CPI's Asia Column Presents:

Open Market Purchases – India Plans to Dilute Standstill Obligation

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Introduction

Consider that a company (say, **A**) is proposing to acquire 49 percent equity shares of another company (say, **B**), a public listed company in India. The transaction is structured to involve: (i) a block deal on the stock exchange where B's shares are publicly traded; (ii) a share purchase from exiting shareholders of B; and (iii) a fresh capital infusion in B through share subscription. Negotiations between A and B are on-going, and the relevant resolutions have already been passed. Before the definitive agreements are executed, A discovers that B's stock price is quite attractive and decides to instantly purchase 6 percent equity shares in B on the stock market. The following day, the definitive documents are executed for acquisition of the remaining 43 percent equity shares and a merger notice is filed with the Indian antitrust watchdog, the Competition Commission of India ("CCI") for its approval.

Looks like a routine M&A deal without any concerns, right?

Until recently, the CCI would have taken a very different stance on this deal (especially, the implementation of the block deal prior to its approval) but that will not be the case going forward. Through this article, we deep dive and trace the history and evolution of this legislative transformation.

The Current Merger Control Regime

The Indian merger control regime is a mandatory and suspensory one. Mergers and acquisitions which breach certain prescribed thresholds ("Threshold Tests")[2] require a prior clearance from the CCI before they can be consummated.[3] Section 5 of the Act provides a catch-all approach. Unlike other jurisdictions, "change in control" is not a pre-requisite to trigger a notification requirement. Thus, irrespective of the number of shares acquired, if the Threshold Tests are breached and no exemption or safe harbour is available, the transaction warrants the CCI's prior clearance.

It is also relevant to note that while acquisitions of non-controlling minority interest of less than 25 percent are exempted from notification requirement,[4] the exemption is lifted if the acquisition is of a competitor's shares or if the deal is a strategic one.[5]

The strictly suspensory nature of the regime requires the transacting parties to not implement any leg of the transaction until the CCI has approved the entire transaction.[6] Contravention of the standstill obligation in any manner raises gun jumping risks and attracts penalties under the Act.[7] The CCI's decisional practice shows that it has and continues to impose significant penalties for gun jumping.[8] Furthermore, the CCI can also call back transactions for review within one year of their closing/completion if, the transaction was notifiable but was not notified.[9]

Challenges Faced in Open Market Purchases

The hallmark of purchase of shares pursuant to a public bid or through an open market acquisition of shares listed on a stock exchange (hereinafter, "Market Acquisitions") is, instantaneous execution and completion of purchase and sale orders. When a bulk or block of shares becomes available on a stock exchange's platform, the seller and the buyer must act quickly to complete the purchase since the market price of shares is highly susceptible to fluctuations which can impact the agreed value of consideration.

The extant regime has no provision which provides an exemption from the standstill obligation for Market Acquisitions. As a consequence, when Market Acquisitions breach the Threshold Tests and require the CCI's prior clearance, the parties are faced with a serious conundrum – they can either complete the transaction without the CCI's prior approval and risk facing gun jumping penalty, or they can wait for the CCI's approval and risk losing the viability of the agreed price or value of the transaction.

This is because the CCI has 30 working days (subject to certain exclusions[10]) to assess if a transaction raises any competition risks and the outer limit of the CCI's review period is 210 days (subject to certain exclusions).[11] However, the extremely short trade settlement period for Market Acquisitions makes it nearly impractical to receive the CCI approval on time.

This conundrum is faced in almost every notifiable M&A deal which has a Market Acquisition leg and even in hostile bids takeovers where, time is of the essence and the window of opportunity to complete the transaction is small. More so, even if the parties decide to notify a Market Acquisition to the CCI, the mere public disclosure of the notification[12] can have serious implications on the agreed value of consideration since the public disclosure may spike the stock price of the target entity's shares.

In the past, the CCI has taken a stern view on Market Acquisitions which were implemented prior to its approval. A few key cases are discussed below.

CCI's Stand on Market Acquisitions

In the combination of *SCM Soilfert Limited* ("SCM Soilfert")*/Mangalore Fertilizers and Chemicals Limited* ("MFCL"),[13] SCM Soilfert had filed a notice with the CCI for acquisition of up to 26 percent equity shares in MFCL, a public listed company. The transaction was structured in two steps: (i) acquisition of MCFL's 0.8 percent equity shares through Market Acquisition ("Secondary Acquisition"); and (ii) acquisition of up to 26 percent equity shares through an open offer under the relevant provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares & Takeovers) Regulations, 2011 ("Takeover Regulations").

The CCI noted that prior to filing the notice, SCM Soilfert (and its parent company) had already consummated the Secondary Acquisition by crediting the 0.8 percent equity shares in a designated escrow account which was to be maintained until the CCI's approval. The CCI held that since the Secondary Acquisition was part of the notifiable combination, SCM Soilfert had jumped the gun by implementing it prior to the CCI's approval. The fact that the escrow agreement specifically restricted SCM Soilfert from exercising its accrued legal and beneficial rights till the time the CCI had approved the transaction was nothing but a self-imposed contractual obligation by SCM Soilfert.

The CCI held that the Act and the relevant regulations did not allow any derogation from the standstill obligation and therefore, did not exempt situations where the buyer had acquired shares but had decided to not exercise its legal/beneficial rights. A penalty of INR 2 crores (approx. USD 0.27 million) was imposed on SCM Soilfert for contravening the standstill obligation which was upheld by the Supreme Court of India ("Supreme Court").[14]

A similar view was also taken in the combination of *Thomas Cook (India) Limited* ("TCIL") and *Sterling Holiday Resorts (India) Limited* ("SHRIL"), where notice was filed with the CCI in respect of a composite scheme of arrangement and amalgamation between TCIL and SHRIL ("Scheme").[15] Through the notice, the parties had also notified certain additional acquisitions which were exempted from notification requirement including, Market Acquisition of SHRIL's publicly listed shares by Thomas Cook Insurance Services (India) Limited. The Market Acquisition was already consummated prior to filing the notice.

The CCI held that the Scheme, the additional exempted acquisitions including the Market Acquisition formed part of one single composite combination, and the Act required the transacting parties to stand still and not implement any steps of the transaction (even the exempted ones) until the CCI had approved the entire transaction. Accordingly, a penalty of INR 1 crore (approx. USD 0.13 million) was imposed on the parties for consummating the Market Acquisition prior to the CCI's approval and the same was ultimately upheld by the Supreme Court.[16]

Considering the CCI's stern position and to pre-empt any gun jumping risks, in the recent combination of *HULST B.V.* ("HULST")/ *NIIT Technologies Limited* ("NIIT"),[17] HULST had to notify all the steps of its proposed acquisition of 71 percent equity shares in NIIT to the CCI, including the Market Acquisition of 15 percent.

Resolving the Conundrum

The blanket restriction imposed on implementation of Market Acquisitions prior to the CCI's approval has raised several commercial and practical challenges for investors and practitioners, deal structuring being one of them. It has also had a bearing on India's larger policy goal of improving the ease of doing business in India.

While the challenges have been apparent, it is only recently that the CCI and the Government of India have taken cognizance of the issue and have proposed concrete steps to resolve it.

The Competition Law Review Committee ("CLRC")[18] was the first to recommend a solution. In its report published in August 2019, the CLRC recommended that the extant standstill obligation could be diluted to facilitate Market Acquisitions lest it should hamper their viability. The CLRC noted that similar dispensations were already in place in other jurisdictions. For example, Article 7(2) of the European Union Merger Regulation ("EUMR")[19] provides an exception to the standstill obligation by allowing implementation of Market Acquisitions, provided: (i) the transaction is notified to the European Commission ("EC") without delay; and (ii) the acquirer does not exercise voting rights attached to the relevant securities or does so only to maintain the full value of its investments based on a derogation granted by the EC under Article 7(3) of EUMR.

Similarly, Articles 107 and 108[20] of Brazil's Internal Regulation of the Administrative Council for Economic Défense - 2017 ("CADE") provide that execution of Market Acquisitions are not subject to CADE's prior approval provided they are notified to it and the acquirer does not exercise any voting rights attached to the acquired shares until CADE's final approval.

Additionally, the acquirer may also request CADE for a derogation from exercising the voting rights attached to the acquired shares, if the same is strictly necessary to protect the investment value.

Therefore, in line with international best practices, the CLRC recommended that the parties could implement Market Acquisitions prior to the CCI's approval provided they surrendered all beneficial interest attached with such securities (including of voting rights and dividend) in a separate escrow account, until the CCI had approved the transaction.[21] Further, it also recommended that the CCI could be empowered to allow derogation from standstill obligation in exceptional cases (i.e., allowing the parties to implement parts of a transaction pending clearance or expiry of the review period). This could also include the power to impose modifications and conditions on the derogation.[22]

The CLRC noted that the CCI could sparingly exercise such power in exceptional cases to preserve the feasibility of certain transactions during the review period. The CCI could allow such derogation after considering the effect of standstill obligation on the parties, the gravity of damage caused to parties, nature of the market, transaction's effect on competition, etc.[23]

Diluting the Standstill Obligation - Proposed Amendments

Following suit, in late November 2019, the CCI proposed amendments to Combination Regulations[24] to allow implementation of Market Acquisitions prior to the CCI's approval provided certain conditions were satisfied ("Draft CR Amendments"). These conditions included: (i) notifying the transaction to the CCI without delay; and (ii) acquirer to refrain from exercising any right attached to the shares and / or influence the target company, in any manner.[25]

Although the public consultation on Draft CR Amendments was completed, before these amendments could be brought into effect; the CCI released the Draft Competition Act (Amendment) Bill, 2020 ("Draft Bill") in early February 2020.[26] The Draft Bill proposes substantive changes in the Act in line with the recommendations of the CLRC. With respect to Market Acquisitions, the CCI has now proposed an amendment in the Act itself. The proposed new provision exempts implementation of both: (i) open market purchase of shares/convertible securities on a regulated stock exchange in India; and (ii) open offers under the Takeover Regulations, from both prior notification requirements and gun jumping proceedings, provided certain conditions are met.[27]

These conditions include: (i) giving notice of the acquisition to the CCI within the time and in the manner specified by the CCI; (ii) maintaining the shares/convertible securities in the manner specified; and (iii) not exercising any ownership or beneficial rights or interest in such shares/convertible securities including voting rights and receipt of dividends or any other distributions, till the CCI has approved the transaction.

The above amendment aims to achieve a middle ground by allowing investors to carry out Market Acquisitions at the choicest share price, without compromising the CCI's power to holistically review the entire transaction. The conditions imposed on the acquirer seek to ensure that until the CCI has finally approved the transaction, the acquirer does not influence the target's affairs and there is no integration of their businesses. Thus, if at all the transaction raises competition risks and the CCI decides to block it, the absence of any integration between the businesses of the acquirer and the target will allow an easy reversal of the transaction, without any harm being caused to competition.

Is There Anything Missing?

On the less green side of things, the amendment seems to have missed out on a key consideration. The current rules in Europe and Brazil (discussed above) allow the acquirer to exercise voting rights attached to the acquired securities only if the same is necessary to maintain the full value of its investment, pending clearance of the Market Acquisition. This is important from a commercial perspective and ensures that target's operations are not run in a detrimental manner. The amendment does not consider this and prohibits the acquirer from exercising any voting rights whatsoever until the CCI has approved the transaction.

To make it successful, the amendment should allow the acquirer to exercise minimum rights attached to its securities (not amounting to decisive or material influence) solely to protect its investment's value. Alternatively, taking cue from the CLRC's recommendation, the amendment may be re-structured and the CCI can be empowered to allow investors a derogation from standstill obligations. This derogation may be limited to acquirer's exercise of only such rights which are necessary to protect the value of its investment.

If the above-mentioned gap is plugged, the amendment will materially boost the confidence of the investors while undertaking Market Acquisitions in India.

Conclusion

All in all, the reform proposed in the Draft Bill is truly a welcome step by the CCI and demonstrates its continuous efforts to streamline the Indian merger control regime to bring it at par with international best practices. The highlight of the proposed policy reform is that it recognises the practical considerations surrounding Market Acquisitions from an acquirer's perspective without taking away the CCI's right to evaluate the transaction to ascertain competitive harm in the market.

Once the missing gap regarding allowing the investors to exercise minimum non-controlling rights to protect the value of their investment is plugged, the amendment will go a long way in enhancing the certainty and confidence of investors to undertake Market Acquisitions in India and will also facilitate the ease of doing business in India.

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[2] Section 5 of the Competition Act, 2002 (as amended) (the "Act") provides the relevant asset and turnover based financial thresholds (as modified by relevant notifications) to assess if a transaction is notifiable. The Threshold Tests involve an analysis of the India and worldwide assets and turnover of the acquirer and target enterprises.

[3] Section 6(2) of the Act requires the parties to mandatorily notify a transaction to the CCI if the Threshold Tests are breached.

[4] Regulation 4 of the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (as amended) ("Combination Regulations") exempts transactions from notification requirement which are not likely to have an appreciable adverse effect on competition in India. In this regard, Item 1 of Schedule I of the Combination Regulations exempts non-controlling minority investments of less than 25 percent which are made *solely as an investment* or in the *ordinary course of the investor's business*. Additionally, acquisitions of less 10 percent are considered as *solely as an investment* if the acquirer: (i) only exercises ordinary shareholder rights in the target; (ii) does not have any board nominations on the target's board; and (iii) does not participate in the affairs or management of the target ("Item 1 Exemption").

[5] For example, if the products/services or portfolio investments of an acquirer overlap with the products/services of the target in India (either horizontally, or vertically, or if the products are complementary), then even if the investment is of less than 25 percent and is non-controlling in nature, it would not be seen as a purely financial investment and will not benefit from Item 1 Exemption.

[6] Section 6(2A) of the Act provides that a notifiable transaction will not be implemented until the CCI has approved the transaction or 210 days (subject to certain exclusions) have elapsed from the date of filing the notice, whichever is earlier.

[7] Section 43A of the Act empowers the CCI to impose a penalty of the higher of 1 percent of the combined assets or turnover of the parties to the combination if, a notifiable transaction is implemented (in part or in entirety) prior to CCI's approval.

[8] As of the date hereof, the highest penalty imposed by the CCI is INR 5 crores (approx. USD 0.66 million).

[9] Section 20(1), Act.

[10] Proviso, Regulation 19(2), Combination Regulations.

[11] Regulation 19(1), Combination Regulations.

[12] Regulation 13(1A), Combination Regulations.

[13] Combination Registration No. C-2014/05/175.

[14] Order under Section 43A, Act in Combination Registration No. C-2014/05/175. The Supreme Court upheld the penalty imposed by the CCI in *SCM Soilfert Limited and Another v. Competition Commission of India*, (2018) 6 SCC 631.

[15] Combination Registration No. C-2014/02/153.

[16] Order under Section 43A, Act in Combination Registration No. C-2014/02/153. The Supreme Court upheld the penalty imposed by the CCI in *Competition Commission of India v. Thomas Cook (India) Limited and Another*, (2018) 6 SCC 549.

[17] Combination Registration No. C-2019/04/658.

[18] The CLRC was formed in October 2018 to review the extant legislation and recommend comprehensive changes to it keeping in mind the changing business environment.

[19] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

[20] See also Article 11, paragraph 2 of CADE's Resolution No. 2/2012 (as amended by CADE's Resolution No. 9/2014) for public offers for securities convertible into shares.

[21] Paragraph 7.3, Page 141, CLRC Report.

[22] Paragraph 7.8, Page 143, CLRC Report.

[23] *Ibid.*

[24] The Combination Regulations set out the principal framework for review of pre-merger notifications by the CCI.

[25] Available at https://www.cci.gov.in/sites/default/files/whats_newdocument/Combination-Regulation-Market-Purchases-For-Public-Comments.pdf.

[26] Available at http://feedapp.mca.gov.in/pdf/Draft-Competition-Amendment-Bill-2020.pdf.

[27] Clause 8, Draft Bill.