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Economy and Politics

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Sebi makes sweeping changes based on panel recommendations, including threshold being raised to 25%

Anirudh Laskar & Vyas Mohan

Mumbai: The mergers and acquisitions landscape in India is set to change with the capital market regulator formalising the recommendations of the takeover regulations advisory committee on Thursday. Following a board meeting, the Securities and Exchange Board of India or Sebi said that a company can acquire up to 25% in a firm without requiring to make an open offer. The new takeover code also raised the open offer size from a minimum of 20% at present to 26%, providing an exit for more investors.

At present an entity requires to make an open offer for at least 20% once its stake reaches 15%. This was preventing a number of companies, especially private equity and venture capital firms, from increasing their stake in target firms without requiring to take control over management through the additional open offer. This move will come as a relief for these firms.

"Increasing the open offer trigger to 25% will allow some companies to address growth capital requirements by getting in a private equity investor," said Sourav Mallik, senior executive director, M&A, Kotak Mahindra Capital Co. Ltd and takeover panel member.

Sebi has also scrapped the non-compete fee that the acquirer firm currently pays to the promoters of target firms to prevent the latter from taking up the same business and compete. Sebi said that removal of the non-compete fee will ensure that all shareholders of the target firm are treated fairly. Recently, minority shareholders of Cairn India Ltd had protested against acquisition of a stake in the firm by Vedanta on grounds of non-compete fee amounting to differential open offer pricing for the promoter shareholders and other stakeholders in Cairn.

There will be no separate non-compete fee provision and all shareholders will be able to exit at the same price.

"Non-compete fees could have been phased out in a calibrated manner, instead of reducing it to zero," said Sidharth Birla, chairman of the Federation of Indian Chambers of Commerce and Industry (Ficci) corporate law committee and chairman of Xpro India Ltd. "India is not at that stage of economic development where the fee could be scrapped altogether."

Bankers said the acquirer may have to pay more for takeovers with the non-compete fee going. "A promoter has certain expectations in mind. With the regulator ensuring the minority shareholder does not lose out, the valuations per share will go up," said Ranu Vohra, managing director, Avendus Capital Pvt Ltd, a domestic investment bank.

Sebi cleared the committee's proposal on pricing takeover issues. At present, open offers are priced at the higher of weekly averages of market price for 26 weeks or two weeks. To ensure that all shareholders of the target firm get a fair value for shares tendered in an open offer, the panel proposed that the minimum price payable shall be the highest of four options—the negotiated price that triggered the open offer, the volume-weighted average price paid by the acquirer in the preceding 52 weeks, the highest price paid by the acquirer during the preceding 26 weeks, or the market price based on the volume-weighted average market prices in the

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preceding 60 trading days. Sebi has accepted this.

The new takeover code took a year to secure Sebi’s clearance. Last July, a panel headed by the former chief of the Securities Appellate Tribunal C. Achuthan had submitted its recommendations to change the existing regulations for takeovers that were framed in 1994. The committee had proposed that an acquirer firm should make an offer for 100% shares in the target firm once an open offer was triggered. According to the committee’s report, an offer for a 100% stake in the target firm would provide an exit opportunity for all shareholders and would attract only serious companies to go for buyouts in Indian firms, though the cost of acquisitions would have gone up.

While most of the recommendations, including the removal of non-compete fee, have been accepted, Sebi refused to agree to the committee’s report on the 100% open offer. While addressing his first press conference at Sebi headquarter in Mumbai, chairman U.K. Sinha said, “The board felt that acquisition financing was an area of concern. Allowing 100% open offer may put foreign entities in an advantageous position over Indian acquirers. So a 26% minimum open offer size was unanimously decided by the board.”

Kirti Shah, director, corporate finance advisory, BDO Consulting Pvt. Ltd, said that Sebi’s move will hugely benefit Indian firms looking for acquisitions vis-a-vis their foreign peers. “With the open offer trigger increased to 25% and the offer itself to existing shareholders to be made for 26% instead of 20% earlier, the acquirer is benefited by getting majority control (i.e. 51%) without putting in additional capital (as was proposed 100% earlier). This is beneficial, especially when there is presently capital deficiency in the system and no established acquisition funding available through banking sources.”

India’s banking regulator does not allow banks to finance mergers and acquisitions. For acquisitions within the country, the acquirer has to arrange for money through internal accruals or raise money through equity issuance.

Sebi didn’t approve the proposal to provide for delisting for the target firms following an offer and proportionate acceptance of shares.

“This would give a chance to existing investors to choose to continue with the acquirer since this would not trigger de-listing of the target company and they too will get a chance to participate in future growth of the company,” Shah added.

At present, when a company’s public shareholding falls below 10% delisting is triggered. The ministry of finance has, however, made it mandatory recently for all listed firms to increase their public shareholding to 25%. Sebi was not clear about the proposal to do away with mandatory delisting following an open offer.

According to an official at an European investment bank, the implications on delisting guidelines should have been clarified while clearing the new takeover code. “That’s one of the biggest shortfalls. There is no clarity on the changes in the delisting guidelines,” he said.

As per the new guidelines, in case of competitive offers, the successful bidder can acquire shares of other bidders after the offer period without attracting open offer obligations. This means if one shareholder who has a 10% stake and a shareholder who has an 8% stake make simultaneous open offers, the former can buy out the one with the smaller holding without triggering an open offer again.

The new 25% threshold will bring rules close to those in some developed markets such as the UK.

Know your client

To simplify the investment processes under Sebi’s jurisdiction, the market regulator plans to set up a Know-Your-Client (KYC) Regulatory Authority and registration agencies under it. They will maintain a database once a customer’s KYC is completed.

At present, even if an investor’s initial KYC is done by one Sebi-registered intermediary, it needs to be done again when investing in a product or opening an account with another Sebi-registered intermediary. Under the new rules, investors will be required to follow the KYC process only once.

The agency will share the details of customers with all Sebi-registered intermediaries to make the process easy.

This will make the KYC process a one-time thing. For example, an investor who has opened a demat account in a broking firm after undergoing KYC formalities has to undergo the process again while investing for the first time in a mutual fund. This duplication of work will be now done away with.

Further, to make initial public offer documents user-friendly, Sebi has proposed that
the issuers would have to disclose the track record of the merchant bankers, the pricing rationale of the proposed floats and compare the price to earnings ratio (a key yardstick to assess the financial prospects of the company) with that of its listed peers. Sebi said the new proposals would halve the number of pages in the offer documents meant for public issues.

**NSDL**

On the contentious issue involving National Securities Depository Ltd (NSDL) in the IPO scam of 2003-2005, Sebi held that following the 9 May order of the Supreme Court, the board decided to release the orders of the two member committee. The committee was formed in 2006 to look into the alleged irregularities and suggest actions. Sebi said it will soon put out the orders of the panel in the matter of IPO irregularities and DSQ software to NSDL for compliance.

Sebi had earlier told the Supreme Court that it will take action against NSDL for failing to prevent the opening of thousands of fictitious demat accounts at the centre of the initial public offering (IPO) scam of 2003-05.

The move marks the revival of an order against NSDL that was headed by former Sebi chief C.B. Bhave when the scam took place.

The two-member panel of G. Mohan Gopal, director of the National Judicial Academy, and former Reserve Bank India deputy governor V. Leeladhar, had passed an order in December 2008 against NSDL, directing it to conduct an enquiry to assess the failure to detect the fake demat accounts. Both were members of the Sebi board at the time.

The panel had held NSDL responsible for the irregularities. NSDL was indicted for failing to put in place adequate risk management systems and processes to prevent the opening of fake accounts. As Sebi chief, Bhave had recused himself from the case.

The panel had directed the NSDL board to conduct an independent inquiry to establish individual responsibility for the failure to meet legal duties and responsibilities. It also ordered the depository to take necessary action to ensure individual accountability for such failure within six months.

A year later, in November 2009, Sebi declared two of three decisions of the committee "null and void", and later in February 2010, withdrew all charges against NSDL. Following a board meeting, Sebi disposed of a show-cause notice to NSDL, effectively clearing it of all pending charges.

On 28 March, a bench consisting of justices R.V. Raveendran and A.K. Patnaik asked why the Sebi board had stopped the order against NSDL going into effect. The bench asked the Sebi board to reconsider the matter, pass an appropriate resolution and place it before the court for further consideration.

Following a board meeting on 26 April, Sebi, on 5 May, filed an affidavit agreeing to reconsider the order. The issue went to the apex court after a special leave petition was filed by Delhi-based NGO Manav Adhikar.

Sneha Shah, Harini Subramani and Aveek Datta contributed to this story.

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