed on 10 September 2012 at 3.00 pm.}

But time and again its validity was challenged before SEBI and SAT as many times, the non-compete fee was unjustly paid to the promoters who could not compete only to make them sell their shares. This caused injustice to public shareholders who were paid less in comparison to promoter shareholders. That’s why SAT very prudently delineated that it is the responsibility of the SEBI to scrutinize every acquisition deal involving non-compete fee, balancing the interest of both, investor and acquirer before validating the ground of reasonableness.\footnote{Cementrum IBV v. SEBI (2008) 83 SCL 374 (SAT-Mum.).} In its prominent ruling in \emph{Tata Tea Ltd. v. Securities and Exchange Board of India,}\footnote{(2010) 103 SCL 140 (SAT-Mum.).} the SAT held that amount which the acquirer had agreed to pay to the promoters as non-compete fee was less than 25 percent. Moreover, it was based on strong business rationale and not an attempt on the part of the appellant to reduce the cost of acquisition to discriminate against the public shareholders. The target company was in possession of a unique source of water and was engaged in the business of sourcing, manufacturing, bottling and distribution of natural mineral water. The knowledge and expertise of the promoters in managing and exploiting the said source was critical to the operations and the worth of the target company. The SAT held that SEBI had erred in directing the appellant to add to the offer price, the non-compete fee paid to the promoter sellers of the company.

Similarly in \emph{E-land Fashion China holdings Ltd. v. Securities and Exchange Board of India,}\footnote{(2011) 107 SCL 406 (SAT-Mum.).} the SAT allowed the payment of the non-compete fee to the promoter of the
target company on the ground that the promoters had the experience and expertise to compete with the target company at a future point in time. It further held that if the payment of non-compete fee is based on a strong business rationale and is not a mere tool to reduce the cost of acquisition to discriminate against the public shareholders, the Board or the Tribunal is not entitled to intervene. However, the non-compete fee can only be paid when there is a ‘lurking fear of competition’ which is a factual question and will have to be determined on a case to case basis.

But the TRAC in its report opined that the permissible payment of non-compete fee was a means to reduce the offer price and had a detrimental effect on minority shareholders. The Committee’s line of reasoning was that non-compete fee ought to accrue to the company as a whole and not merely to one group of shareholders as they were in the nature of compensation for loss of potential value on account of sacrificed business opportunities. It also concluded that control was an incident of benefit rising out of share ownership and hence there was no logical basis for the payment of an extra control premium or non-compete fees to controlling shareholders. Based on an examination of the equities and merits involved, as also the law in other jurisdictions and market realities, it was decided that such a payment would not be fair to minority shareholders.  

The Committee’s recommendations were accepted by SEBI in their entirety and thus regulation 8(7) of the 2011 Code was framed keeping in mind the Committee’s spirit of equal treatment for all shareholders and to avoid the scope for abuse of non-compete payments. According to regulation 8(7) of the 2011 Code, the offer price shall include non-compete fee or any control premium. Thus, there would be no difference in the price per share paid to the controlling shareholders and to the ordinary shareholders. Thus, the regulations do not expressly prohibit the payment of non-compete fee.

3.5.15.1. Outcome of the Above Measures:

(1) On Promoters: Payment of non-compete fees in order to restrict another party from competing in the same or similar business has two viewpoints to it—one which holds it

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invalid on the ground of public interest and the other which holds it valid on the ground of reasonableness.\textsuperscript{169} The result of factoring in of non-compete fee will be a great relief for the public shareholders who will be treated equally along with the promoter shareholders. They won’t get feeling of a raw deal while the promoters laugh all their way to the bank. On the other hand, as a result of this provision, promoters would be the biggest losers. The control premium/non-compete fee is the often a recognition of the reality that the promoter could be an innovator in technology, a progressive leader or a manager with an in-depth understanding of the business environment.

This provision may act as repellant for promoters to sell their business since they do not get any extra amount which represents their effort for the growth of the business. They will feel aggrieved by the fact that other shareholders who have been benefiting from the success of the business due to their share efforts, expertise and hard work will get the same price. It seems unfair to ask such promoters to share the monetary grant they receive in lieu of a self-restraint on carrying out a similar business with ordinary shareholders who have no connection with this issue.\textsuperscript{170}

\textbf{(2) On Acquirers:} As promoters will like to get their share of non-compete fee, the cost of acquisitions will be higher as non-compete fee is to be included in offer price. If the promoters won’t get their share of non-compete fee, they won’t be willing to provide a non-compete clause in the acquisition agreement, they may pose a serious threat and competition to acquirer because of their knowledge and expertise in running the business. This can be evidenced from the example of Cairn-Vedanta deal. Vedanta made an open offer price of Rs. 355 to minority shareholders of Cairn India whereas Rs. 405 a share was paid to Cairn India’s parent Cairn Energy Plc. This included non-compete fee due to which Cairn would not compete with Vedanta in India, Sri Lanka and Bhutan for next three years. According to Vedanta chairman, Anil Agarwal, Rs. 50


\textsuperscript{170} Karan Talwar and Nivedita Saksena, “Anti-acquirer and Pro-shareholder? An Analysis of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011”, retrieved from \url{www.niylslawreview.org/-/karan-talwar-and-nivedita.saksena.pdf}, accessed on 10 September 2012 at 3.00 pm.
non-compete fee was very important to them as they wanted India to have exclusivity in operations in India and neighbouring countries.\textsuperscript{171} As a result of non-compete clause, Cairn Energy Plc-the promoter group could not work in their area and pose a threat to Vedanta. Could this clause have been possible without a non-compete fee. But unfortunately, Vedanta could not get benefit from this non-compete clause and had to lower its open offer price to Cairn Energy to 355 as offered to Cairn India due to condition imposed by Cabinet Committee on Economic Affairs.

Overall, we can conclude that the SEBI has ignored the importance of promoters, considering the Indian scenario. Considerations put forth in the case of \textit{E-Land Fashion China Holdings Ltd.}, that non-compete fee should only be allowed on ‘strong business rationale’ and when there is a ‘lurking fear of competition’ are quite reasonable ones as they balance the interests of both the parties.\textsuperscript{172} Hence such regulations by the SEBI in the new Takeover Code require a serious and imminent re-consideration.

\textbf{3.5.16. Mode of Payment}

The offer price may be paid as per regulation 9(1) of the 2011 Code which provides that the offer price may be:

1. In cash;

2. By issue, exchange or transfer of shares in the equity share capital of the acquirer or of any person acting in concert; or

3. By issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not inferior to investment grade as rated by a credit rating agency registered with the board;

4. By issue, exchange or transfer of convertible debt securities entitling the holder thereof to acquire listed shares in the equity share capital of the acquirer or of any person acting in concert; or

\textsuperscript{171} For details, see, “Vedanta Open Offer for Cairn Held Up”, \textit{The Tribune}, 12 October 2010, p. 17.
\textsuperscript{172} Murtuza Bohra, 2011, p. 92.
5. A combination of the mode of payment of consideration stated in clause (a), clause (b), clause (c), and clause (d).

In India, as acquisition financing is not allowed, so the acquirer may have difficulty in arranging sufficient cash to be paid to the target company. To overcome this problem, the TRAC felt the need to permit and facilitate non-cash takeovers, where other securities can be used as a currency for M&A transactions. The objective of an open offer is to provide an exit to the shareholders and therefore adequate care should be taken to ensure that the shareholders are not stuck holding illiquid paper. Therefore, the shares ought to be issued or transferred or the shares to be issued upon conversion of other securities, towards payment of the offer price shall be required to conform to the requirements mentioned in regulation 9(2).

3.5.17. Timing of the Public Announcement

A short public announcement shall be made on the same date as the date of transaction which triggered the open offer to all the stock exchanges where the shares of the target company are listed for the purpose of dissemination of the information to the public. A copy of the public announcement shall be sent to the board and to the target company at its registered office within one working day of the date of the public announcement. This should be followed by a detailed public statement not later than five working days of the public announcement. This period of five working days thereafter is to accord the acquirer the sufficient time to actually work out the logistics of the offer obligations. In the event the acquirer does not succeed in acquiring the ability to exercise or direct the exercise of voting rights in, or control over the target company, the acquirer shall not be required to make a detailed public statement of an open offer for acquiring shares under these regulations.

174 Regulation 13(1) read with regulation 14(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
175 Regulation 14(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
176 Regulation 13(4) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, Regulations, 2011.
177 Explanation to regulation 13(4) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, Regulation, 2011.
As short public announcement is to be made on the same day, the time period is relatively short. In that regards the TRAC recommended as follows:

“The committee is of the view that given the number of parties involved in the deal, by that point of time, the time period was short and yet, permitting a longer period of time to make a public announcement may lead to selective leakage of price sensitive news regarding the impending deal with the possibility of price distortions in respect of the script…” 178

The timing for making public announcements for specific transactions in specific situation is explained in the regulation 13. Under the 1997 Code, a public announcement regarding the open offer has to be made within four working days of acquiring or agreeing to acquire shares in the target company. In the case of *Unijules Life Sciences Ltd. v. Securities and Exchange Board of India*, 179 preferential allotment of shares of target company was made to appellants but they failed to make public announcement within four days of acquisition of voting rights. SEBI directed appellants to withdraw public announcement made on a later date and directed them to provide an exit opportunity to shareholders of target company by making a delisting offer in terms of SEBI (Delisting of Equity Shares) Regulations, 2009. The Adjudicating Officer also imposed penalty upon them. On appeal, SAT held that direction by SEBI to provide exit opportunity to shareholders was on facts and circumstances of case and not with a view to condone violations of Takeover Code and, therefore, penalty proceedings were rightly initiated against appellants.

3.5.17.1. Timelines Involved in the open Offer Process: The 2011 Code provides that the entire process of open offer shall be completed within 57 working days whereas under the 1997 Code, the process took 95 calendar days. The present Code has tried to speedify the open offer process. A detailed account of those 57 days is given below:

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179 (2012) 116 SCL 469 (SAT-Mum.).
Table of Key Process in Open Offer:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Maximum Time Allowed under 2011 Code (in terms of working days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Announcement to stock exchange</td>
<td>X (on the date of agreeing to acquire voting rights or control)</td>
</tr>
<tr>
<td>PA to target company and SEBI</td>
<td>X+1</td>
</tr>
<tr>
<td>Opening of Escrow Account</td>
<td>X+2</td>
</tr>
<tr>
<td>Detailed Public Statement in newspaper, sending to Stock Exchanges, SEBI, Target Company</td>
<td>X+5</td>
</tr>
<tr>
<td>Draft letter of offer to be submitted to SEBI and sent to target company</td>
<td>X+10</td>
</tr>
<tr>
<td>SEBI provides its comments on the letter of offer (LOF)</td>
<td>X+25</td>
</tr>
<tr>
<td>Identified date for determination of names of shareholders to whom letter of offer is to be sent</td>
<td>X+27</td>
</tr>
<tr>
<td>Dispatch of letter of offer to shareholders</td>
<td>X+32</td>
</tr>
<tr>
<td>Upward Revision in offer</td>
<td>X+34</td>
</tr>
<tr>
<td>Comments on the offer by independent directors of target company</td>
<td>X+35</td>
</tr>
<tr>
<td>Advertisement for commencement of tendering period</td>
<td>X+36</td>
</tr>
<tr>
<td>Offer Opens</td>
<td>X+37</td>
</tr>
<tr>
<td>Offer Closes</td>
<td>X+47</td>
</tr>
<tr>
<td>Payment to shareholders</td>
<td>X+57</td>
</tr>
<tr>
<td>Report to be sent by merchant banker to SEBI</td>
<td>Within 15 working days from the close of the tendering period.</td>
</tr>
</tbody>
</table>

Note: In the 1997 Code, shareholder could withdraw the tendered shares upto 3 business days prior to the closure of the offer, but this provision has been withdrawn from the 2011 Code.

3.5.18. Publication of Public Statement

The Public Announcement shall be sent to all the stock exchanges on which the shares of the target company are listed and the stock exchanges shall forthwith disseminate
such information to the public.\textsuperscript{180} A copy of the public announcement shall be sent to the Board and to the target company at its registered office within one working day of the date of the public announcement.\textsuperscript{181} The Detailed Public Statement (DPS) shall be published in all editions of any one English national daily with wide circulation, any one Hindi National Daily with wide circulation and any one regional language daily with wide circulation at the place of the stock exchange where the maximum volume of trading in the shares of the target company are recorded during the 60 trading days preceding the date of the public announcement.\textsuperscript{182} Simultaneously with publication of such DPS in the newspapers, a copy of the same shall be sent to:

1. The board through the manager to the open offer.

2. All the stock exchanges on which the shares of the target company are listed and the stock exchanges shall forthwith disseminate such information to the public.

3. The target company at its registered office and the target company shall forthwith place the same before the board of directors of the target company.\textsuperscript{183}

The public statement is to be sent to the Board through the manager to the open offer which is none other than the merchant banker registered with the Board according to regulation 12 of the 2011 Code. According to 1997 Code, also a copy of the public announcement shall be submitted to the SEBI through merchant banker. In the case of \textit{Dooger and Associates v. SEBI},\textsuperscript{184} the appellant was a merchant banker. The appellant failed to deliver within the time prescribed the copy of the public announcement with the respondent. The appellant submitted that the employee who was entrusted with the responsibility suddenly left the office on hearing the death of a close relative. She neither delivered a copy of public announcement nor informed any one in the office. The appellant came to know only when the copy was published in the newspaper. The matter was referred to adjudicating officer who imposed a penalty of Rs. 50,000. On appeal the SAT applied the principles laid down by Supreme Court in Hindustan Steel’s

\textsuperscript{180} Regulation 14(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{181} Regulation 14(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{182} Regulation 14(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{183} Regulation 14(4) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{184} (2003) 48 SCL 115 (SAT-Mum.).
Case,\textsuperscript{185} and held that there was little justification for imposing the penalty on the appellant as the failure to deliver the document was unintentional and beyond the control of appellant.

3.5.19. Contents of Public Offer

Regulation 15 of the Takeover Code 2011 provide for the information to be disclosed in the public announcement. The public announcement shall contain such information as may be specified, including:

1. Name and identity of the acquirer and persons acting in concert with him.
2. Name and identity of the sellers, if any.
3. Nature of the proposed acquisition such as purchase of shares or allotment of shares or any other means of acquisitions of shares or voting rights in, or control over the target company.
4. The consideration for the proposed acquisition that attracted the obligation to make an offer for acquiring shares, and the price per share, if any.
5. The offer price, and mode of payment of consideration.
6. Offer size and conditions as to the minimum level of acceptances, if any.

3.5.19.1. 1997 Code v. 2011 Code: The regulation 16 of the 1997 Code requires the public announcement to be very detailed containing as many as nineteen heads. Whereas under the regulation 15 of the 2011 Code, public announcement is to be short and not to contain such detailed information. It will be followed by a DPS pursuant to the public announcement.

3.5.19.2. Contents of the DPS: The DPS pursuant to the public announcement shall contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.\textsuperscript{186}

3.5.19.3. Precautionary Note: Regulation 15(3) contains precautionary note that the public announcement of the open offer, detailed public statement and any other

\textsuperscript{185} Hindustan Steel Ltd. v. State of Orissa, AIR 1970 SC 253.
\textsuperscript{186} Regulation 15(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations shall not omit any relevant information or contain any misleading information. The 2011 Code has even included any omission that makes documents misleading. It has expanded the scope of the regulation 17 of the 1997 Code.\textsuperscript{187}

The test or the touchstone for deciding whether the representation is misleading or not has to be guided by principle laid down by Supreme Court in \textit{Lakhanpal National Ltd. v. MRTP Commission},\textsuperscript{188} where it was held that the test is the effect of the representation on a common man. Does it lead a reasonable person in the position of the shareholder to a wrong conclusion? The issue cannot be resolved by merely examining whether the representation is correct in literal sense. A representation containing a statement apparently correct in the technical sense may have the effect of misleading the shareholder by using tricky language. Similarly, a statement, which may be inaccurate in the technical literal sense can convey the truth and sometimes more effectively than a literally correct statement. Therefore, it is necessary to examine whether the representation, complained of contains the elements of misleading the buyer. Does a reasonable man on reading the advertisement form a belief different from what the truth is? The position will have to be viewed with objectivity in an impersonal manner.

\textbf{3.5.20. Conditional Offer}

Open offer can be made by an acquirer conditional as to minimum level of acceptance.\textsuperscript{189} In such a case acquirer and PAC shall not acquire during the offer period any shares in the target company.\textsuperscript{190} In case the open offer is pursuant to an agreement, such an agreement shall contain a condition to the effect that in the event the desired level of acceptance of the open offer is not received, the acquirer shall not acquire any shares under the open offer and the agreement attracting the obligation to make the open offer shall stand rescinded. Execution of the terms of agreement triggering the open

\begin{footnotes}
\item[187] The 1997 Regulations contained provision prohibiting misleading information only in regulation 17.
\item[188] AIR 1989 SC 1692.
\item[189] Regulation 19(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\item[190] Regulation 19(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\end{footnotes}
offer will be allowed after the expiry of 21 working days, if hundred percent of the consideration payable pursuant to the offer is deposited in the escrow account. Thus, the new Takeover Code has come out with a practical step and the parties can act and be able to act in pursuant of the agreement triggering the open offer, since the public shareholders are secured by the entire consideration being deposited in the escrow account. This is a welcome decision and would clear the uncertainties among the public shareholders.  

3.5.21. Competing Offers

Any person who is not an acquirer who has made the first public announcement but is desirous of making any offer shall be entitled to make a public announcement of an open offer within fifteen working days of the date of the detailed public statement made by the acquirer who has made the first public announcement for acquiring shares of the same target company. Such an offer is called competing offer. The provision relating to competing offer, the time frame within which such a competitive offer should be made and the position of the acquirer vis-à-vis the competitive offer are laid down in regulation 20.

The intent behind such provisions is to achieve orderly competition between acquirers vying for the same target company. If the competing offers were undertaken in a fair, transparent and equitable manner, they would be in the interest of the shareholders at large and thus need be facilitated. But the Achutlan Committee felt that certain reasonable restrictions should be placed on the target company as well as on the bidders so as to make the process more robust. With a view to rationalise the time lines for making a competing offer, regulation 20 provides that a competing offer may be made within 15 working days from the date of the original detailed public statement instead of 21 calendar days from the date of the original public announcement. The time period was reduced as Committee felt that the permitted time period should not be long as to result in prolonged uncertainty.

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The 2011 Regulations provide a course of drill for the competitors in the takeover bid comprising of the following features:

1. Any competitive offer by an acquirer shall be for such number of shares which, when taken together with shares held by him along with persons acting in concert with him, shall be atleast equal to the holding of the first bidder including the number of shares for which the present offer by the first bidder has been made.\(^{193}\)

2. Unless the first open offer is a conditional offer, the competing offer cannot be made conditional as to the minimum level of acceptance.\(^{194}\)

3. No further open offer is allowed to be made after the expiry of the said period of 15 working days until the completion of all the competing offers. This provision is critical to ensure that competing acquirers compete on an identical end-objective and shareholders are truly able to compare them on the offer price.\(^{195}\)

4. A competing offer shall not be regarded as voluntary open offer under regulation 6 and therefore all provisions of the regulations, including that of offer size, apply accordingly.\(^{196}\)

5. The schedule of activities and the tending period for all completing offers shall be carried out with identical timelines and the dates for tendering shares shall be revised to the dates for tendering shares in acceptance of the competing offer last made.\(^{197}\) In *M.V. Subramanyam v. Union of India*,\(^{198}\) there were two competing bidders for publicly acquiring the shares in VST industries. The third respondent’s public offer was dated 15.02.2001. Later SEBI advised the respondent to incorporate further particulars in the offer letter on 8.5.2001. Revised offer letter was mailed on 11.5.2001. Under sub-regulation (7) of regulation 25 [now regulation 20(8) under the 2011 Code], the date of closure of

\(^{193}\) Regulation 20(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{194}\) Regulation 20(6) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{195}\) Regulation 20(5) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{196}\) Regulation 20(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{197}\) Regulation 20(8) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{198}\) (2001) 33 SCL 111.
original and subsequent bids will be the date of closure of last competitive bid. All bids would close on the same day.

6. On public announcement of competing offer, an acquirer who has made a preceding competing offer is allowed to revise the terms of his open offer if the terms are more beneficial to the shareholders of the target company. The upward revision of the offer price can be made any time upto three working days prior to the commencement of the tendering period.\textsuperscript{199}

3.5.22. \textit{Provision of Escrow}

Under the Takeover Code 2011, the acquirer is required to deposit an amount to secure performance of the acquirer’s obligation, in an escrow account in the form of cash deposited with a scheduled commercial bank or bank guarantee in favour of the manager to the open offer or in the form of securities. The acquirer is required to open an escrow account atleast two working days prior to the date of detailed public announcement and deposit an amount aggregating to 25 percent of the consideration on first five hundred crore rupees and an additional amount of 10 percent of the balance consideration.\textsuperscript{200} It is one of the important obligations of the acquirer to create an escrow account.

In \textit{K.K. Modi v. M.K. Modi},\textsuperscript{201} the applicants had agreed to purchase certain shares of a company which were held by another company, by way of inter-corporate holding. An amount of Rs. 8.27 crores was deposited in the escrow account, the offer was at Rs. 90 per share which was higher than the stock value. However, the shares were neither transferred in favour of the applicants nor the money was refunded to them. On an application for transfer of shares in favour of the applicant, an interim arrangement was worked out which safeguarded the interest of all concerned by transferring 50 percent of the total number of shares at offer price in favour of the applicants subject to further orders to be passed in the main appeal. It was also ordered that amount deposited as escrow was to be kept in a suitable interest bearing deposit with IFCI instead of an escrow account till final orders.

\textsuperscript{199} Regulation 20(9) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{200} Regulation 17(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{201} (2002) 38 SCL 93 (Del.).
3.5.23. Completion of Acquisition

The Takeover Code, 2011 provides that an acquirer is allowed to complete an acquisition which has resulted in the triggering the open offer obligations after a period of 21 days from the date of public announcement. But the completion of the acquisition will be subject to the acquirer depositing 100 percent of the consideration payable under the open offer in an escrow account. The Takeover Code, 2011 further provides that in cases where the acquisition is not completed before the expiry of the offer period, the acquirer is allowed to do so after the expiry of the offer period but not later than 26 weeks from the expiry of such period. This provision allows the acquirer to have a representation in the target Company and exercise control over it even before the completion of the open offer. However, in the event of any extraordinary and supervening circumstances rendering it impossible to complete such acquisition within such period of 26 weeks, SEBI may grant an extension if it deems fit after making public the reasons. While granting extension, the SEBI shall keep the interest of investors in mind.

3.5.24. Withdrawal of Open Offer

An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances:

1. Statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer.

2. The acquirer, being a natural person, had died.

3. Any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer.

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202 Regulation 22(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
203 Regulation 22(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
204 Regulation 23(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
(d) Such circumstances as in the opinion of the SEBI, merit withdrawal. In this case, SEBI shall pass a reasoned order permitting withdrawal, and such order shall be published.

Clause (d) of regulation 23(1) corresponds to clause (d) of regulation 27(1) of the 1997 Code. This clause was interpreted by SAT in *Nirma Industries Ltd. v. SEBI*, it was held by SAT that ‘such circumstances’ referred to in clause (d) of regulation 27(1) have to be limited to kind of circumstances mentioned in preceding clauses (b) and (c) which would make it impossible for acquirer to go through with the public offer. But the appellants wanted to withdraw from the public offer taking shelter under the term ‘such circumstances’ on the ground that:

1. They came to know many months after the public announcement was made that target company had lost its substratum and that petition for winding up of target company was admitted by High Court.

2. Erstwhile directors of target company who resigned in December 2005 had embezzled large sums of that company.

3. A company had given a notice to the target company under ‘Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002’ to make payment of an amount of Rs.260.32 crore and the said notice had been challenged in the High Court of Gujarat in a writ petition which was dismissed and the matter was pending in appeal.

But SAT held that circumstances pointed out were not ‘such circumstances’ as referred in clause (d) of regulation 27(1) in as much as none of them individually or cumulatively made it impossible for appellants to meet their obligation of carrying out public offer made under the regulations. The SAT further upheld the decision of the board that there was lack of due diligence on the part of the appellant and that circumstances mentioned could only mean business misfortune which did not fall in exceptions mentioned in regulation 27(1). Aggrieved by the order of SAT, appellant went on appeal before the Supreme Court, but the Supreme Court also dismissed the

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205 (2009) 90 SCL 23 (SAT-Mum.).
appeal and held that appellant acquirers had acquired shares of target company on basis of an informed decision and made public announcement in terms of Regulations, they could not be permitted to take advantage of their own laxity to justify seeking withdrawal of public offer on finding that it had become uneconomical for them to perform public offer. Regulation 27(1)(d) thus not empower SEBI to permit withdrawal of an offer merely because it has become uneconomical to perform public offer. The term ‘such circumstances’ in regulation 27(1)(d) would be restricted to situation which would make it impossible for acquirer to perform public offer. Clause (d) is a residuary clause containing general words. The specific circumstances under which the public offer could be withdrawn are mentioned in clauses (b) and (c) followed by the general words in clause (d). In such a situation, the rule of ejusdem generis gets attracted and the general words in clause (d) have to be construed as limited to things or circumstances of the same kind as those specified in the preceding clauses. To put it differently, the general words ‘such circumstances’ in clause (d) must draw their colour from the circumstances referred to in clauses (b) and (c).

3.5.25. Withdrawal of Voluntary Offer

The law regarding withdrawal of voluntary offer was recently settled by SEBI in its landmark order in the case of Mr. Promod Jain and Pranidhi Holdings Pvt. Ltd’s Case. Although this ruling is based on the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation 1997 which have been repealed in 2011 by new set of regulations, this ruling still carries significance as the provision relating to withdrawal of offer is substantially the same in both the regulations. In this case, the acquirers Mr. Pramod Jain and Pranidhi Holdings Private Ltd. alongwith J.P. Financial Services Private Ltd. (PAC) made a voluntary public announcement to acquire 25 percent equity shares of the target company. The controversy arose when the acquirer and the PAC requested the SEBI for a permission to withdraw the open offer under regulation 27(1)(d) (now regulation 23(1)(d) of the 2011 Code).

The acquirers contended that target company had suppressed material facts, acted in malafide manner by depleting valuable fixed assets and advancing fictitious advances
and loans. Moreover, this was a case of voluntary offer which has to be distinguished from a triggered offer as voluntary offer do not give any vested rights to shareholders. Moreover, public offer has to be governed by the provisions of Indian Contract Act, 1872, and as the offer has not been accepted by the shareholders of the target company, it can be withdrawn. Ruling of SAT in *Nirma’s Case*, 208 has to be distinguished as it was based on mandatory offer whereas in the present case, it is a voluntary offer and moreover the promoters had perpetuated the fraudulent activities after the public announcement was made. SEBI held that voluntary offer is governed by the same provisions as a mandatory offer i.e. regulation 10 and 12 of the Takeover Code 1997 and hence, when the public announcement is made there is no difference between the two. They are governed by the same principles which are *inter alia* incorporated in regulation in 22(1) (now regulation 25(1) of 2011 Code) according to which the public announcement of offer to acquire shares should be made only when the acquirer is able to implement the offer.

The SEBI further held that, the phrase ‘such circumstances’ as incorporated in regulation 27(1)(d) has to be read *ejusdem generis*. This means SEBI has no plenary discretion to allow withdrawal of an open offer. It has power to permit withdrawal only when circumstances are similar to that of regulation 27(1)(d) and 27(1)(c). This view also finds support in SAT’s decision in Nirma’s case, where in it was held that regulation 27(b) to (d) are to be constructed strictly and the phrase ‘such circumstances’ in clause (d) had to be construed *ejusdem generis* i.e. there has to be an element of impossibility in implementing the offer.

The last argument also did not find favour with SEBI as according to it Takeover Code is a special law and all public offers such as the one in this case are to be governed by this Code and not the Indian Contract Act otherwise it may lead to a peculiar situation wherein the acquirer could withdraw the public offer even when only some of the shareholders would have tendered the shares and others would have not. SEBI refused the permission to withdraw the offer by emphasising the fact that an acquirer who wished to invest a substantial sum of money and acquire control of the target company

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208 *Nirma Industries Ltd. v. Security and Exchange Board of India* (2009) 90 SCL 23 (SAT-Mum.).
ought to exercise proper due diligence before making the public announcement. This is further aggravated by the fact that the acquirer and the PAC were not an outsider in the sense that they were already holding 6 percent equity shares in the target company.

3.5.26. Exemptions from the Open Offer Obligations

Very often acquisition of shares or voting rights may become necessary in commercial and business interests and all such cases of transfer of shares among two set of persons may not result in a takeover and the interest of shareholders may not be jeopardised. It stands to good reason that such cases merit exemption from the requirement of making mandatory public offers. The regulations have been made inapplicable in the first place for such cases, so that the need to approach SEBI for seeking exemptions would not arise in such cases.209 These are the cases of automatic exemptions under regulation 10 of 2011 Code. Such circumstances are delineated so that it means greater transparency besides minimising the exercise of discretionary power.

In a dynamic and developing securities market, there would always be situations, all of which cannot be covered even by delineating circumstances in the widest possible terms. This lead to the provision in regulation 11 namely exemptions by the board whereby the acquirer can apply to SEBI for availing the exemption from the open offer obligations.

3.5.26.1. Automatic Exemptions (Regulation 10): Regulation 10(1) exempts the following categories of acquisitions from open offer obligations under regulation 3 and 4 without SEBI’s approval:

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(1) **Inter-se Transfer between Qualifying Parties:** The qualifying parties are:

(i) Immediate relatives.

(ii) Persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition.

(iii) A company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than 50 percent of the equity shares of such holding company, other companies in which such persons hold not less than 50 percent of the equity shares, and their subsidiaries subject to control over such qualifying parties being exclusively held by the same persons.

(iv) Persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to fillings under the listing agreement.

(v) Shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to fillings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holding in the target company without any differential entitlement to exercise voting rights in such company.

The exemption under this clause is available subject to the compliance of the following conditions:

- If the shares of the Target Company are frequently traded, then the acquisition price per share shall not be higher by more than 25 percent of the volume-weighted average market price for a period of sixty trading days preceding the date of issuance of notice for the proposed inter-se transfer under regulation 10 (5), as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

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210 Regulation 10(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.  
211 The term ‘Immediate Relatives’ has been defined under Regulation 2(l) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
If the shares of the target company are infrequently traded, then the acquisition price shall not be higher by more than 25 percent of the price determined under regulation 8(2) (e) of the regulations.

The benefit of exemption will be available subject to such transferor (s) and transferee (s) having complied with disclosure requirements set out in chapter V.

The acquirer shall intimate the stock exchange where the shares of the target company are listed, the details of the proposed acquisition at least 4 working days prior to the proposed acquisition.\textsuperscript{212}

The acquirer is required to file a report within 4 working days of the date of acquisition to the stock exchange giving all details in respect of acquisitions and the stock exchange shall disseminate the information to public.\textsuperscript{213}

The acquirer is further required to file a report within 21 working days from the date of acquisition to SEBI giving all details in respect of acquisitions.\textsuperscript{214}

In Aman More v. SEBI,\textsuperscript{215} the facts of the case were that the appellant and his uncle ‘A’ were both promoters of the target company. The appellant acquired 27.4 per cent of the paid up share capital of target company from ‘A’ as a result of a family settlement. The acquisition was exempt from the regulations as that was an inter-se transfer of shares amongst the promoters of the target company. The appellant did not furnish the necessary information relating to acquisition to the exchange(s) where the shares were listed, nor did he submit report to the board within stipulated period as per regulations. The Adjudicating Officer found the appellant guilty of violating the regulation 3(3) [now regulation 10(5)] and regulation 3(4) [now regulation 10(9)] and imposed a penalty of Rs. 1 lakh thereupon. On appeal, it was held that shares were acquired by the appellant from his uncle in a family settlement and the transfer was inter se between the promoters of the target company. By not filing the requisite report with the board, the appellant did not make any gain for himself much less disproportionate gain, nor did he take an advantage in that regard. Again, non-filing of the report did not cause any loss

\textsuperscript{212} Regulation 10(5) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{213} Regulation 10(6) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{214} Regulation 10(7) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{215} (2008) 83 SCL 7 (SAT-Mum.).
to any investor or a group thereof and the nature of the default was not repetitive in nature. The appellant was a minor and having regard to the aforesaid factors, the amount of penalty levied deserved to be reduced. The ends of justice would be adequately met, if the penalty was to be reduced to Rs. 10,000.

(2) Acquisitions in the Ordinary Course of the Business: The following acquisitions by the following parties in the ordinary course of the business are exempt from the obligation to make on open offer under regulation 3 and regulation 4:

(i) An underwriter registered with SEBI by way of allotment pursuant to an underwriting arrangement.

(ii) A stock broker registered with SEBI acting on behalf of his clients.

(iii) A merchant banker registered with SEBI or a nominated investor in the process of market making or subscription to the unsubscribed portion of issue in terms of chapter X B of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(iv) Any person acquiring shares pursuant to a scheme of safety net in terms of regulation 44 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(v) A merchant banker registered with SEBI acting as a stabilisation agent.

(vi) Promoter or pre-issue shareholder in terms of regulation 45 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009.

(vii) Acquisition by a registered market maker of a stock exchange in respect of share for which he is a market-maker.

(viii) A Scheduled Commercial Bank (SCB) acting as an escrow agent.

(ix) Invocation of pledge by SCB.

The TRAC felt that acquisition of shares in the ordinary course of business by stock brokers, underwriters, merchant bankers and specific persons performing specific

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216 Regulation 10(1)(b) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
routine commercial roles should be out of the purview of an open offer obligation. The above exemptions under regulation 10(1)(b) are unconditional. Acquirer shall give intimation to stock exchanges where shares of target company are listed not later than 4 working days from acquisition as required by regulation 10(6).

(3) Acquisition Pursuant to Disinvestment Agreement: Acquisition which is at the subsequent stage by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment in a public sector undertaking is exempt but subject to conditions that both the acquirer and the seller are the same at all the stages of acquisition and moreover full disclosure of all the subsequent stages of acquisition, if any, have been made in the public announcement of the open offer and in the letter of offer.

(4) Acquisition Pursuant to a Scheme of Arrangement: Under the Takeover Code 1997, acquisition of shares or voting rights pursuant to any scheme of arrangement or reconstruction including amalgamation or merger or demerger under any law or regulation, Indian or foreign, had a blanket exemption from the open offer requirement, irrespective of the nature of the scheme. But this exemption became a subject of a deluge of litigation and the position was not clear as to when any company entering into a merger or acquisition could avail this exemption and when not. The stand of SEBI and SAT was not consistent which caused a lot of confusion as regards the position of law on this point. Time and again the Board or SAT has cited same reasons for granting the relief but the relief granted differed from rejection to conditional exemption to complete exemption from making a public offer. Which merger will be exempted from making a public offer and which not became a matter of great speculation. This lead to lot of confusion on this point as market players could not plan the future course of action. But such inconsistent stand on such a crucial point of law proved to be extremely detrimental.

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218 Regulation 10(1)(c) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
From the case of *Glaxo Smithklin Plc.*\(^{220}\) and *Eaton Corp. v. Chairman, SEBI,\(^{221}\) the conclusion could be drawn that whenever there is a global restructuring or merger taking place, whether in India or any foreign country which effects the change in control of any listed company in India, then the same shall be exempted under regulation 3(1)(j)(ii). But the position was obscured by SAT in further decisions especially in the case of *Luxottica Group SPA v. SEBI.*\(^{222}\) The facts in this case were similar to two cases discussed above in the sense that here again it was a case of international restructuring effecting a change in control of a company listed in India. But the SAT surprisingly did not grant exemption and asked the company to make a mandatory public offer. This stand by SAT quite evidently ran contrary to its earlier decisions discussed above and resulted in great confusion as regards the true interpretation and application of the exemption clause provide in regulation 3(1)(j)(ii) of the 1997 Code. Such inconsistent stand on such a crucial point of law has proved to be extremely detrimental. This confusion at times has frustrated or caused delay in various business operations entailing huge costs for the market players. But the 2011 Code has clearly laid down the things i.e. which cases are exempted, the conditions for exemptions etc to facilitate more M&As in a hassle free manner.

(5) **Other Exemptions:** In addition to above, following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and 4 of the Takeover Code, 2011.

- Acquisition pursuant to a scheme made under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 or any statutory modification or re-enactment thereto.\(^{223}\)

- Acquisition under operation of law which are made pursuant to the provision of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) Act,\(^{224}\) and the SEBI (Delisting of

\(^{220}\) As quoted in Ravi Shankar Jha, 2010, pp. 40-41.
\(^{221}\) (2001) 33 SCL 326 (SAT-Mum.).
\(^{222}\) (2003) 47 SCL 1 (SAT-Mum.).
\(^{223}\) Regulation 10(1)(d) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\(^{224}\) Regulation 10(1)(e) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
Equity Shares) Regulations, 2009, shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4.

- Acquisition by way transmission, succession or inheritance.
- Acquisition pursuant to CDR schemes.
- Acquisition by promoters of target company.
- Acquisition pursuant to rights issue.
- Increase in voting rights pursuant to buy back of shares.
- Acquisition of shares in a target company by any person in exchange for shares of another target company.

**Case Laws on Regulation 10**

Regulation 10 exempts certain acquisitions from open offer obligations under regulation 3 and 4. However, there is no exemption of acquisitions from disclosure obligations under regulation 29. This view is supported not only by the plain wordings of regulation 10 but also by the decision in *Classic Credit Ltd. v. SEBI,* wherein it was held that:

"Regulation 3(1)(c) as it stood at the relevant time provided that nothing contained in regulation 10, 11 and 12 of the Regulations shall apply to preferential allotment made in pursuance of a resolutions passed under section 81 (1A) of the Companies Act, 1956. It is, thus, clear that regulation 3 exempts the acquisition made through preferential allotment only from regulations 10, 11 and 12. It does not exempt the acquisition from the provisions of regulation 7."

**Compliance with Sub-regulations (5), (6) and (7)**

In *J.M. Financial & Investment Consultancy Services Ltd v. Shri Ananta Barua, Adjudicating Officer,* it was held that compliance of the requirement of the said sub-regulations is required only if the acquisition comes under the exempted category.

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225 Regulation 10(1)(f) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
226 Regulations 10(4)(a) and 10(4)(b) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
227 Regulation 10(4)(c) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
228 Regulation 10(4)(d) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
229 (2007) 76 SCL 57 (SAT-Mum.).
Requirements of notifying stock exchange and reporting to SEBI in terms of these sub-regulations are consequential to availing of exemption and not a requirement to avail exemption under regulation 3 as is made crystal clear in the regulations.

In the case of *Naresh Chand and Three Others v. SEBI*, the appellants were imposed a penalty of Rs. 2 lakhs for belated intimation to stock exchange under regulation 3(3) [now regulation 10(5)] while seeking exemption for inter-se transfer among promoters under the Regulations in the share capital of Ashiana Ispat Ltd. SAT after hearing the parties set aside the penalty as there was a delay of just one day.

**Distinction between regulation 3(3) [now regulation 10(5)] and regulation 3(4) [now regulation 10(7)]**

In *Samrat Holdings Ltd. v SEBI*, the SAT very well explained the difference between these two sub-regulations by highlighting their respective objective. The object of these two sub-regulations is different while sub-regulation (3) is meant to enlighten the investing public in their investment decision in the shares of the company through report to the concerned stock exchange, requirement under regulation 3(4) is essentially meant to serve as an input to enable SEBI to ensure that the acquisition is one which enjoys exemption and if not to follow up with further course of action in order to protect investors interest.

**3.5.26.2. Exemptions by the Board:** As already seen, regulation 3 (now regulation 10) enumerates acquisitions which are exempt. Some of the exemptions under regulation 3 are automatic while others are conditional. As an exhaustive list of exempt transactions is not possible to be brought under regulation 3, it became necessary to enact regulation 4 (now regulation 11) which facilitates exemption in deserving cases. The order of exemption would be passed by SEBI purely on the basis of its subjective satisfaction based on material before it. The decision of SEBI cannot be interfered with unless there are adequate reasons.

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231 (2006) 68 SCL 20 (SAT-Mum.).
232 (2001) 29 SCL 417 (SAT-Mum.).
233 *B.P. Plc Foseco Plc v. SEBI* (2001) 45 CLA 154 (SAT-Mum.).
On an application being made by the acquirer, SEBI may for reasons recorded in writing grant exemption from the obligation to make an open offer for acquiring shares under these regulations subject to such conditions as SEBI deems fit to impose in the interest of investors in securities and the securities market.\textsuperscript{234} The SEBI may also constitute a panel of experts to which an application for an exemption may, if considered necessary, be referred to make recommendation on the application to the Board.\textsuperscript{235} Thus, the requirement of making a mandatory reference to a Panel by SEBI before granting an exemption has been done away with and such requirement has now been made discretionary.

Overall, we can say that SEBI would continue to have the power to grant exemption from making an open offer and SEBI also has the discretion to give relaxation from strict compliance with procedural requirements of open offer process and other obligations.

3.5.27. Disclosures of Shareholding

The intent behind the disclosure regime is not only to ensure that the target company is not taken by surprise but also to ensure that price discovery in the market for shares of the target company takes place in an informed manner, where the very fact of an interested acquirer increasing his holding would contribute to the emergence of price at which sellers would be willing to sell their shares in the market. Also, such price discovery has implications for the computation of the minimum offer price in the look back period.\textsuperscript{236}

Any acquisition of shares or voting rights in a target company by an acquirer which taken together with existing shares or voting rights, if any of acquirer and PACs entitle them to 5 percent or more of the voting rights in such target company obligates them to disclose their aggregate shareholding and voting rights in such target company and also every acquisition or disposal of shares of such target company representing 2 percent or

\textsuperscript{234} Regulation 11(3) read with regulation 11(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\textsuperscript{235} Proviso to regulation 11(5) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

more of the shares or voting rights in such target company by the acquirer who together with PAC holds 5 percent or more voting rights in a target company.\(^\text{237}\) The above disclosures shall be made within two working days of the receipt of intimation of allotment of shares or the acquisition of shares or voting rights in the target company to:\(^\text{238}\)

(a) Every stock exchange where the shares of the target company are listed; and

(b) The target company at its registered office.

The above disclosures shall be made by following the requirements of regulation 28 which are:

- The disclosures shall be of the aggregate shareholding and voting rights of the acquirer and PAC with him.\(^\text{239}\)

- Convertible securities including warrants and convertible debentures are to be regarded as shares.\(^\text{240}\)

- Upon receipt of the disclosures, the stock exchange shall forthwith disseminate the information so received.\(^\text{241}\)

3.5.27.1. 1997 Code v. 2011 Code: The 2011 Code has made the disclosures more stringent and frequent as compared to 1997 Code. Erstwhile Regulation 7 stipulated that disclosure of shareholding have to be made on the acquisition of more than 5%, 10%, 14%, 54% and 74% of shares in the target company.\(^\text{242}\) The 2011 Code replaces multiple trigger points for disclosure obligation with one single trigger point 5 percent or more voting rights in target company. Any further acquisition of 2 percent or more of the voting rights in the target company by an acquirer along with PAC who holds 5 percent or more voting rights has to disclose such acquisition. But under 1997 Code such disclosure was to be made if the above 2 percent was acquired under the creeping

\(^{237}\) Regulations 29(1) and 29(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{238}\) Regulation 29(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{239}\) Regulation 28(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{240}\) Regulation 28(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{241}\) Regulation 28(4) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.


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acquisition route. Such rise in frequency of disclosure is considered to be in line with global best practices and helps in overall administration by the SEBI over the capital market.

3.5.27.2. Legal Issues on Disclosures:

Disclosure by Acquirer to be in a Prescribed Format: The acquirer should make the disclosure to the company in a proper format prescribed by SEBI according to which disclosure has to cover the name of the acquirer, shareholding before acquisition, shares acquired, shareholding after acquisition, mode of acquisition, date of acquisition etc.\(^{243}\)

In *Bombay Dyeing & Mfg. Co. Ltd. v. Arun Kumar Bajoria*,\(^ {244}\) the acquirer merely sent a letter to the target company which read: “This is to inform you that our holding in your company with our associates have exceeded 5 percent. This is just for your information as required under SEBI Guidelines.” The Company Law Board held that such letter could never be considered to be a disclosure in terms of regulation 7 (now regulation 29). Since the letter is incomplete and without relevant particulars, it cannot be termed as valid disclosure in terms of regulation 7.

Disclosures under Regulation 7 (now Regulation 29) is Mandatory: In the same case, it was held by Company Law Board that since the regulation 7 of the Takeover Code uses the words ‘shall disclose’ with regard to disclosure to be made to the company once the acquirer acquires shares or voting rights which would entitle him to more than five per cent shares or voting rights. The use of the words ‘shall disclose’ make it a mandatory requirement which has to be fulfilled.

3.5.27.3. Consequences of Violation of Disclosure Requirement (now Regulation 29): In *Karamsad Investment Ltd. v. Nile Ltd.*,\(^ {245}\) it was held that violation of this regulation does not effect the legality of the acquisition but the failure to comply with an obligation created under regulation 7 after the acquisition is validity made would expose the acquirer to penalty.

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\(^{244}\) (2001) 34 SCL 320 (CLB-New Delhi).

\(^{245}\) (2002) 1 Comp LJ 251 (A.P.).
In *Liquid Holdings (P.) Ltd. v. Securities and Exchange Board of India*,\(^\text{246}\) the appellants were promoters of the target company. The group company of appellant M took loans from two banks and pledged shares of appellants in target company by way of collateral security. Bank became beneficial owner of shares and bank made necessary disclosures as per regulation 7. Subsequently, loan accounts were settled and all debts liquidated. Shares were transferred back to appellants. But appellants neither made public announcements nor disclosure as per regulation 7. Therefore, Adjudicating Officer imposed penalty for violating regulation 7 and 11. On appeal SAT upheld the order of SEBI’s Adjudicating Officer.

In *Mega Resources Ltd. v. SEBI*,\(^\text{247}\) there was acquisition of more than 5 percent shares or voting rights of a company by the appellants and no intimation was received by target company, it was held that penalty was rightly imposed on appellants for violation of regulation 7 (now regulation 29).

**Regulation 29 Requires Acquisition of 5 Percent or more Shares or Voting Rights by Acquirer along with PAC:** In *Triumph International Finance India Ltd. v. SEBI, Mumbai*,\(^\text{248}\) investigations in scrip of the target company revealed that appellant along with entities belonging to ‘KP’ group acquired more than 5 percent of shares or voting rights in target company. They did not disclose aggregate of their holdings to company thereby violating regulation 7. The Adjudicating Officer of SEBI imposed penalty on appellant holding that he had acted in concert with other entities in acquiring shares and violated regulation 7 by not making disclosures. But on appeal, SAT reversed the findings and held that merely because the appellant acted as a broker of some of the companies owned and controlled by ‘KP’ did not make it a ‘person acting in concert’ with those companies. That could, if at all, mean association with those companies. Close business association between two or more person does not by itself make them persons acting ‘in concert’.

**Are ‘Overseas Corporate Bodies’ Liable to Make Disclosures under Regulation 29?:** In *Kensington Investment Ltd. v SEBI*,\(^\text{249}\) appellants were overseas corporate

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\(^{246}\) (2011) 106 SCL 463 (SAT-Mum.).

\(^{247}\) (2006) 54 SCL 270 (SAT-Mum.).

\(^{248}\) (2010) 98 SCL 319 (SAT-Mum.).

\(^{249}\) (2002) 40 SCL 170 (SAT-Mum.).
bodies, registered in Mauritius, who bought and sold shares in secondary markets through approved intermediaries. They were not entitled to hold more than 5 percent in capital of a company as per restrictions put by RBI. The SEBI’s adjudicating officer imposed penalty for violation of reporting requirement under regulation 7. But the appellants contention was that they had crossed benchmark of 5 percent slightly but this ‘over benchmark’ holding was only for a couple of days in any case less than four days. On appeal, the Tribunal held that an acquirer cannot acquire shares of the company beyond 5 percent of the company’s paid up capital as per the RBI regulations, etc. and the excess holding is just for a lightning duration such an acquisition should not be a concern of the company or the investor for whose benefit the reporting is stated to be provided. The appellant’s could not be considered as ‘raiders’ aiming to usurp the management or control of the investee company. The appellant’s conduct had to be viewed in that context.

Similarly in Far East Investment Ltd. v. SEBI, two Mauritius based companies and overseas bodies corporate (the appellants) disposed of their excess holding of 0.11 percent the very next day after hearing from the company, it was held that as the acquirers were not only making portfolio investment and not ‘raiders’, penalty imposed was unjustified.

**Sum Up:** To sum up, the object underlying this provision is that no one should acquire substantial number of shares in a company without disclosing them to the company. The SAT has very aptly summed up the object of the provision in Milan Mahendra Securities (P.) Ltd. v. SEBI:

“The Regulations were framed on the basis of the input provided by a Committee headed by Justice P.N. Bhagwati which had recommended that substantial acquisition of shares and takeovers should operate principally to ensure fair and equal treatment to all shareholders in relation to substantial acquisition of shares and takeovers. The object of the regulations is to give equal treatment and opportunity to all shareholders and protect their interests. To translate these principles into reality measures have to be taken by the Board to bring about

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251 (2007) 76 SCL 365 (SAT-Mum.).
transparency in the transactions and it is for this purpose that dissemination of full information is required. It is with this end in view that the regulations require the making of disclosures on pre-acquisition and post-acquisition stages and the requirement in regulation 7 at post acquisition stage is one among them. As observed, the purpose of these disclosures is to bring about transparency in the transactions and assist the regulator to effectively monitor the transactions in the market."

3.5.28. Continual Disclosures

Every person who together with PAC is holding 25 percent or more of voting rights in a target company shall disclose their aggregate shareholding and voting rights as of the 31st March in such target company in such form as may be specified.\(^{252}\) The promoter of every target company along with PACs shall have the same obligation.\(^{253}\) In both the above cases, the disclosures have to be made within seven working days from the end of each financial year to:

(a) Every stock exchange where the shares of the target company are listed.

(b) The target company at its registered office.\(^{254}\)

Thus, the limit for continual disclosures has been increased in the Takeover Code 2011 from 15 to 25 percent. In the case of \textit{Upendra C. Shah and Nilam U. Shah v. SEBI},\(^{255}\) the SAT held that regulation 6 and regulation 8 (now regulation 30) were mandatory and appellants who were past promoters of the company did not disclose number and percentage of shares held by them and by PAC with them and thus violated regulation 6(3), 8(1) and 8(2) and thus penalty was levied.

Position of Director

A situation can arise where a query arises that whether a director is a promoter and therefore is entitled to make necessary disclosures that are required under regulation 30. The question arose before Securities Appellant Tribunal (SAT) in \textit{Nimish Kantilal Unadkat v. Adjudicating Officer, SEBI},\(^{256}\) the SAT held that appellants as the directors

\(^{252}\) Regulation 30(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{253}\) Regulation 30(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{254}\) Regulation 30(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

\(^{255}\) (2006) 69 SCL 129 (SAT-Mum.).

\(^{256}\) (2010) 98 SCL 133 (SAT-Mum.).
of the company were controlling the management of the company and were taking policy decisions on its behalf on a day to day basis. Based on the definitions of ‘control’ and promoter in the 1997 Code, they were not only promoters within the meaning of the Takeover Code but were also having control over the company as defined in regulation 2(1)(c). Therefore, they were required to make continual disclosures under regulation 8(2) corresponding to regulation 30(2) of 2011 Code.

But to overcome this decision of SAT, a proviso was added in regulation 2(1)(g) of the 2011 Code which clarifies that in view of this proviso, the directors of a company cannot be regarded as in control and consequently as ‘promoters’ merely by virtue of holding such position and will not be liable to make disclosures under regulation 30(2) of 2011 Code merely by virtue of being directors.

3.5.29. Disclosure of Encumbered Shares

The promoter of every target company shall disclose in such form as may be specified:

- Details of shares in such target company encumbered by him or by PACs with him.\(^{257}\)
- Details of invocation or release of such encumbrances.\(^{258}\)

The above disclosures shall be made within seven working days from the creation, invocation or release of encumbrance to every stock exchange where the shares of the target company are listed and the target company at its registered office.\(^{259}\)

In the 1997 Code, by an amendment in 2009, disclosure of pledged shares was made mandatory. But the Takeover Code 2011 has widened the scope of disclosures by replacing the term pledge with encumbrance. Under regulation 28(3) of the Takeover Code, 2011, it has been explicitly clarified that an encumbrance shall include a pledge, a lien or any such transaction by whatever name called. In the case of *K. Nirmala v. Securities and Exchange Board of India*,\(^{260}\) the appellants had not disclosed information about pledging of shares and their revocation which was required by law to be

\(^{257}\) Regulation 31(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\(^{258}\) Regulation 31(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\(^{259}\) Regulation 31(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\(^{260}\) (2013) 120 SCL 91 (SAT-Mum.).

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disclosed. Therefore, Adjudicating Officer of SEBI imposed penalty upon them. The SAT held that as appellants had non disclosed information regarding pledge, so the findings of the Adjudicating Officer cannot be faulted with. But considering the apologetic approach of the appellants, the penalty was reduced to 50 percent of the penalty imposed by the Adjudicating Officer.

The Satyam Episode and the Enormities of Pledging: In the 1997 Code, before February 2009, it was not mandatory for the promoters to disclose the quantum of shares that they had pledged, but post Satyam Computers fiasco, the Indian regulators realised the importance of the disclosure of information as regards the pledging of shares by the promoters of the company and the grave circumstances, adverse to the interest of the investors that could result from such an omission on the part of the promoters of such companies who had pledged their shares without informing the stakeholders, potential investors and general public about it. Post Satyam, this ordinary world ‘pledging’ has come to hold extraordinary significance in the Indian security markets because when the shares are pledged by the promoters of a company, it is a matter of critical importance as many investors consider promoter holding and management structure of the company as a crucial aspect of their investment decision and pledging is considered to be an additional leverage on the company and is a risk factor which might indicate that the company is so cash strapped that it is not even able to take out day to day working capital for continuing its operations. If promoters engage themselves in such an activity without informing the general public in this regard, it may even amount to insider trading and is definitely unfair to the growth oriented investors who invest in a company in a bid to earn profits out of their investment. Generally, the investors react to the news pertaining to pledging of shares by the promoters of a company negatively by selling the shares they hold in large chunks as was seen in Satyam case. When Ramaligan Raju made the confession pertaining to the fraud, the price of the scrip fell by more than 80 percent on the day.

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261 Pledging in the corporate world refers to an activity whereby a specific amount of shares of a particular company are kept as collateral with a bank, a NBFC or a financial entity which, in turn, advances a loan or a specific amount of money to the pledger.


263 Id., pp. 3-4.
Now when the promoters sell their stake in the companies, there are regulations which require them to disclose it to the stock exchanges and therefore it eventually comes to the notice of the market participants as well. But if they pledge the shares with financial institutions to raise funds, the market participants would never come to know about it even if the financial institution sells all the pledged shares in an event of default and the company could still continue projecting a healthy image of the company.\textsuperscript{264}

The 2011 Code has retained the 2009 amendment (introduction of regulation 8-A) in the form of regulation 31 but also has widened its scope by including all encumberances of shares including pledge, lien and any like transactions so that investors can be fully protected against all these. Such disclosure norms would surely protect the investors against misfortune of the sort they had faced due to the Satyam debacle as analyst believe that even Raju wouldn’t have been able to go this far in his fraudulent fudging and manipulation of accounts, had proper pledge disclosure norms been in place.\textsuperscript{265}

All kind of encumbrances on shares by the promoters to raise finances, while keeping the investors holding equity interest in the companies promoted by them, ignorant of it is definitely detrimental to investors’ interest. Thus SEBI has taken an absolutely appropriate step in retaining the amendment while expanding its scope so that investors who are already crying foul due to ongoing recession and severely battered markets are not harmed by the malpractices of irresponsible promoters. This move would definitely enable the investors to make a prudent and reformed decision.

\textbf{3.5.30. Lifting the Corporate Governance Standards}

Earlier, the potential acquirers could make its intentions known through public announcements, but the shareholders of the target company got no information from their own Board as to the future course of action. But the 2011 Code has endeavored to improve the corporate governance by suggesting that the target company should form a Committee comprising of independent directors to make a reasoned recommendation on the open offer to the public shareholders.\textsuperscript{266} The target company shall publish such recommendations at least two working days before the commencement of the tendering.

\textsuperscript{264} Id., p. 6.
\textsuperscript{265} Id., p. 8.
\textsuperscript{266} Regulation 26(6) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
period in the same newspaper where the public announcement of the open offer was published.\textsuperscript{267}

3.5.30.1 Rationale for Such Change: The 1997 Code entirely leaves it to discretion of the directors of the target company to issue their recommendation on the open offer. Due to which, this provision was seldom used. But most jurisdictions the world over including UK, Canada, Singapore and Hong Kong mandate that the board of directors of the target company issues its considered recommendations on the open offer to the target’s shareholders.\textsuperscript{268} Therefore, in line with the international best practices, this new provision was inserted in regulation 26 of the 2011 Code. Even the 2011 Code explains the rationale of this new provision to further the objectives of good corporate governance. The boards of directors, in particular, the independent directors have a fiduciary responsibility towards the shareholders.\textsuperscript{269}

3.5.30.2. Other Obligations of Various Parties for Lifting the Corporate Governance Standards: During the offer period, no person representing the acquirer shall be appointed as director on the board of directors of the target company. Such appointment may be made only after the deadline for making competing offer expires provided the acquirer places in escrow account 100 percent of the consideration amount.\textsuperscript{270} During the pendency of competing offers, there shall be no appointment of additional directors to the board of directors of the target company irrespective of the amount deposited in escrow account by acquirers.\textsuperscript{271} Further material transactions outside the ordinary course of business such as alienation of material assets, effecting any material borrowings, material contracts, issue of authorised but unissued securities, buy-back of shares etc cannot be undertaken by the board of directors of either the target company or any of its subsidiaries unless the approval of shareholders of the target company by way of a special resolution by postal ballot is obtained.\textsuperscript{272}

\textsuperscript{267} Regulation 26(7) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{268} Anand G. Srinivasan, 2011, p. 1.219.
\textsuperscript{270} Regulation 24(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{271} Regulation 24(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
\textsuperscript{272} Regulation 26(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
3.6. Conclusion

The first attempt at regulating takeovers was the introduction of clause 40 in the Listing Agreement. But the clause suffered from major lacunas due to which it was replaced in 1990 by introduction of clause 40A and 40B in the Listing Agreement. But as already discussed, the amended clauses were unable to provide a comprehensive regulatory framework governing takeovers due to their limited applicability and weak enforceability. But still they made a good beginning towards regulating takeovers and acquisitions in India.

As the process of takeovers is complex and is closely interlinked to the dynamics of the market place, the SEBI in pursuant to the powers vested in it under section 30 of the SEBI Act, 1992 came out with SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations in 1994. Within two years of the working of regulations, a need was felt to improve the regulations to make them more comprehensive. Therefore, Bhagwati Committee was constituted which came out with a new set of regulations in 1997.

Taking into consideration, the growing level of M&A activity in India, the increasing sophistication of takeover market, the decade long regulatory experience and various judicial pronouncements, it was felt necessary to review the 1997 Code and to bring it in line with the current understanding of the international market. The Indian capital market has witnessed a lot of changes since the Takeover Code was enacted in 1997. Based on the recommendations of the TRAC committee, international practices and feedback from interest group and general public, the SEBI notified a new Takeover Code in 2011.

The necessity for a Takeover Code to regulate corporate takeovers cannot be underestimated. Since time immemorial there have been acquirers who are always ready to grab successful business entities at the weakest moments and generally at the cost of the promoter investors and retail investors. Be it technology giants like Wipro and Infosys or steel magnets like Tata or Lakshmi Mittal or telecom giants like Vodafone or Airtel, all had an eye on takeover. It is important that the process of substantial

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acquisition of shares is not only fair but also equitable to all the parties concerned in the process.\textsuperscript{274} The 2011 Code is an excellent effort in this direction which has tried to balance the interest of acquirers, promoters, large as well as small shareholders. The approval of majority of TRAC recommendations by SEBI marks the beginning of a new era in the history of India Inc. The TRAC report on which 2011 Code is based has relied on sound statistical analysis, past court rulings, analysing International Takeover Codes, and plugging of loopholes on the basis of recent cases etc., all of which are essential to develop a robust legislation which can stand the test of time. It has tried to incorporate the best takeover practices from around the world. The new Code tries to provide clarity to deal makers by simplifying it and aligning it with international best practices.

Every coin has two sides. Therefore, there are certain areas in the new Code as already discussed in the previous pages which require immediate attention such as fear of hostile takeovers due to increase in offer size, abolition of non-compete fee and the resultant injustice caused to promoters, ambiguity in the definition of control, auto-delisting, parity in tax treatment, disclosures regarding encumbrances on shares, etc. The timelines mentioned for completing the offer is an attempt to reduce the time taken in relation to the open offer process. However, whether it can be practically achieved will depend upon other regulatory approvals required, including the approval from the Competition Commission of India under the Competition Act. Barring these difficulties or lacunas, the researcher believes that the new Takeover Code could pave the way for a transparent environment for M&As and will go a long way in curbing various kinds of undesirable practices affecting our capital market and will protect the interests of small investors from manipulations of any kind.

\textsuperscript{274} Vinayak Mishra and Priyanka Rathi, 2008, p. 102.