Evolution of the Definition of 'Control' under Indian Law and Regulations

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The term "control", in the context of a company, has two connotations – *de jure* control and *de facto* control. When a person exercises control over the management and affairs of an entity due to holding a majority or substantial stake in such entity, such person could be construed to have *de jure* control over the target entity. Whereas, when a person is able to exercise control over the target entity irrespective of its shareholding in such entity or the ability to appoint the management of the entity such person could be construed to have *de facto* control over the entity.

It is important from a regulatory perspective to clearly prescribe the barometers and triggers for "control". Indian regulations seek to cover *de facto* control, which is what introduces ambiguity and subjectivity. This article seeks to analyse the context in which different regulations and regulators in India have defined the term "control" and seeks to make recommendations on how these different regulations can and should be read harmoniously.

SEBI AND THE TAKEOVER CODE ON CONTROL

The Securities and Exchange Board of India ("**SEBI**"), established under the SEBI Act, 1992, has played an instrumental role in regulating and developing the securities and capital markets and protecting the interests of investors (including foreign investors) who invest in the securities market.

Amongst the various rules and regulations laid down by SEBI, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "**Takeover Code**") provides the regulatory framework for the direct and/or indirect acquisition of shares or voting rights in, or control over, an Indian company listed on a stock exchange.

The term "control" has been defined under Regulation 2(1)(e) of the Takeover Code and the extract of the same has been reproduced hereunder:

"Control" includes the right to appoint majority of the directors or to control the management or policy decisions 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.

Provided that 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."

From the aforesaid definition of "control" under the Takeover Code, one understands that an acquirer, or person acting in concert with such acquirer or person, can acquire control of the target company by virtue of (i) his shareholding; or (ii) management rights; or (iii) shareholders agreements; or (iv) voting agreements; or (v) in any other manner, wherein such person is entitled to either (a) appoint majority of the directors of the target company; or (b) control the management or policy decisions of the target company. It has always been a vexed issue as to whether the granting of 'veto rights' to investors in a listed company would be construed as such investors having acquired 'control' over the relevant company. This has also been the subject matter of legal proceedings before SEBI, the Securities Appellate Tribunal and the Supreme Court.

An open offer to the public shareholders of the target company is required to be made in the following circumstances (i) acquisition of shares and/ or voting rights above the prescribed thresholds; (ii) acquisition of control, directly or indirectly, over the target company irrespective of acquisition or holding of shares or voting rights in a target company; and (iii) an indirect acquisition of shares or voting rights in, or control over the target company by way of acquiring shares or voting rights in, or control over, any company or other entity (other than the target company) that would enable the acquirer to exercise such percentage of voting rights in, or control over, the target company, the acquisition of which would otherwise attract the obligation to make an open offer.

The consequence of acquiring control, either directly or indirectly, over the target company triggers the requirement (on the part of the acquirer) to make an open offer to the public shareholders of the target company.

While the triggers for making an open offer on acquisition of shares/ voting rights are fairly clear and less vexed, the open offer with respect to acquisition of control, irrespective of the acquirer's holding in the target company, is a complex issue. Determination of control is relatively ambiguous and depends highly on the facts of the matter and intentions, perception, and objectives of the acquirer, which have to be examined on a case-to-case basis.

With respect to the above, it would be worthwhile to note the following extracts from the ruling of the SAT in the case of M/s Subhkam Ventures (I) Private Limited:

"Control, according to the definition, is a proactive and not a reactive power. It is a power by which an 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 not control. In that event, the acquirer is only reacting rather than taking the initiative. "

"In other words, 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 organization. If yes, he is in control, but not otherwise. In short, control means effective control."

THE COMPANIES ACT ON "CONTROL"

The Companies Act, 1956, (the "**1956 Act**"), which till recently was the governing law for corporate establishments in India, interestingly did not define the term "control". However, Section 4 of the 1956 Act which defined a holding company and a subsidiary, stated that the composition of a company's board of directors shall be deemed to be controlled by another company, if the holding company can exercise power at its discretion, without the consent of any other person, to appoint/remove all or a majority of the directors of the subsidiary company. The 1956 Act, therefore, while not specifically defining the term "control" established that the ability to control the composition of the board or the power to appoint or remove the majority of the board, a holding-subsidiary relationship would be deemed to exist.

However, the recently enacted Companies Act, 2013 ("**2013 Act**"), seeks to clarify the position under the 1956 Act, and under Section 2(27) of the 2013 Act, which states that control "*shall include the right to appoint majority of the directors or to control the management or policy decisions 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*". This definition appears to be almost completely aligned with the Takeover Code.

FDI POLICY ON CONTROL

The Consolidated FDI Policy ("**FDI Policy**") released by the Department of Industrial Policy and Promotion on April 17, 2014, states that a downstream investment by an Indian company owned and controlled by resident Indian citizens would be treated as a domestic investment and in other cases as a downstream/indirect foreign investment. The FDI Policy defines "control" as "*control shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements*." Again, in the FDI Policy, while the definition has been largely aligned to the definitions of "control" under the Takeover Code and the 2013 Act, the FDI Policy does not recognize the concept of persons acting in concert with the acquirer, and does not specify that the right to appoint a majority of the director or control management decisions could be exercised directly or indirectly.

The FDI Policy further provides that in any sector/activity, where Government approval is required for foreign investment and in cases where there are any *inter-se* agreements between/amongst shareholders which have an effect on the appointment of the directors or on the exercise of voting rights or of creating voting rights disproportionate to shareholding or any incidental matter thereof, such agreements will have to be considered for determining ownership and control when considering the case for approval of foreign investment. Therefore, while the definition of control under the FDI Policy may be limited, the ambit of the same is widened by encompassing *inter-se* shareholder rights within it, possibly including veto or affirmative vote rights as well.

COMPETITION ACT ON CONTROL

Section 5 of the Competition Act, 2002 ("**Competition Act**") defines the term "control" for the purposes of determining whether an acquisition or a merger would be a combination under the Competition Act. Control is defined to include controlling the affairs or management by:

(a) one or more enterprises, either jointly or singly, over another enterprise or group;
(b) one or more groups, either jointly or singly, over another group or enterprise.

Further, the Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 provide that transfer of joint to sole control would not be an exempt transaction and would require a prior clearance from the Competition Commission of India ("**CCI**"). However, in an order passed by the CCI on October 4, 2012, in response to a notice for clearance filed by Tata Capital Limited and Century Tokyo

Leasing Corporation, the CCI has held that the granting of special rights such as affirmative votes, right to appoint key managerial personnel, approval of business plans, etc., are tantamount to transfer of sole to joint control and hence, trigger the Competition Act. Here, again, we see that the ambit of "control" is far wider than the definition, encompassing *inter-se* shareholder rights within it, including veto or affirmative vote rights.

HARMONIOUS READING, SHAREHOLDER RIGHTS AND RECENT DEVELOPMENTS

As evident from the above, there is currently a lack of a brightline test on whether affirmative voting rights form part of the meaning and scope of the term "control". The recent Jet-Etihad deal, where Etihad Airways, an Abu Dhabi based airline company, proposed to acquire 24% (twenty four percent) shareholding in Jet Airways, provided an opportunity for the regulators to clarify the position on "control" and convey the intent behind each of the differences in the various regulatory definitions.

In the Jet-Etihad deal, the parties had entered into certain contractual arrangements governing the operations of the target company. However, certain clauses (such as rights in favour of Etihad where it could appoint its nominees on the board of Jet, the right to appoint a vice-chairman and members of the audit committee, a say in the appointment of officials of senior management etc.) in the proposed transaction documents were seen to be giving Etihad excessive powers, which attracted the attention of regulators. SEBI's view on the final arrangements entered into was that these arrangements did not result in the acquisition of control by the acquirer over the target company. However, the CCI while approving the combination, observed that the effect of these agreements including the governance structure envisaged established the acquirer's joint control over the target company, more particularly over the assets and operations of Jet. After the ruling of the CCI, SEBI sent a show cause notice to Etihad alleging that Etihad had acquired control over Jet and asking them to show cause as to why they should not be required to make an open offer as a result. SEBI has however, subsequently cleared these arrangements as not resulting in any requirement to make an open offer under the Takeover Regulations. These developments have further muddied the waters on this issue and it is essential that clarity in this regard is provided at the earliest.

A stable legislative and regulatory climate is a pre-requisite for inbound M&A activity in India to flourish. While the promise of a new investor-friendly government has brought certain hope, and along with it, expectations, issues that could have adverse implications on the same, such as the scope of control, still require clarity. Even though each transaction is distinct and would require to be examined subjectively, the level of subjectivity and resulting uncertainty can be reduced to a great extent by the Government setting out guidelines with respect to certain protective rights that may not be considered as acquiring control. For instance, as highlighted above, the Government could clarify, as was held by the CCI in the Century Tokyo case, that joint control over an enterprise implies control over the strategic commercial operations of an enterprise by two or more persons, as opposed to mere investor protection rights.

The Government should take the initiative to ensure that apprehensions and concerns of investors, including uncertainty over policies, are addressed. A sense of protection of investment and clarity of policy will ensure that India is projected to investors as an economy that is open to business and that has a friendly investment climate.