# New Takeover Regulations: Issues and Challenges

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Takeover is an effective means of restructuring and is a faster route for growth and expansion of business. The investors, while investing in an IPO of a company, rely on the credentials of the promoter and invest on his assurance about the Company's growth. If such promoter exits unwarrantedly and a new person acquires the control of the Company, investors may not be willing to continue with their investment, and may wish to exit. An opportunity to exit on terms not lower than what is offered to exiting promoters, to these unwilling Investors has been ensured by the Takeover Regulations issued by SEBI.

SEBI had first issued SEBI (Substantial Acquisition of Shares & Takeovers) Regulations in 1994 and later reframed them in 1997 to regulate such takeovers. With the change in market dynamics, SEBI thought it fit to replace the 1997 Regulations (Old Regulations) with the SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011(New Takeover Regulations).

The major changes which have been made in the New Takeover Regulations are as follows:

1. Increase in the initial threshold limit from 15 per cent to 25 per cent.
2. The minimum public offer limit has been increased to 26 per cent as against 20 per cent under the old regulations.
3. Creeping acquisition Limit of 5% in each Financial Year has been allowed for shareholding between 25% to 75% as against earlier shareholding between 15% to 55%.
4. Independent Directors' Recommendations have been made Mandatory under the new Regulations while there was no such requirement under the old Regulations.
5. Indirect acquisition of shares or control has been introduced afresh.
6. The non-compete fee which was earlier permitted to be paid to the promoters, up to 25% of the offer price, without paying the same to other shareholders has been done away with.
7. The alternative route for 'change in control' which was available earlier by passing of special resolution of shareholders by way of postal ballot is not available any more and open offer will be the only mode of acquisition of control also.
8. Two new additional exemptions have been granted, in cases of increase in the shareholding beyond the threshold as a result of buyback and CDR.
9. A distinct category of open offer, viz, voluntary open offer, by persons holding more than 25% shareholding has been introduced, whereby the acquirer has the liberty to acquire 10% shares, subject to certain conditions.

It is true that the new Takeover Regulations will enhance India's capability and credibility to create a level playing field for bigger economic engagements, thereby developing a transparent and business friendly environment for mergers and acquisitions (M&As). It has been hailed as a welcome step and aligns more closely with global practices in other countries.

However, there are some issues and challenges as well. I would like to discuss some of them hereunder:

1. Increase in the initial threshold limit from 15 per cent to 25 per cent will provide better muscle power to Indian promoters and will allow institutional investors, including private equity players, to hold a larger pie in listed companies. It will also give them more say in the company's affairs and help improve transparency. At the same time, there is also a possibility of negative control. Any large investor can acquire some shares from the market to keep his holding upto 24.99% (without making open offer) and still able to block any Special Resolution as not all investors are present in the shareholders meeting and keep a check on the management.

   Moreover, there is no transitional provision for the person holding upto or more than 15% but less than 25% shares in the Target Company? Earlier he had already made an open offer to get into the creeping acquisition limit till 55%, but now to enter into that zone for consolidation, he will have to trigger the code at least once and make an open offer.
2. While Takeover Regulations Advisory Committee had recommended 100% offer size, it was kept at 26%, the rationale for 26 % open offer size was to create a level playing field for all potential acquirers, an issue that was strongly highlighted by representatives of India Inc. during a series of meetings with regulatory officials. In the absence of acquisition finance in our country, it was felt that (100 % offer size) would give outside acquirers an advantage and while it was desirable, the decision was likely to have helped only one set of entities.

   However, looking from the Acquirers' viewpoint, even open offer for 26 % will make the deal more expensive than it was under the old Regulations, it is an upward march of 6 %. If due to this, a larger offer exceeds 75 % then the implication of down scaling also needs to be factored in working out the costs.

3. The danger of hostile takeover bids for promoters has always been there for many years but this risk has certainly gone up as the new regulations have given enough incentive to mount an attack.

   The acquirers have got an opportunity to gain absolute control of target with an open offer for an additional 26% on purchase of 25% stake of the target company. Hostile takeover threat looms over the listed companies with lower promoter shareholding. Of 3000 BSE companies, 480 have promoter holding of less than 25% of which 290 companies promoters hold less than 15%.

   Most recently, hotel chain operator EIH managed to get Mukesh Ambani, Reliance Industries' Chairman, to buy a stake in the company to prevent ITC from launching a takeover bid for the company. ITC has been steadily accumulating EIH shares in the last few years.

   On a flip side, fear of hostile takeover bids puts the promoters on the edge, which is a positive thing in the context of governance.

4. Another consequence of the new regulations' mandate for an open offer for an additional 26% stake by an entity buying more than 25% stake in a listed company will be felt by the foreign investors. Specifically, sectors such as civil aviation, where up to 49% FDI is permitted, will be affected by the move. So, a foreign investor who wants to buy 49% stake will first have to make an open offer. If the investor manages to acquire say 20% from the public, it will have to buy the rest from the promoter. The reverse process, which is usually the acquisition from the promoters followed by the open offer, might result in breach of the sectoral limits. It is understood that SEBI does not want the rules to be pro-foreign investor and is keen that they should be the same for local and overseas players.

5. The non-compete fee which was earlier permitted to be paid to the promoters, upto 25% of the offer price has been done away with. SEBI's logic appears to be that the promoters who already enjoy large pay packets and hefty commissions as a compensation to run the companies are not entitled to increased price advantage vis-à-vis an ordinary shareholder. However, in my opinion, it made sense to give an extra payment to the Promoters, who had incorporated the company, brought it to the heights where it could command the premium on its shares. In the case of E-Land Fashion China Holdings Limited, SAT also upheld the payment of non-compete fee of Rs.15 which constituted 25% of the offer price of Rs.60, to the Promoters. SAT quoted from its earlier judgment in the case of Tata Tea Ltd. vs. Securities and Exchange Board of India and anr. [2010] 103 SCL 140, "..The recommendations made by the Bhagwati Committee clearly recognize the legitimacy of the non-compete fee payable to the outgoing sellers……. We are of the view that a non-compete agreement would then protect not only the target company but also its continuing shareholders. An acquirer has a right to protect his investment/ business from competition by a seller of the business and this right is a long standing customary element in business sale transactions and is even recognised by law.

6. Under the new Regulations, individual shareholding also will determine trigger as against consolidation of individual + consolidated shareholding. What is the rationale for considering the Individual shareholding of the Acquirer for the Open Offer Obligations? If the transfer is only inter-se the promoter group, it should not be considered as it falls under exemptions in any case. Other modes of stake increases by promoters such as market purchases, creeping acquisition and preferential allotment will trigger the mandatory open offer at the individual shareholder level, if the 25 % limit is breached. As a basic principle, in takeover laws, acquirer should always be considered with PACs with him and the prescribed thresholds should be based on collective holding of Acquirer and PAC. The very definition of the word 'acquirer' conceives of acquisition by himself or through or with PACs. But this new sub-regulation makes threshold individual as well as collective.

7. No effective impact of withdrawal of alternative for the change in control by shareholders' approval. Change by way of postal ballot was possible only in closely held companies, under the old Regulations. Even now under the new Regulations, acquirers' offer to the same closely held shareholders may not have a real impact, except for increasing the expenses, paperwork and formalities.

8. SEBI has also not included the corporate event of forfeiture of shares, wherein due to extinction of shares, shareholding of certain persons may cross the threshold limits.This could be because the Regulations cover acquisition and agreement to acquire and in case of foerfeitures, there is no acquisition..

9. Another gap which appears to me as significant is that an Acquirer can not go for voluntary delisting for 12 months post completion of offer**.** In case the Acquirer intends to voluntarily delist the Target Company, then whether he can keep the Target Company in violation of clause 40A, obliging a listed company to have the minimum level of public shareholding, for a period of 12 Months or should he first offload shares to come within the maximum non public shareholding and then again start the process all over again of buying shares, for the voluntary delisting?

10. Further, the provisions on voluntary offers are ambiguous. The new Regulations prescribe that voluntary offers with a minimum offer size of 10 percent can be made by persons who already hold at least 25 per cent stake. From this regulation, arise two views. One view which is possible is that a voluntary open offer by persons who hold less than 25 per cent is not permitted at all. The second view which is arising out of the FAQs on SEBI website, is that a voluntary offer can be made by persons holding less than 25 per cent so long as the minimum offer size is 26 per cent. This second view does not find a specific mention in the Regulations but is probably being read into Regulation 3(1) of the new regulations. In my view, the offer made under 3(1) cannot be termed as Voluntary Offer as it is the mandatory offer, which any acquirer has to make, if he wishes to cross the threshold of 25% shareholding.
11. Last but not the least is the issue that the new regulations seem to have left out one of the major recommendations made by TRAC that in the case of competitive offers, the successful bidder can acquire shares of other bidder(s) after the offer period without attracting open offer obligations. I am of the view that this could have been allowed by SEBI since the successful bidder has already made one public offer and the other bidders' failed offer could be treated as having been tendered in the open offer. To make the successful bidder make another open offer, to acquire these shares might amount to some kind of hardship on the bidder and also may be a loss of opportunity to the non successful bidder who is now ready and willing to sell his shares to the successful bidder.

Having discussed above points, which in my view are some of the issues which can be considered as gaps or ambitious wishes of the industry, I would like to record my appreciation for SEBI, the Regulator which is ever ready to lend its ears to the views of the market participants as well as the other regulators. It has adopted the route of consultation paper before issuing regulations and has given due weightage to the comments received in the process. With these new Regulations in place, there could be interesting developments on the corporate front, particularly in cases like that of East India Hotels where ITC and Reliance Industries have the option of increasing their stake up to 24.99 percent.

Several companies are complaining that the new Regulations are not to their advantage and are putting more burden on them. In recent weeks there have been suggestions that some elements of the New Takeover Regulations will be reviewed. It will be interesting to see the changes which shall be made by SEBI in these Regulations.