ANTI-ACQUIRER AND PRO-SHAREHOLDER? AN ANALYSIS OF THE SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 2011

*Karan Talwar & Nivedita Saksena**

In September 2011, the Securities and Exchange Board of India ('SEBI') notified an overhaul of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, by introducing the 2011 Regulations. The changes introduced in the new regulations are based substantially on the recommendations of a committee that it had set up to review the working of the 1997 Regulations. Three fundamental changes have been introduced by the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. First, the level of share ownership or voting rights, which triggers the application of the Takeover Regulations has been increased from 15% of the shareholding to 25%. Once this level is reached, an acquirer now has to make a minimum open offer of 26% of the shareholding of the company, which is an increase from the 20% that was stipulated previously. The third major change introduced has been the compulsory inclusion of non-compete fees (fees paid by the acquirers to promoter shareholders, so that they do not start a competing business after the takeover of their company) in the offer price per share. This paper analyses the effect of these amendments to the Takeover Code on the acquirers and shareholders of target companies. The paper seeks to provide a reasoned assessment of the effect of these amendments on the Indian capital market.

I. INTRODUCTION

The Indian regulatory landscape has witnessed dramatic changes over the past few years with significant modifications proposed to the direct and indirect tax regimes as well as several corporate and securities laws. One of these important changes has been introduced by SEBI- the overhaul of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('The Takeover Code'). The takeover of a substantial number of shares, voting rights or control in a listed Indian company attracts the provisions of the Takeover Code. The Takeover Code regulates the process of acquisition of additional

* 4th and 2nd year students respectively, the W.B. National University of Juridical Sciences, Kolkata.

shares by an acquirer, once the acquirer has ownership of a designated level of shareholding or voting rights in a listed company. The Takeover Code has been amended by the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, in operation from October 22, 2011 ('the New Regulations'), which form the primary focus of this paper. The new amendments introduced by SEBI have largely been made on the basis of the July, 2010 report submitted by the Takeover Regulations Advisory Committee, under the chairmanship of Mr. C. Achuthan ('the Committee'). The Committee was constituted by SEBI to suggest improvements in the Takeover Code. The Committee's report has been prepared taking into account a plethora of important factors having a strong bearing on the performance of the Indian capital markets, which have witnessed changes since the Takeover Code was enacted in 1997. These include the rapidly increasing level of merger and acquisition activity,[1] the increasing sophistication of the takeovers market, SEBI's decade-long regulatory experience of capital markets, and various judicial pronouncements pertaining to the Takeover Code.[2] 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.[3]

The New Regulations have made, *inter alia*, three fundamental modifications to the Takeover Code, which experts believe will substantially affect merger and acquisition activity in the Indian market.[4] The *first* change has been to increase the initial open offer threshold, which triggers the application of the Takeover Regulations, from 15% to 25% of the shareholding or voting rights in a company.[5] The *second* change has been to prohibit the payment of separate non-compete fees to the controlling promoters in the acquired company.[6] The *third* change has been to increase the minimum offer size provided by the acquirer to public shareholders of the target company[7] from 20% to 26%.[8] While most of the Committee's recommendations have been approved by SEBI in their entirety, a few have been modified to accommodate the views

---

1 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. *See* SEBI, Report of the Takeover Regulation Advisory Committee (2010) available at http://www.sebi.gov.in/commreport/tracreport.pdf (Last visited on December 29, 2011) ('TRAC Report').

2 *Id.,* ¶5.

3 TRAC Report, *supra* note 1. ¶¶1.12 and 5.3.

4 *See* Shardul Shroff, *Major Recast of Takeover Code*, July 20, 2012, available at http://www.livemint.com/2010/07/19224733/Major-recast-of-takeover-code.html (Last visited on January 25, 2012).

5 SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('New Regulations'), Regulation 3(1).

6 New Regulations, Regulation 7(1).

7 The company sought to be acquired by the acquirer.

8 New Regulations, Regulation 8(7).

of Indian chambers of commerce, such as FICCI, ASSOCHAM and CII and of industry experts and professionals on the Committee's report. Two notable proposals of the Committee which were rejected were the proposal of 100% minimum offer size and the proposal of automatic delisting of shares on a particular level of shareholding being reached by the acquirer.

This paper confines its scope to the three fundamental recommendations made by the Committee and accepted by SEBI. We seek to evaluate the changes introduced on the parameters of improvement in efficiency in takeover activity in the Indian market and deference to market realities. The objective behind this study is to analyse the possible implications of the New Regulations on the Indian capital markets.

II. ABOLITION OF SEPARATE NON-COMPETE FEES FOR PROMOTERS

A non-compete fee is a fee that is paid by the acquirers to the promoter(s) of the target company so that they do not re-enter the same business and pose a threat to the acquired company.[9] Under the Takeover Code, acquirers were permitted to make such payments to the selling promoters, if they so desired[10] and if SEBI was convinced of the competing ability of the selling promoters to start a similar business.[11] The Takeover Code, however, prescribed certain stipulations governing the payment of such fees. It was prescribed that such non-compete fees would not be included in the offer price made to the public shareholders,[12] provided that they fell within a specified ceiling limit. As per §20(8) of the Takeover Code, non-compete payments would not be factored into the offer price, only if they did not amount to more than 25% of the calculated offer price. Thus, any non-compete payment totalling more than 25% of the calculated offer price would be added to the offer price per share, *i.e.*, 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. For example, if the offer price was calculated at Rs. 70 per share, and Rs. 10 was agreed as the non-compete fee per share, ordinary shareholders would receive Rs. 70 per share, as opposed to Rs. 80 per share paid to the promoters.

---

9 K. Venkatasubramanian, *Non-Compete Fees*, August 22, 2012, available at http://www.thehindubusinessline.in/iw/2010/08/22/stories/2010082251021200.htm (Last visited on January 25, 2012).

10 SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ('Takeover Code'), Regulation 20(8).

11 *See* E-Land Fashion China Holdings Limited v. Securities and Exchange Board of India, Appeal No. 27 of 2011, before the Securities Appellate Tribunal, Mumbai.

12 Takeover Code, Regulation 20(8).

A. *COMMITTEE'S RECOMMENDATIONS REGARDING THE PAYMENT OF SEPARATE NON-COMPETE FEES*

The Committee opined that such a position of inequality between the public shareholders and the selling promoters was not desirable and recommended the abolition of separate non-compete fees for promoters. The Committee negated the primary argument proffered in favour of retaining separate non-compete fees- that the non-compete terms constituted a distinct benefit which the selling shareholder conferred to the acquirer, which needed to be separately compensated for being distinct from the price for the shares paid to all shareholders.[13] The Achutan Committee's line of reasoning was that non-compete fees 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.[14] The Committee's decision was strengthened by its views on payment of premium for control over the company. It concluded that control was merely an incident 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. The eventual conclusion was further assisted by the inclusion of non-compete fees and other collateral fees in the calculated offer price in various other jurisdictions and the market realities of the payment of large, disguised fees to promoters in the form of control premium witnessed in India.[15] The Committee's recommendation that apart from the share acquisition agreement, consideration in any form inclusive of all ancillary and collateral agreements, would form part of the negotiated price, has been accepted by SEBI in its entirety.[16] This is unsurprising as one of SEBI's primary mandates is to ensure equality of opportunities between shareholders.[17]

It is important to clarify at this juncture that SEBI has not expressly prohibited the payment of non-compete fees. It is incorrect to say that non-compete fees have been 'abolished' by SEBI. All that the new regulations provide is that any direct or indirect non-compete fees or 'control premium', which is paid to the controlling shareholders is to be added to or made part of the public offer price. Thus, there would be no difference in the price per share paid to the controlling shareholders and to the ordinary shareholders in furtherance of the spirit of equal treatment of all shareholders.

---

13 TRAC Report, *supra* note 1, ¶4.9.2.

14 *Id.*, ¶4.9.3.

15 *Id.*, ¶ ¶4.9.3 and 4.9.4.

16 *Id.*,¶ 4.9.5.

17 *See* SEBI, Report of the Internal Group on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, available at http://www.sebi.gov.in/commreport/internal.html (Last visited on January 25, 2012).

B. *OUTCOME OF FACTORING IN OF NON-COMPETE FEES IN THE OPEN OFFER PRICE.*

It is evident that since non-compete fees are to be included in the calculated offer price, promoters must ensure that the negotiated price arrived at is a fair reflection of their expectations. It is a possibility that the negotiated price will now be higher under the new code as promoters will try and procure the best value possible, inclusive of the amount they would probably have charged for restraining themselves from starting a competing business. The cost of acquisitions may thus be higher under the New Regulations.

SEBI could counter criticism directed towards the New Regulations as being anti-promoter, using the argument that a mere additional burden being imposed on promoters, for a far greater good. We, however, believe that such an answer still leaves some issues unresolved. *First*, experts have argued that the complete negation of separate non-compete fees for promoters is a drastic policy decision, which should have been implemented in a phased manner.[18] The primary cause of friction on this count is the fact that SEBI has completely backtracked on its previous policy of allowing promoters separate control premium under the previous Takeover Code. It is pertinent to note that under decided cases before the SAT, the legitimacy of separate control premium had been authoritatively affirmed by the market regulator, albeit on its satisfaction that the payments were genuine.[19]

Second, it can be argued that SEBI, in its over-eagerness to ensure parity between shareholders, has indulged in over-classification by seeking to treat a set of unequals equally. Although promoters and shareholders have certain fundamental similarities, an important point of distinction that exists between them is the fact that the former class has the capacity and know-how to start a competing business to the detriment of the target company, which the latter class does not.[20] On this count, 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. It has been suggested that SEBI could have considered a via-media solution whereby a system of checks and balances could have ensured that only genuine non-compete transactions were permitted, and abuse of the process could have been avoided.[21]

---

18 Bar & Bench News Network, *SEBI Proposes New Takeover Rules; Uniform KYC Norms; Simplifies IPO Forms,* August 1, 2011, available at http://barandbench.com/brief/2/1634/sebi-proposes-new-takeover-rules-uniform-kyc-norms-simplifies-ipo-forms-conversation-with-reeba-chacko (Last visited on January 22, 2012).

19 Tata Tea Ltd. v. Securities and Exchange Board of India, [2010] 103 SCL 140, ¶6.

20 Shroff, *supra* note 4.

21 Bar & Bench News Network, *supra* note 18.

The reaction of the industry associations to the inclusion of non-compete fees in the calculated offer price has been unanimous. CII, FICCI and ASSOCHAM have all demanded that the concept of separate non-compete fees for controlling shareholders be retained.[22] SEBI has, however, remained firm in its decision of negating separate non-compete fees.

III. RAISING OF THE MINIMUM PUBLIC OFFER LEVEL UNDER THE CODE FROM 20% TO 26%

Prior to the 2011 amendments, the Takeover Code mandated that every acquirer which had increased its ownership to 15% shares or voting rights of the target company necessarily had to make a minimum public offer bid of 20% of the remaining shareholding of the target company.[23] The Committee in its review of the Takeover Code felt a need to make an upward revision of the minimum public offer bid value from the existing 20%. The reason behind this was the Committee's belief that the public offer model followed was not the most efficient in terms of providing all shareholders an equal opportunity to exit in case of a change of ownership.

A. ISSUE OF THE INEQUITABLE NATURE OF THE MINIMUM PUBLIC OFFER REQUIREMENT OF 20%

The Committee was of the opinion that the minimum open offer requirement of 20% gave rise to inequity,[24] as substantial shareholders[25] received superior treatment compared to the public shareholders. It felt that the substantial shareholders and promoters had a stronger opportunity to exit in the event of a takeover. This can be explained as follows. There are three eventualities that can occur when an open offer bid is made- (1) the number of shares demanded is exactly equal to the number offered; (2) the number of shares demanded is higher than the actual number of valid shares offered; and (3) the number of shares demanded is lower than the number of valid shares actually offered for sale. In the first case, there will be a complete exit of those shareholders who desire to exit from the company. In the next case where the

[22] Business Line Bureau, *Takeover Code Changes: India Inc Wants 'Non-Compete Fee' To Stay,* April 21, 2011, available at http://www.thehindubusinessline.com/industry-and-economy/economy/article1715714.ece (Last visited on December 14, 2011).

[23] Regulation 21(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (prior to 2011 amendment): The public offer made by the acquirer to the shareholders of the target company shall be for a minimum twenty per cent of the voting capital of the company.

[24] TRAC Report, *supra* note 1, ¶1.3.

[25] A single shareholder who controls more than half of a corporation's outstanding shares, or sometimes, one of a small group of shareholders who collectively control more than half of a corporation's outstanding shares.

number of validly tendered shares is less than the offer size, but *above* the stipulated minimum, *all* validly tendered shares will have to be accepted by the acquirer. There will be no disparity of opportunity to exit between shareholders in this scenario. An inequity can, however, be observed in the contingency of over-subscription of shares. In case shares offered under the open offer are more than the shares demanded, there is an obligation on acquirers to proportionally allot shares.[26] The inefficiency in the allotment process can be seen as public shareholders can only make a *partial* exit as the response to the open offer is higher than the size of the open offer. In case of an over-acceptance, as the Committee has observed, the shares tendered in response to the open offer have to be accepted on a proportionate basis. This proportional acceptance would lead to the public shareholder being saddled with shares in companies whose share prices would fall sharply after the takeover bid.[27] Consequently, each public shareholder would only be able to sell a part of their shareholding, with the balance being returned to them after the open offer was completed. Promoters with large stakes, on the other hand, would be in a position to have a large proportion of their shares sold to the acquirer, reducing their burden of ownership of shares in the target company substantially.

It is evident that in the situation abovementioned, public shareholders would be unable to realise the full premium, if any, on their entire shareholding. This, the Committee believed, was an eventuality that should be avoided. It led the Committee to recommend a minimum open offer of the *entire* remaining shareholding of the target company, once the threshold level of shareholding or voting rights of 25% was breached.

B. COMMITTEE'S RECOMMENDATION OF A 100% OPEN OFFER

The Committee 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.[28] Thus, it opined that all public shareholders should be permitted to obtain a

[26] Takeover Code, Regulation 21(6): Minimum Number Of Shares To Be Acquired - Where the number of shares offered for sale by the shareholders are more than the shares agreed to be acquired by the person making the offer, such person shall accept the offers received from the shareholders on a proportional basis, in consultation with the merchant banker, taking care to ensure that the basis of acceptance is decided in a fair and equitable manner and does not result in non-marketable lots: Provided that acquisition of shares from a shareholder shall not be less than the minimum marketable lot or the entire holding if it is less than the marketable lot.

[27] We believe that a reduction in share price after a takeover bid is merely *one* of the possible eventualities seen. Research exists to suggest that there is in fact a general trend in appreciation of share prices when a takeover bid is made, provided it is not a hostile bid. *See* Jeff Grabmeier, *Study Shows How Takeover Bids Change Stock Prices of Firms*, November 16, 2004, available at http://researchnews.osu.edu/archive/specsprd.htm (Last visited on February 16, 2012).

[28] TRAC Report, *supra* note 1, ¶1.6.

complete exit whenever an open offer was made. This led to its recommendation that when an acquirer reaches the trigger point of ownership of 20% of a company's shares, the acquirer has to make a mandatory open offer for the *entire shareholding*, *i.e.*, 100% of the voting capital of the company.[29]

Apart from providing all shareholders with equal exit opportunities, there was an additional reason behind the Committee's recommendation for a mandatory open offer of the entire shareholding of the company. The Committee felt that it was prudent for the Indian capital market regulations to be in line with other international secondary market norms, and to mirror the international practices followed.[30] Reference can be made, *inter alia*, to the UK City Code on Takeovers[31] and the Singapore Code on Takeovers and Mergers,[32] which provide for mandatory 100% offers on acquisition.

C. REASONS BEHIND SEBI'S REJECTION OF THE COMMITTEE'S RECOMMENDATION

The suggestions of the Committee on this count were met with stiff criticism. It was widely felt that such an onerous open offer requirement could adversely affect the takeover market,[33] for reasons explained below.

The primary reason behind the belief that the takeover market would be adversely affected by this recommendation was the fact that

---

29 *Id.*, ¶1.14.

30 *Id.*, ¶1.4.

31 City Code of Takeovers, Rule 14.1:Where a company has more than one class of equity share capital, a comparable offer must be made for each class whether such capital carries voting rights or not; the Panel should be consulted in advance. An offer for non-voting equity share capital should not be made conditional on any particular level of acceptances in respect of that class, or on the approval of that class, unless the offer for the voting equity share capital is also conditional on the success of the offer for the non-voting equity share capital.

32 Singapore Code on Takeovers and Mergers, Rule 14.1: Except with the Council's consent, where:-

(a) any person acquires whether by a series of transactions over a period of time or not, shares which (taken together with shares held or acquired by persons acting in concert with him) carry 30% or more of the voting rights of a company; or

(b) any person who, together with persons acting in concert with him, holds not less than 30% but not more than 50% of the voting rights and such person, or any person acting in concert with him, acquires in any period of 6 months additional shares carrying more than 1% of the voting rights, such person must extend offers immediately, on the basis set out in this Rule, to the holders of any class of share capital of the company which carries votes and in which such person, or persons acting in concert with him, hold shares. In addition to such person, each of the principal members of the group of persons acting in concert with him may, according to the circumstances of the case, have the obligation to extend an offer.

33 The Hindu Business Line, *SEBI's Takeover Code Raises Open Offer Trigger To 25%*, July 28, 2011, available at http://www.thehindubusinessline.com/markets/stock-markets/article2302790.ece (Last visited on December 14, 2011).

acquisition financing is not permitted by Indian banks. A 1983 circular[34] 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." Further, qualifications made by the Department of Supervision's (DoS) inspectors also argue against takeover funding.[35] 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,[36] or through equity issuance, all of which are very arduous processes. It is evident that the lack of acquisition financing would make it extremely difficult for domestic players to generate the funds necessary to make a bid for the complete shareholding of the target company, which in turn would affect acquisition activity by domestic players.

An additional dimension to the problem was the knowledge that such a move had the potential to benefit foreign companies over Indian companies. Foreign companies do not have the same acquisition financing constraints as Indian companies. With easy bank financing at their disposal, it was a plausible eventuality that the 100% open offer requirement, if implemented, would lead to increased foreign takeovers in the Indian market.

Further, this move was also questioned on the grounds that it is a myth that *all* international norms require a 100% open offer.[37] Such a requirement only exists in the UK and Singapore. In fact, no country in the EU requires such a standard in the open offer.[38]

It is for these reasons that SEBI rejected the Committee's recommendation for a mandatory offer of the entire shareholding of the company, under the New Regulations.

D. SEBI'S MIDDLE GROUND ALTERNATIVE OF A MINIMUM OPEN OFFER OF 26%

For the abovementioned reasons, SEBI was not prepared to accept the dynamic recommendations made by the Committee. Instead, it chose the middle-path and decided to peg the minimum offer size at the level of 26%.

[34] Reserve Bank of India, DBOD Circular (FOL.BC 100/c.249-83) dated December 13, 1983.

[35] Indian Express, *Banks in Dark over Takeover Funding*, April 23, 1998, available at http://www.indianexpress.com/Storyold/29019 (Last visited on December 14, 2011).

[36] Shroff, *supra* note 4.

[37] Outlook Business, *Same Game, New Rules*, August 20, 2011, available at http://business.outlookindia.com/article.aspx?277960 (Last visited on December 14, 2011).

[38] *Id.*

There are divergent views about SEBI's rationale behind the selection of the threshold level of 26% as opposed to any level in the range between 20% and 99%. One school of thought argues that the primary reason behind this selection is the controlling stake conferred on the acquirer as an outcome of every takeover under the new code. Under the New Regulations, with the open offer trigger at 25%, and the subsequent mandatory open offer requirement at 26%, an acquirer would now acquire a minimum 51% stake as compared to 35% (15% initial threshold plus 20% open offer) under the previous Takeover Code.[39] Thus, acquirers can now gain substantial control of the company sought to be taken over, instead of mere *de-facto* control of the target company, without putting in additional capital (as was proposed with the 100% open offer earlier).[40] This helps bring stability by achieving a definite controlling stake. It is believed that this measure will also increase private equity investments coming in by way of growth capital in a number of companies.[41] Lastly, fixing the offer size at 26% would make the open offer process an affordable one for strategic acquirers and also create a level playing field between Indian acquirers and their foreign counterparts. Thus, it has been predicted that there may be an overall increase in mergers and acquisitions in the market.[42]

Another school of thought believes that the abovementioned argument cannot provide the rationale behind SEBI's move, for even under the previous code, acquirers would have to make an offer of a *minimum* of 20%, on reaching the threshold level of 15% shareholding. There was nothing preventing the acquirers from making an open offer for more shares, thereby acquiring *de facto* control. A more plausible explanation, this school of thought believes, is that SEBI chose the figure of 26% arbitrarily without any scientific or empirical analysis.[43] The additional 6% grant was made by SEBI with the intent that a larger fraction of shareholders get an opportunity to exit the firm with a change in management.

---

[39] *See* Rajiv Bhuva, *Decoding SEBI's New Takeover Code*, July 28, 2011, available at http://businesstoday.intoday.in/story/sebi-new-takeover-code/1/17416.html (Last visited on January 14, 2012).

[40] Amrish Shah, *Takeover Code Maintains an Even Keel,* August 5, 2011, available at http://www.moneycontrol.com/news/features/takeover-code-maintains-an-even-keel_573519.html (Last visited on October 14, 2011).

[41] Saumil Shah & Amit Jain, *Please All Takeover Code*, August 5, 2011, available at http://www.thehindubusinessline.com/features/mentor/article2523595.ece?ref=wl_features (Last visited on October 14, 2011).

[42] Rediff Business, *India Inc welcomes new Takeover Code*, July 29, 2011, available at http://www.rediff.com/business/slide-show/slide-show-1-india-inc-welcomes-new-takeover-code/20110729.htm (Last visited on October 14, 2011).

[43] *Rules of the M&A Game - Acquirer Point of View (1)*, (CNBC-TV18, November 8, 2012), available at http://thefirm.moneycontrol.com/video_page.php?autono=612916&video_flag=1 (Last visited April 4, 2012).

IV. RAISING OF THE TAKEOVER TRIGGER LIMIT FROM 15% TO 25%

The previous code directed that the takeover regulations would mandatorily be applicable when an acquirer reached an ownership level of 15% of the shareholding of a company.[44] This threshold level of 15% came under the scrutiny of the Committee. The Committee observed that the trigger point of 15% was fixed in an environment where the shareholding pattern in corporate India was such that it was possible to control listed companies with holdings as low as 15%.[45] Thus, the threshold was considered to be a substantial voting power.[46] There had, however, been a revision in the general shareholding levels in a company, with recent trends showing a tangible change in shareholder patterns in listed companies. The share of promoters in listed companies is now observed to be much higher. As per the Committee's research, the mean and median of promoter shareholdings in listed companies were found to be 49.5% and 50.5% respectively of the total equity capital of the company.[47] Furthermore, less than 8.4% of listed companies had promoter shareholding of less than 15%.[48]

With the recognition of these changes, a need for an upward revision of the trigger point for open offers was felt, which would serve two primary purposes. *First*, it would give potential acquirers more leeway to acquire a stake in a company without attracting takeover regulations and *second*, it would ensure that promoters still retained control over the company through ownership of a majority share capital of the company.

An effort was also made to bring Indian regulations in line with international best practices. While the open-offer trigger point in the UK is 30%, it varies between 30% and 35% in other jurisdictions such as Singapore, Hong Kong, the EU and South Africa.[49] These trigger points have been set at levels where it was felt that an acquirer company could exercise *de facto* control over a target company. This means that in a general meeting of shareholders the acquirer is likely to get a majority of the votes cast in its favour. Moreover, a shareholder acquires the veto right to block a special resolution above the 25% limit under the Companies Act, 1956.[50] A special resolution is to be passed by a majority of at least one-fourth shareholders in a general meeting. Such a resolution is required for several important corporate actions including alteration of

[44] Takeover Code, Regulation 10.
[45] TRAC Report, *supra* note 1, ¶ 2.2.
[46] *Id.*
[47] *Id.*, ¶ 2.3. *See also* Annexure II of the report.
[48] *Id.*, *supra* note 1, ¶ 2.5.
[49] *Id.*
[50] The Financial Express, *New Takeover Guidelines Hike Open Offer Trigger To 25%*, September 24, 2011 available at http://www.financialexpress.com/news/New-takeover-guidelines-hike-open-offer-trigger-to-25-/850989/ (Last visited on February 16, 2012).

the provisions of the memorandum, change in objects and name of the company, reduction of share capital, etc. Thus, in view of such *de facto* control at the level of a 25% share in the company, the Committee recommended a raise in the open offer trigger point from 15% to 25%.

It is interesting to note at this juncture that the revised trigger limit of 25% dates back to the 1980s when the trigger for an open offer was at 25% as per the listing agreement. Later, it was pared down to 10% and then to the current 15%.[51]

A. EFFECTS OF THE REVISION OF THE TAKEOVER TRIGGER LIMIT

The move to raise the threshold limit that triggers the applicability of the Takeover Code, from 15% to 25% has met with general acceptance among experts and practitioners alike. 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 investments in Indian companies, and companies will find it easier to raise capital without triggering open offer requirements.[52] Promoters will now be less averse to having large financial investors as such investors will now be entitled to hold a larger proportion of shares, without triggering public offer requirements under the New Regulations.[53] This will provide great impetus to that category of investors who wish to make investments, but are not interested in takeovers.[54]

The effect of these changes is readily noticeable. For example, the insurer and hospital firm Max India, in which private equity firm Warburg Pincus holds 14.7%, and supply chain manager Redington India, where more than 10% is held by Standard Chartered Private Equity, have already seen an increase in their private investor stakes.[55]

---

[51] Reena Zachariah, *SEBI's Proposed Changes In Takeover Rules To Alter India's M&A Scene*, August 10, 2011, available at http://articles.economictimes.indiatimes.com/2011-08-10/news/29872000_1_offer-size-open-offer-acquirer (Last visited on October 1, 2011).

[52] Business Line Bureau, *SEBI's Takeover Code Raises Open Offer Trigger To 25%,* July 28, 2011, available at http://www.thehindubusinessline.com/markets/stock-markets/article2302790.ece (Last visited on October 14, 2011).

[53] Bar & Bench News Network, *supra* note 18.

[54] Business Standard, *SEBI's New Takeover Rules Come Into Force*, available at http://www.business-standard.com/india/news/sebi%5Cs-new-takeover-rules-come-into-force/149558/on (Last visited on October 14, 2011).

[55] IBNLive, *SEBI Raises Threshold For Mandatory Takeover Offer,* July 29, 2011, available at http://ibnlive.in.com/news/sebi-changes-takeover-code-trigger-at-25-pc/171151-7.html (Last visited on January 7, 2012).

B. FEAR OF HOSTILE TAKEOVERS.

There has been one singular exception to overarching positive acceptance of the revised trigger limit. 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. Most listed companies on an average have promoter shareholding to the tune of 51%, as stated by Mr. U.K. Sinha, Chairman of SEBI,[56] and these companies are outside the realm of hostile takeovers. The Committee's report, however, reveals that out of 4,054 companies, promoter stakes in 584 companies are below 25%,[57] of these, promoter stakes in 340 companies are below 15%.[58] It is thus possible now for private investors to discreetly acquire 25% of a company's shareholding through multiple secondary market transactions, and then make a minimum offer bid of 26% 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 shares trading at low values.

V. CONCLUSION

The underlying vein of all changes recommended by the Committee, which SEBI has eventually accepted, is that of promotion of the welfare of public shareholders. The major change that the New Regulations have brought about is that there now exits parity in the benefits accruing on exit from a company to the controlling shareholders and the ordinary shareholders. This has been brought about through the abolition of non-compete fees, and to some extent by the raising of the minimum public offer level to 26%. We believe that these are welcome changes, which shift the balance of convenience away from the acquirers in whose favour they were heavily tilted under the previous code.

On the whole, there are two major advantages that have been brought about by the New Regulations. *First*, SEBI has opened the gates for greater investments through a higher trigger threshold, which has the potential to positively affect our sluggish capital markets. *Second*, the process of acquisitions has now become more meaningful and refined, with the Takeover Regulations now being used by only those acquirers who wish to control management of the company, as opposed to merely enjoying a high level of shareholding and substantial voting power. We believe that the New Regulations will

---

56 P. Vaidyanathan Iyer & George Mathew, *New Takeover Code: India Inc May Have To Live With Hostile Bids Now,* July 30, 2011, available at http://www.indianexpress.com/news/new-takeover-code-india-inc-may-have-to-liv/824605/ (Last visited on January 25, 2012).

57 *Id*.

58 *See* TRAC Report, Annexure II.

incentivize merger and acquisition activity in the country, with the additional benefit of equal treatment of public and controlling shareholders.

For the above reasons, we believe that the aggregate effect of the New Regulations on the Indian capital market will be a positive one, for the reasons abovementioned. We also believe that there are some inconsistencies in SEBI's handling of the issue of separate non-compete fees. There are three primary reasons why there might be a need for SEBI to reconsider its stance on non-compete fees. *First*, there is a strong possibility of an increase in the cost of takeovers, as non-compete fees which were previously only paid to promoters will now accrue to all shareholders. With promoters wanting reasonable consideration for their agreement not to compete with the target company, there will be an upward revision of the price at which shares are tendered. The *second* reason makes a more fundamental attack at SEBI's approach to confer maximum benefits to shareholders at the expense of acquirers. The critique lies in the fact that SEBI has sought to confer upon shareholders a benefit that they do not deserve. The fact remains that it is only the promoters who are capable of harming the prospects of a target company, and to distribute their non-compete fees among ordinary shareholders would seem unfair on the promoters. *Third,* SEBI's handling of the issue of non-compete fees is questionable, as it has completely turned around its stance from accepting non-compete payments to an outright rejection of the same. We advocate that a phased removal of such separate fees would have ensured a smoother transition.

In totality, we believe that the New Regulations have introduced important benefits for shareholders, thereby shifting the balance away from the acquirers to a certain extent.