Need to relook at the Takeover Regulations?

Ravi Kumar
M&A Partner
Induslaw

India's takeover regulations for listed companies was first codified in 1997 with the promulgation of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the "**Takeover Code, 1997**"). The Takeover Code set out a detailed process on par with the then prevalent global standards. Triggers for making an open offer were clearly set out along with a detailed process, involving SEBI registered intermediaries (i.e. merchant bankers as persons in-charge of the process). As was expected, there were a slew of cases, which set the moorings right for takeovers of Indian listed entities.

A subsequent overhaul was implemented with the advent of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2013 (the "Takeover Code, 2013"). Again, this overhaul was preceded by a rigorous consultative process by the Takeover Regulations Advisory Committee, which reassessed the entire framework of the Takeover Code, 1997 and suggested a thorough overhaul of the Takeover Code, 1997. The advent of the Takeover Code 2013 was rather inauspicious as the Achuthan Committee Report was filed in 2010 and SEBI expressed serious reservations against some core recommendations. These recommendations were cast aside by SEBI while notifying the Takeover Code in 2013. Nonetheless, the Takeover Code, 2013 appears to have worked rather well and SEBI has been taking care to finetune the Takeover Code, 2013 with an eye on prevailing circumstances and market conditions, for e.g., permitting promoters of listed companies to plough in cash by way of a preferential allotment during the COVID stricken period, ironing out a smooth direct delisting process for new acquirers/ owners of listed companies etc.

Having said that, there are still certain areas that would require constant review and evolution to ensure a smooth, sustainable, easily workable and understood Takeover Code. This piece is an attempt to discuss some of these issues, while leaving the core of the Takeover Code, 2013 intact- as the popular adage goes, "If it ain't broke, then don't fix it."

(a) Change in mindset of the review of the Draft Letter Of Offer by SEBI will significantly improve the timing for completing the Open Offer

Despite constant tweaks by SEBI, including changes based on feedback from market participants, prevalent market practice and various types of underlying transactions, the timeline for completion of an open offer process remains very long. While the officially prescribed time process from the date of launch of a takeover offer till the completion is 8 weeks, this timeline has proved very elusive to achieve.

Instead of always or necessarily focussing on more efficiency in the process (i.e. more personnel being hired by SEBI etc.), a fair amount of efficiency can be achieved in the entire process if there is a change in outlook regarding the review of the Draft Letter of Offer by SEBI. SEBI has already prescribed a detailed format for the Draft Letter of Offer, with very thorough and detailed guidance on the information that needs to be set out in the Draft Letter of Offer. SEBI has ensured that entire repository of Open Offer Documents are available for public review, thereby ensuring that the drafting and submission of a Draft Letter of Offer is fairly standard. Despite these safeguards already established by SEBI, SEBI tends to review the Draft Letter of Offer like an IPO document or prospectus.

This results in a fair amount of additional information being reviewed by SEBI as part of the Draft Letter of Offer review process, especially with respect to the past actions of the target company such as regulatory compliance by the target company and its existing promoters. In some cases, it has led to SEBI unravelling older non-compliances of applicable laws (including listing regulations by the Target Company and exiting promoters/shareholders). SEBI has then proceeded to move forward with prosecution on such non-compliances. While this is completely in consonance with SEBI's role as the securities market regulator, this inevitably causes a fairly significant delay on the progressing with and completing the Open Offer.

This mindset doesn't sit right with the theme and spirit of the Takeover Code, which is to: (a) ensure sufficient details/information regarding the Acquirer, including future plans for the target company; (b) ensuring a transparent and timely offer is provided to at least 26% of the public shareholders of the listed company; and (c) safeguards in the process to ensure that there will be a clear path for payments to tendering

shareholders of the listed company.

Given the price volatility that often surrounds the launching and completion of an Open Offer, it does not augur well for anybody (whether the target company, the acquirer, shareholders of the target company, the incumbent management and the new management) for this period to be fairly extended. The target company remains under the purview of SEBI's jurisdiction for its past non-compliances, if any. So why not permit the open offer to be completed and then follow up with investigations around non-compliances instead of closing out non-compliances before the Open Offer commences? If this outlook were to be adopted, there will be a significant improvement in the timing for the completion of the review of the Draft Letter of Offer by SEBI as the focus of the review will be limited (as it should be) to the compliance with the format of the Draft Letter of Offer prescribed by SEBI given the context of the underlying transaction and details of the Acquirer.

(b) Tightening the Open Offer pricing for Infrequently" traded shares- mandate SEBI registered valuer valuation

The current framework for open offer pricing for a Target Company's shares which are "infrequently or thinly" traded is the computation of a fair value based on certain broadly prescribed valuation parameters such as book value, comparable trading multiples and customary valuation parameters for the relevant types or classes of companies. However, given this framework of allowing acquirers to complete their valuation of such "infrequently" traded shares, there have been a series of cases recently, where the fair valuation undertaken by third party valuers appointed by the Acquirer has been challenged before SEBI, the Securities Appellate Tribunal and thereafter the Supreme Court (e.g. recent open offers triggered by the indirect acquisition of control of Federal Moghul Limited). The outcome through various rulings is a sensible one- valuation is a technical subject and should only be confirmed by a qualified, independent third party valuers- courts and regulators do not have a role to play in computing the fair value.

But, when the Open Offer price of such "infrequently traded" shares is very significantly delayed by these legal tangles, there is immense disruption caused pending this finalisation of the valuation. Perhaps it is time for SEBI to require the Open Offer price for such infrequently traded shares should be certified by a SEBI registered valuer. This should probably put an end to the endless tangle of legal cases and proceedings around the Open Offer price and provide much needed structure and improvement in timing for the Open Offer for such infrequently traded shares.

(c) Withdrawal of Open Offers-

This particular vexing issue is a clear case of an issue that has got caught in the cusp of the transformation of the Takeover Code, 1997 to the Takeover Code, 2013. The Takeover Code, 2013 clearly sets out that the Acquirer has the right to withdraw an open offer once made if: (1) any condition (i.e. conditions precedent) disclosed in the Open Offer documents and set out in the underlying transaction document, which triggered the Open Offer, is not met for reasons outside the reasonable control of the Acquirer; and (2) the underlying agreement which triggered the Open Offer is rescinded. There is a clear basis for this line of thought, which is that if the Acquirer doesn't complete the underlying transaction for reasons out of the Acquirer's reasonable control, then surely it makes no sense to force the Acquirer to acquire a significant position of 26% in the Target Company pursuant to the Open Offer.

Unfortunately, a couple of judgements of the Supreme Court on the ability of an Acquirer to withdraw an Open Offer made under the Takeover Code, 1997 changed SEBI's position on this position under the Takeover Code, 2013!! This is an inexplicable situation given that the judgements on withdrawal dealt with a Takeover Code, 1997 that did not have this provision permitting an Acquirer to withdraw an Open Offer once made without SEBI's express consent. Consequently, SEBI is effectively refusing to acknowledge or permit withdrawals of Open Offers once made, even if the parties to the transaction that triggered the Open Offer wish to walk away on account of non-fulfilment of conditions that are beyond the reasonable control of the Acquirer. What makes the situation even more peculiar is that the Takeover Code, 2013 has not been amended to set out SEBI's position. This dichotomous position is something that should end since it causes a fair amount of concern to all potential acquirers.

(d) Acquirers need to have an ability to get interest on the amount deposited in the Open Offer escrow or Open Offer guarantee;

Given the various changes to banking regulations, Acquirers are now faced with a situation where they are unable to get any interest for amounts deposited in the open offer escrow account. While admittedly, this is a banking issue, perhaps

the situation demands that the Takeover Code sets out the ability for an Acquirer to get interest paid by the escrow agent. Such a situation may result in the banking authorities and regulators regularising the payment of interest to Acquirers in the context of an Open Offer.

(e) Re-look at the requirement to include the price for any "incidental, contemporaneous or collateral agreement" in the Open Offer Price

The Takeover Code, 2013 requires the Acquirer to increase the Open Offer price on account of any other "incidental, contemporaneous or collateral agreement." While the intent is clearly to ensure that the public shareholders receive the proper value pursuant to an Open Offer and to ensure that they are not short-changed, it leads to a situation where transactions of proper value involving separate assets are in jeopardy of attracting this requirement. A clarification setting out that this rule is not intended to cover genuine transactions involving the sale and purchase of assets for fair value would really help in Acquirers having certainty over the way Open Offer prices are computed. Currently, there is a fair amount of nervousness on entering into genuine transactions for assets and businesses that are being acquired along with the shares of the Target Company by the Acquirer. Perhaps the better solution would be for the merchant banker appointed by the Acquirer to provide a confirmation to SEBI and the public shareholders that such genuine transactions are being conducted at fair value. Once there is a confirmation from the merchant banker, who is also regulated by SEBI, there can be assurance to both the public shareholders of the Target Company and the Acquirer that the Open Offer Price will not be revisited.