

Anomalies need to be sorted out

Sebi, CCI should rectify inequities in the takeover code and reduce conflict among the various regulations

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The Securities and Exchange Board of India (Sebi) on 28 July accepted recommendations made by its takeover regulations advisory committee (Trac). What's the likely impact on key stakeholders?

For promoters: The committee's original recommendation required an acquirer who crosses the threshold to make an offer for 100% of the company. In a hostile bid, the promoters have to make a counter-bid at the same level, an undue burden on an acquirer, given the lack of adequate acquisition financing.

The consequence of delisting a company if a 100% offer succeeds is drastic. By accepting a minimum public offer norm of 26% (versus 15%), Sebi has removed the anomaly between its delisting regulations, which require a Swiss auction method, and Trac's recommendation of a fixed-price offer. This is welcome.

This
will



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encourage promoters to raise their stake to 50%+1 share to immunize themselves from a hostile takeover. However, promoters will remain vulnerable to the blocking of special resolutions as institutional investors, including foreign institutional investors (FIIs) and private equity (PE) firms, could enhance holdings to 24.9% individually and, in the aggregate, unconnected investors could exceed 25% of the issued capital.

The minority could then position itself as an assertive block against the promoter. Stock exchanges that disable affirmative voting rights on listing will have to recognize the minority rights of vocal institutional investors.

For PE and institutional investors:

On listing, most special affirmative voting rights agreed to before the listing and usually available to an investor at a pre-listing stage are deleted by the exchange. As described above, it's now easier for minority investors to exceed 25% vote of persons present and voting at a general meeting and impose fiscal discipline and better governance norms on management.

PE and financial investors will have a better status as white knights and/or allies of strategic investors in a hostile bid. They can comfortably participate in preferential allotments, enhancing their stakes above 15% without triggering a public offer.

In the past, affirmative voting rights available to investors have been misconstrued as acting in concert with the promoter, whereas in fact these are minority protection provisions. Now, with the ability of exceeding 25% and having blocking rights in relation to special resolutions, the minority stakeholder can negotiate better with the majority promoter.

For strategic investors: A strategic investor can launch a hostile attack on undervalued listed companies where the promoter has less than 50%+1 share by allying with financial investors or by itself. The dilution of Press Note 18 of 1998 has introduced a level playing field for foreign and domestic hostile takeovers, which can be triggered at the threshold of 25%. Instead of a dormant 35% (15% + 20% minimum open offer), a strategic investor, by commencing the minimum public offer at 25% and reaching 26% additional shares or voting rights on a fully successful offer (25% + 26% = 51%) can oust a weak promoter, by simple majority. An unsuccessful bidder with shares from the open offer can now sell those to the winner without triggering a second offer.

For minority shareholders: The fact that PE or institutional investors can assert themselves at a shareholder meeting by virtue of 25% vote of persons present and voting will strengthen the position of stray minority shareholders as they will be protected by positions taken by larger minority blocks. Minority shareholders also benefit as there won't be differential price payments related to non-compete fees paid to promoters. Non-compete payments without sale of goodwill are void as agreements in restraint of trade under Section 27 of the Indian Contract Act, 1872. The exception that a non-compete agreement is valid under contract law when the business is sold with goodwill will still prevail, despite the deletion of the non-complete provisions in the takeover code. Non-compete clauses may also constitute an anti-competitive pact and may be

contrary to the Competition Act of 2003.

Sebi has corrected an anomaly that has persisted since 1997 and has brought its regulations in line with takeover codes in other countries. This is a significant achievement in the interest of minority shareholders.

For competitors: A hostile bid on the back of a financial investor will become easier for a competitor that has no market share in India and won't adversely affect competition as provided in the Competition Act of 2003 and the Competition Commission of India (CCI) merger control regulations of 2011. The advent of these regulations and the need for CCI approval prior to completing the deal is a twist in the tail. This has three important aspects. In the case of a hostile bid, it may well be that the original acquirer won't get CCI approval while the hostile bidder is a more acceptable bidder from the competition perspective. Secondly, if the CCI investigation goes into Phase II, then effectively the acquirer has no option but to withdraw the bid. If the offer proceeds pending CCI approval the open offer cannot be concluded, shareholders can't get their money and the acquirer's interest obligation keeps mounting. An ideal situation would be suspension of the open offer till CCI approval is given, or giving the acquirer the option to withdraw the offer. This could have been addressed. Thirdly, an open offer is triggered only on the acquisition of 25%, while CCI regulations require that an acquisition of 15% is filed with it. CCI should revisit this anomaly.

The complications of reducing price, not concluding the sale of shares, denying consideration to members of the public, denying the bidder or acquirer access to the company while it has fully funded the Escrow Account and fully paid out the value of the shares for 51% acquisition or more, are serious matters. Sebi and CCI must rectify the inequitable aspects of these.

The fine print of the regulations hasn't been published. The ministry of corporate affairs, CCI and Sebi should seek to reduce conflict and anomalies among simultaneously applicable regulations.

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Comments are welcome at theirview@livemint.com