New Takeover Code

For the past 13 years, the M&A deals in India have been governed by the age old takeover rules. A lot has changed in the corporate world during this while. It seems that now, the SEBI has realised that these rules need to be revamped to keep them in line with the ever changing global scenario. Hence, earlier this year, the SEBI has notified the new takeover rules. This article discusses the major amendments and analyses what would be its impact on different stakeholders.

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The M&A landscape in India is all set to change, and this time for the right cause. On 23rd September, 2011, the Securities and Exchange Board of India (SEBI) amended the 13 year old takeover rules and notified them with the new set of takeover rules i.e.; the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (commonly referred to as the takeover code) to align it closer to global practices. While the new takeover code is being appreciated by a lot of industry experts; one can still hear some voices not completely in appreciation of the new takeover code. The main purpose for the new takeover code is also to prevent hostile takeovers and at the same time, provide some more opportunities of exit to innocent shareholders who do not wish to be associated with a particular acquirer. Read on to know more on the takeover code.

Important Definitions

To understand the concept of the takeover code, it would be pertinent to first go through some of the important definitions.

(a) Acquirer [Regulation 2(1)(a)]

Acquirer means:

- Any person who, directly or indirectly,
- acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him,
- shares or voting rights in, or control over a target company.

It means that any person who enters into an agreement for acquiring the shares in future will

also be an acquirer for the purpose of the takeover code.

(b) Acquisition [Regulation 2(1)(b)]

Acquisition means

- Directly or indirectly, acquiring or **agreeing to acquire**
- Shares or voting rights in, or control over a target company.

It means that any agreement entered into between two persons for acquiring the shares in future will also be covered within acquisition for the purpose of the takeover code.

(c) Persons acting in concert [Regulation 2(1)(q)]

Persons acting in concert means:

- Persons who, with a common objective or purpose of
- acquisition of shares or voting rights in, or exercising control over a target company,
- pursuant to an agreement or understanding, formal or informal, directly or indirectly cooperate
- for acquisition of shares or voting rights in, or exercise of control over the company.

For example:

The takeover code itself specifies that the persons falling within the following categories shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established (this is not the complete list):

- A company, its holding company, subsidiary company and any company under the same management group;
- Immediate relatives;
- Promoters and members of the promoter group.

(d) Control [Regulation 2(1)(e)]

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.

The concept of "control" brings such type of persons under the purview of the takeover code who do not hold the shares in their name, but actually control the majority of the directors or control the management or the policy decisions of the company.

Old Takeover Code v/s New Takeover Code

Basis	*Old Takeover Code*	*New Takeover Code*	*Impact*
Threshold limit (initial acquisition)	When an acquirer's shareholding in a listed firm reaches 15%, the acquirer has to bring a public offer to the existing shareholders.	In the new takeover rules, the triggering limit for making the public offer has been increased to 25%.	As a result, an acquirer can buy up to 24.99% in a listed firm without being required to bring a pubic offer.
Minimum offer size	As soon as the 15% limit is reached, the acquirer has to bring a public offer to acquire another 20% of the voting share capital of the target company.	The offer size, too, has been changed to 26%.	The revised offer size will provide an exit option to more investors who do not wish to be associated with the new acquirer.
Creeping acquisition	Here, whenever an acquirer, already holding 15% or more shares, but less than 55% of shares, acquired more than 5% voting rights in the target company in a Financial Year, then he had to bring another mandatory public offer to the remaining shareholders	In the takeover code, an acquirer holding 25% or more shares in a target company will have to bring a mandatory public offer if he acquires more that 5% voting rights in the target company in a Financial Year.	The rationale behind the principle of creeping acquisition is that the shareholders are given an opportunity to exit every time a major shareholder increases his shareholding in the company by a material percentage (the SEBI considered 5% as the material percentage).

Basis	Old Takeover Code	New Takeover Code	Impact
The limit of 55%-74%	Once the shareholding of an acquirer in the target company reaches 55%, then he will have to bring a mandatory public offer every time he acquires even a single share in the target company.	No such provision	With the increase in the limits of initial acquisition and the minimum offer size, this provision would have become almost redundant.
Non-Compete fees	As per the present takeover rules, the acquirer can make a payment up to 25% of the offer price to the seller promoters to prevent the latter from entering the same business and compete.	No such payment in the nature of non-compete fees is allowed under the new rules.	The payment of non-compete fees to the seller promoters results in differential pricing, which is against the principle of equity. Recently, in the Cairn-Vedanta deal, it was seen that the seller promoters were being paid ₹50 more than the remaining shareholders representing a non-compete fee. Abolishing this will mean that the price premium will be distributed over a wider base of shareholders.

Comparison of Global Provisions Governing M&As

Areas of Comparison	India	US	Hong Kong	UK	Singapore	South Africa
Are takeovers regulated	Yes	Yes	Yes	Yes	Yes	Yes
Who regulates	Securities and Exchange Board of India	Securities and Exchange Commission	Securities and Futures Commission	Financial Services Authority	Securities Industry Council	Securities Regulation Panel
Threshold limit (Initial acquisition)	25% (Earlier 15%)	Offers are only voluntary	30%	30%	30%	35%
Offer size	Minimum 26% of the voting share capital of the target co. from 20%	No percentage prescribed	To all the remaining shareholders	To all the remaining shareholders	To all the remaining shareholders	To all the remaining shareholders

Areas of Comparison	India	US	Hong Kong	UK	Singapore	South Africa
Non Compete Fees	Not allowed (Earlier up to 25% of the offer price is allowed)	-	-	Not allowed	Not allowed	Not allowed (But panel may be consulted)

(Source: The Economic Times dated 10th August, 2011)

Major M&A Deals in India

Announce Date	Target Name	Acquirer Name	Announced Total Value (₹ Crore)
23rd February 2008	Centurion Bank of Punjab	HDFC Bank	281.33
15th November 2009	Samruddhi Cement	Ultratech Cement	247.26
1st July 2010	Digicable Network India	Reliance Communications	157.09
13th December 2010	Paras Pharmaceuticals	Reckitt Benckiser Group	72.24
18th May 2010	Bank of Rajasthan	ICICI Bank	54.26

(Source: The Economic Times dated 10th August, 2011)

Computation of Offer Price [Regulation 8(1)]

Once it is established that the acquirer has to bring about a public offer of minimum 26%, then the next question arises as to what should be the offer price; i.e. what should be the price at which the acquirer offers to buy the shares of the remaining shareholders. The takeover regulations govern the computation of offer price because had there been no standard method for computing the offer price, it would have led to the following two types of adverse situations:

a. Suppose the market price of the share is ₹500 and the acquirer offers to buy the shares of the remaining shareholders at just ₹5 per share, then no one would have would have accepted his offer (due to such a low price being offered). Thus, the acquirer would have fulfilled his obligation and ending up with no requirement to buy the shares of other shareholders and that too, completely within the provisions of the law.

b. In another case, suppose the market price of the share is ₹500 and the acquirer offers to buy the shares of the remaining shareholders at a very high price of ₹2000 per share, then most of the remaining shareholders would have accepted the offer of the acquirer (due to such a high price being offered by the acquirer) and hence, the acquirer would have easily gained a majority stake in the company and that too, completely within the provisions of the law. This would have meant that hostile takeover can be done by complying with the provisions of law itself.

To avoid such type of adverse situations, the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 has prescribed that the offer price shall be the higher of the following:

(a) The highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;

(b) The volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the 52 weeks immediately preceding the date of the public announcement;

(c) The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in

concert with him, during the 26 weeks immediately preceding the date of the public announcement;

(d) The volume-weighted average market price of such shares for a period of 60 trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;

(e) Where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies; and

(f) The per share value computed under sub-regulation (5), if applicable.

Let's understand the computation of offer price with the help of an illustration:

Illustration:

Suppose the date of public announcement is 30th September 2011

Particulars	*Basis of computation*	*Computed price*
Price as per condition 1	Highest negotiated price as per agreement (say ₹10)	₹10
Price as per condition 2	Working Note 1	₹8.76
Price as per condition 3	Working Note 1	₹11
Price as per condition 4	Calculation will be done similar to condition 2 & 3. Only difference is that here, the computation will be done considering the Stock Exchange if the shares are frequently traded. Say, the price comes to be ₹10.50	₹10.50
Price as per condition 5	If shares are not frequently traded, then computation will be on the basis of valuation principles. Say, the price comes to be ₹9.50	₹9.50
Price as per condition 6	As per Reg.8(5)	₹9.50
Hence, the Offer Price will be:	Highest among the above 6 calculated prices	₹11

Working Note 1:

	Date of acquisition	*No. of shares (Volume of shares)*	*Price at which the shares were bought*	*Volume weighted price*
	(A)	*(B)*	*(C)*	*(D = B * C)*
	5-April-2010	2000	10.00	20000
	15-Oct-2010	5000	8.00	40000
	25-Nov-2010	1	50.00	50
	5-Jan-2011	6000	9.00	54000
	6-Jan-2011	9000	8.50	76500
26 weeks	6-April-2011	4000	7.00	28000
	6-May-2011	15000	8.50	127500
	6-July-2011	10000	8.50	85000
	16-Sep-2011	8000	11.00	88000

Date of acquisition	No. of shares (Volume of shares)	Price at which the shares were bought	Volume weighted price
TOTAL (the figures relating to acquisition on 5th April, 2010 have not been considered in these total's because that acquisition was made prior to the 52 weeks immediately preceding the date of public announcement)	**57001**		**499050**
Price as per condition 2 (Volume weighted price_52 weeks)			499050/57001 = ₹8.76
Price as per condition 3 (Highest price_26 weeks)			Highest price paid for the share after 1st April, 2011 i.e. 26 weeks immediately preceding the date of Public announcement = ₹11.00

Rationale behind the New Takeover Code

As we can clearly see from the above table, the main rationale behind the new takeover code is to align India's M&A scene to the global practices.

c. The earlier threshold limit of 15% was too early to trigger an open offer considering the fact that a major portion of almost all the listed companies is financed by the Private Equity (PE) firms. The 15% limit meant that the PE firms had to restrict their holding in the company to less than 15% if they didn't want to make an open offer. The new threshold limit of 25% is one at which a potential acquirer can exercise *de facto* positive control over a company and is able to get a majority of votes in a shareholder's meeting. Also, the Companies Act recognises any holding in excess of 25% as the threshold at which a special resolution can be blocked.

The new takeover code spells different things to various stakeholders. The retail investors should benefit with the removal of the non compete fees as now, the price premium will be distributed over a wider base of shareholders and not just to the promoters.

d. The minimum offer size has been increased from 20% to 26%. However, this has been a matter of controversy among many. The twelve member takeover advisory committee had recommended a 100% public offer once the trigger button is pressed as it will give all minority shareholders an opportunity to exit. Even though this proposal appears to be fine in theory, the corporate sector was not in favour of the proposal; and they had their valid reasons. A public offer to all the remaining shareholders would have proven to be very expensive as there would be a lot of financial issues in raising finances for the entire remaining shareholding. The main financial concern is that the RBI doesn't allow banks to finance domestic acquisitions; hence a public offer to all the remaining shareholders would have meant that the buyers would have had to raise expensive funds from other sources. Hence, a middle path was chosen and the minimum offer size was increased from 20% to 26%.

What This Means to Different People

The new takeover code spells different things to various stakeholders.

(a) For retail investors

The retail investors should benefit with the removal of the non compete fees as now, the price premium will be distributed over a wider base of shareholders and not just to the promoters.

(b) For Institutional investors

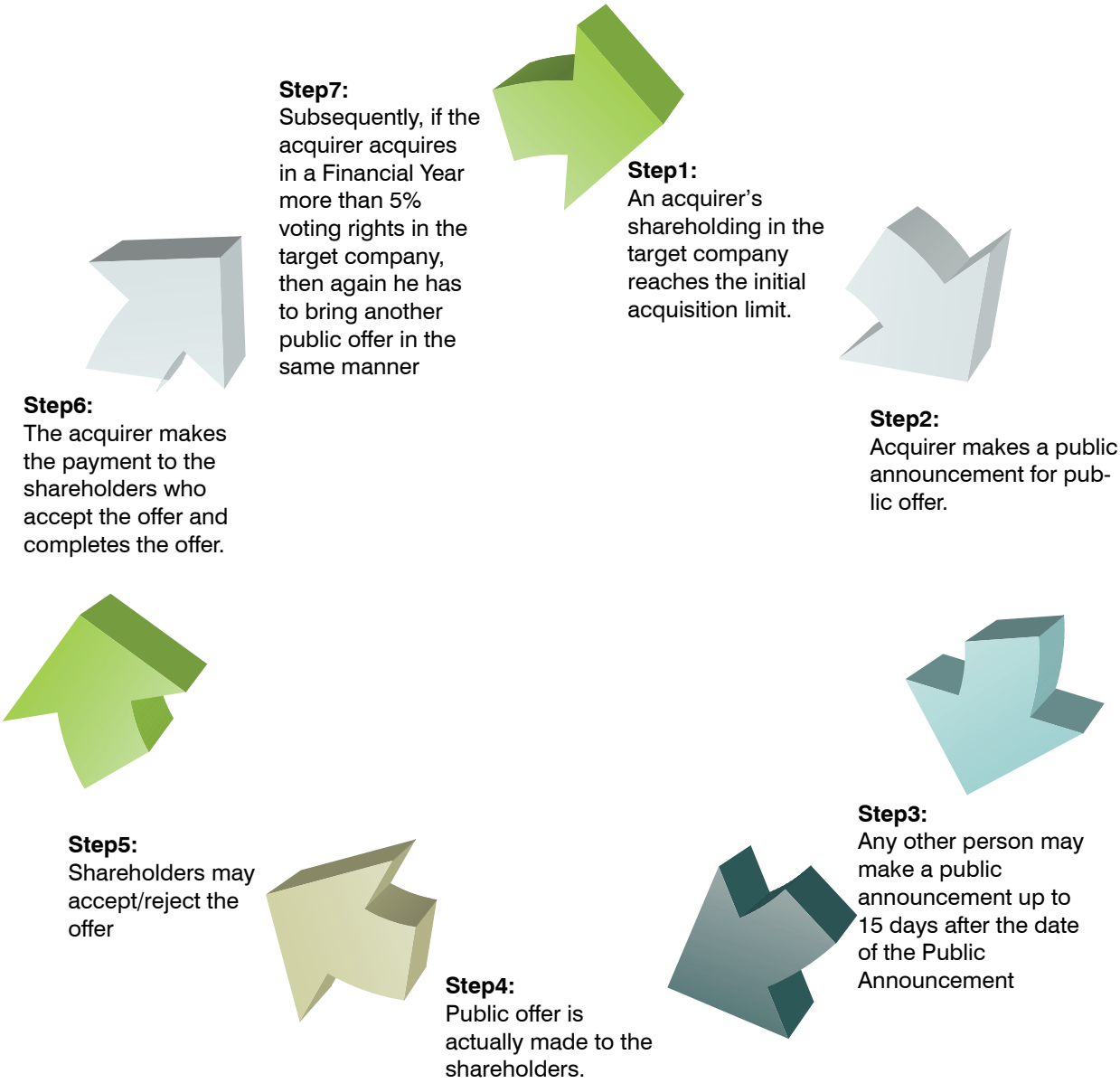
The Institutional investors, especially the PE firms will now be able to acquire up to 24.99% without triggering an open offer. This also means that the listed companies do not necessarily have to depend only on public markets for capital.

(c) For promoters

The new takeover code means that the promoters with low holdings should increase their holdings to shield themselves from a potential hostile bid.

Summary

To summarise, one may say that the takeover code operates in the following manner:



Open Offer Process

Step 1 Appoint a merchant banker [Reg.12(1)]

Step 2 Before making a public announcement, open an Escrow a/c for the following amount:
1. On the first ₹500 crore (₹100 crore in the old takeover code) of the consideration payable under the open offer = 25% of the consideration
2. On the balance consideration = Additional 10% of the balance consideration [Reg. 17(1)]

Step 3
1. Send public announcement to concerned stock exchange, SEBI, target company
2. Publication of announcement in English daily, Hindi daily, Regional newspaper of the target company, Regional newspaper of the concerned stock exchange [Reg. 14]

Step 4 Within five days (14 days in the old takeover code) from the date of public announcement, file a draft Letter of offer with SEBI along with non refundable fee (calculated on the basis of consideration payable under the offer, concerned stock exchange, target company

Step 5
1. SEBI can give its comments on the draft letter of offer up to after 15 days (21 days in the old takeover code) of the receipt of the draft letter of offer.
2. If SEBI specifies any changes, then carry out such changes in the letter of offer before dispatch to shareholders.
3. If no comments are issued by SEBI, then it shall be deemed that SEBI does not have any comments to offer. [Reg. 16(4)]

Step 6 Within seven days from the receipt of the comments from SEBI or where no comments are offered by SEBI, within seven days from the expiry of the period stipulated in Reg.16(4), dispatch the letter of offer to the shareholders [Reg.18(2)]

With new takeover code, the Institutional investors, especially the PE firms will now be able to acquire up to 24.99% without triggering an open offer. This also means that the listed companies do not necessarily have to depend only on public markets for capital. For promoters, it means that the promoters with low holdings should increase their holdings to shield themselves from a potential hostile bid.

Withdrawal of Offer [Reg.23]

A public offer can be withdrawn only in the following circumstances:

- Some statutory approvals have not been received; or
- The acquirer, being a natural person, has died; or
- any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or

- such circumstances as in the opinion of the SEBI, merit withdrawal.

Conclusion

Though the new takeover code has increased the threshold limit and the minimum offer size, it is also felt that the RBI should do away with the restriction on banks to fund domestic acquisitions. The SEBI has successfully done one part of the reform process by preparing the new takeover code; the other part requires it successful implementation. Let us hope that it is able to do so. ■