ICAI'S COMMENTS ON DRAFT REGULATIONS FOR SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVER REGULATIONS), 2010

AUGUST 31, 2010

Part I – Observations on Fundamental Issues

Takeover Regulations Advisory Committee (TRAC) of SEBI was set up to improve upon the existing regulations for Takeover of listed companies. Before providing the regulation wise detailed comments, following are some of our observations on the fundamental issues:

1. CONSTITUTION OF TRAC

It is suggested that constitution of such committees are broad based with due participation of professional bodies, professionals, other interested stakeholders and industry.

2. CONTROL

The aim of any "Takeover" is the Acquisition of "Control" and acquisition of shares is only one of the means by which the objective of Acquisition of Control can be achieved. Control can be acquired without acquiring shares. This fact has been recognised by both the SAST 1997 (Regulation 12) and SAST 2010 (Regulation 4) which covers cases of takeover of companies without acquisition of shares.

In spite of such regulations being in place, many takeovers as given below have taken place without triggering an open offer by acquiring substantial or almost entire operations of the company:

(Amount in Rs.)

Company	Market Cap. crs. (date)	Deal size crs.	Trigger at 15% crs.
Indo Asian Fuse Gear	175 (23.7.10)	530	26.25
Piramal Health	10425 (23.7.10)	16,700	1564
Orchid chemicals	1500 (15.12.09)	1860	225
Zicom	103 (23.7.10)	224.75	15.45
Gwalior Chemicals(GEE CEE)	133 (23.7.10)	536	19.95
Eicher Motors	2675 (23.7.10)	1575	401

As mentioned, in the above cases *de facto* control has been acquired by the acquirer through acquisition of substantial or almost the entire operations of the company, lock stock & barrel, employees without triggering the open offer. But the definition of "control" has not been redefined to include control over substantial part of the activities of the company, by virtue of purchase or otherwise of the plant/ factory/ workshop/ office or any other set-up by whatever name called.

The TRAC itself in its deliberations observed (Page 29, 3.6) "that it was desirable to underline and emphasize that acquisition of *de facto* control, and not just *de jure* control should expressly trigger an open offer obligation."

3. OFFER SIZE

The TRAC admitted that takeovers play an important role in the economic development of a country and recognised the need of encouraging takeovers. However, having raised the size of Open Offer to 100%, it has made takeover activity that much more difficult. Some points against 100% offer size that may be considered are:

- This is against Securities Contract (Regulation) Act, 1956 requiring minimum 25% holding with public in a spread out manner. Proportionate acceptance of offer could be a good solution.
- Size of open offer could be linked to size of acquisition and could be a percentage fixed in a manner that public holding is not impacted - minimum size of at least 20% and a maximum size of such number of shares as would not result in a breach of the maximum permissible non-public shareholding.
- Very few offers get oversubscribed (page 19, para 1.5), no need to increase the size.
- Funding is not easily available in India for purchase of shares. The Committee (page 19, para 1.9) recognizes the need for allowing *more flexible norms for grant of loans for strategic investments in Indian entities, particularly for funding open offers in deserving cases under Takeover Regulations.* The Committee further noted that this *could help create a level playing field for domestic acquirers vis-à-vis foreign acquirers for speedy deal execution.* In our view, till such flexible norms for Indian acquirers are put in place, increasing the offer size to 100% would put them at disadvantage vis-à-vis foreign acquirers.
- It oversteps other regulations—delisting regulation.
- Delisting exercise is rewarding for the investors and painful for the promoters. The investors will lose this edge.
- If more companies get delisted, the market cap of India Inc. will get reduced and investors will have lesser investment opportunities.
- For companies with low promoter holding, say 15-20% it will be prohibitive for the acquirer. Data reveals that during the last four years, in less than 15 % of the open offers, the offer size has been higher than 20%.

4. TRIGGER POINT

The trigger point has been increased from 15% to 25%. This is not a desirable step for the following reasons:

- Hostile takeover threat to the listed companies with lower promoter shareholding.
- With this voting power, minority to provide threat to majority.…15% thresh hold was reasonable.
- Smaller trigger point means more Takeovers & Open offers, Investors interest & excitement in the investment activity is maintained.
- Existing promoters who are controlling and managing their Companies, with their present holding between 15% and 24.99%, will not be able to raise their holding beyond 25%, without an open offer, which would mean a huge financial commitment for them.
- Mismanagement of companies - Any large investor can acquire some shares from the market to keep his holding upto 25% which is sufficient to block any Special Resolution and keep a check on the management. It may be noted that a number of shareholders may not come to meeting and to pass any special resolution the management or those in control will not be able to generate 3 times voting power to support their resolutions.

5. OFFER PRICE

- The transparent availability of this data could be an issue; this should be based on only delivered shares and not all transactions.
- The offer price should not only be the highest of negotiated price, volume weighted average price, or price paid/payable for acquisition, but also the highest price at which the acquirer has sold the shares or the Company has issued the shares during the offer period.
- The 2 week period as one of the criteria must be retained as that acts as a check on the clandestine activity of the acquirer or insider. It has been observed that the 2 week price is, in majority of the cases, higher than 26 week price, indicating some insider trading or any clandestine activity.
- In case of delayed offers, the offer price should be additionally calculated with reference to the date of announcement of the offer and the highest of the price arrived at must be the offer price. **In the recent past there have been several cases where the defaulter acquirer kept on delaying the offer for years and when the market price became higher than the price he was liable to pay even after adding interest, he announced the offer just to legally fulfill his obligation. Thus instead of punishment, the defaulter got rewarded.**

6. EXEMPTIONS

- The various exemptions need to be broad based and more logical.

- Permitting acquisitions by Market intermediaries beyond 25% delivery in ordinary course of business is open to misuse.
- Inter se transfers among group companies of same promoter(s) and Persons acting in Concert to be permit and exemption should not be restricted to only subsidiaries/parents and co subsidiaries. Indian promoters holding method is different as compared to international pattern.
- Scheme of Mergers and Restructuring under Section 391 and 394 of The Companies Act, 1956 may be permitted freely as exempt.
- Debt restructuring by BIFR or by CLB or by NCLT may also be considered for undisputed exemption.
- Voting right acquired by Banks pursuant to Mortgage may not be free and be restricted to avail exemption from open offer. Persons acquiring from Bank to be subject to open offer by the bank in a transparent manner.
- It is proposed to give discretion to SEBI to decide which of the exemptions requests falling within category two shall be forwarded to Takeover Panel for their approval. In order to maintain uniformity in the decision making process and to make it independent of individual's interpretation, it would have been appropriate to continue to maintain the existing procedure for referring all such cases to the Takeover Panel. The process of takeover panel and its constitution should be transparent.

Part II – Clause wise Detailed Comments

Clause wise comments are given below:

Sr. No.	Draft Provision / Recommendation of the Committee	Comment	Rationale
1.	Reg 2 (g) Definition of control	"control" should be defined to include control over substantial part of the activities of the company, by virtue of purchase or otherwise of the plant/ factory/workshop/office or any other set-up of a company by whatever name called. Also consider to include here the same parameters as prescribed under regulation 8(4) of SAST i.e. in case such purchase of an undertaking results in (a) more than 15% of net asset value being transferred or (b) transfer of assets contributing more than 15% of sales turnover or (c) the value of such sale of asset/entity/plants is in excess of 15% of the market capitalization of the target co.	In the recent past there were some takeovers that have successfully bypassed the SAST, 1997 although the amount involved was as high as Rs. 16,700 crs. The acquirer seems to have taken a plea he has not acquired control over the co. because he has not purchased its shares nor is he sitting on the Board of the co. although functionally he may have acquired the control over the entire company — its factory and entire work force, as in the case of Piramal health (Rs.16,700 Crs.), Gwalior Chemicals (Rs. 536 Crs.), Indo Asian Fuse (Rs. 530 Crs). The TRAC itself also observed (Page 29, 3.6) "that it was desirable to underline and emphasize that acquisition of *de facto* control, and not just *de jure* control should expressly trigger an open offer obligation."
2.	Reg 2 (1) (k) Frequently traded shares	Frequently traded shares has been defined as where trades turn during the twelve month preceding the calendar month in which the public announcement is made, is at least 10% of total number of shares.	The present 5% norms are OK and serving well. Making it 10% will mean more companies will have to be valued separately making the takeover exercise more cumbersome and challengeable.
3.	Reg 2 (1)	No need to change an	There is no need to tweak the

	(l) Identified date	already accepted nomenclature — *'specified date'*	definition. "Identified date" is supposed to mean the same as *'Specified date'* which has been in prevalence for years and well understood by all.
4.	Reg 2 (1) (r) "Persons acting in concert"	It shall be expressly provided that there are 2 contra parties in any deal – a seller & a buyer. They cannot become PAC of each other similarly PAC of Seller/ buyer cannot become PAC of the opposite party.	It is unconceivable that the seller can have "common objective or purpose of acquisition of shares" with the buyer, yet in the Open Offer of Tata Teleservices (Maharashtra) Ltd., Tata Sons Ltd. (TSL) was named as PAC (person acting in concert) with the acquirer NTT DOCOMO INC although TSL was a seller.
5.	Reg 2 (1) (ab) 'Tendering period'	Definition should be changed to – *'Tendering period means the period determined after the final approval Letter of Offer & schedule of activity by SEBI, within which shareholders may tender their shares in acceptance of an open offer to acquire shares made under these regulations.'*	Tendering period has been referred at many places and must have a practical definition. It is more of rule than exception that Open offer do not Open as first schedule given in the PA.
6.	Reg 3(1) - Trigger point	Keep the Open offer Trigger Point at 15%.	➢ Hostile takeover threat. ➢ With this level of voting power minority will provide threat to majority. ➢ Smaller trigger point means more Takeovers & Open offers, Investors interest & excitement in the investment activity is maintained. ➢ Existing promoters who are controlling and managing their Companies, with their present holding between 15% and 24.99%, will not be able to raise their holding beyond 25%, without an open offer, which would mean a huge financial commitment for them. ➢ Mismanagement of companies - Any large investor can acquire some shares from the market to keep his holding upto 25%

			which is sufficient to block any Special Resolution and keep a check on the management. It may be noted that a number of shareholders may not come to meeting and to pass any special resolution the management or those in control will not be able to generate 3 times voting power to support their resolutions.
7.	Reg 3(2) – Creeping Acquisition	Regulation may be revised to provide that their should be a time gap of at least 6 months between two creeping acquisitions.	This regulation provides that acquirer or PAC already holding more than 25% shares or voting rights in the company can within any financial year acquire 5% shares or voting rights without making an open offer. However, if any acquirer purchases 5% shares or voting rights on the year ending i.e. 31st march and again 5% shares on next day i.e. on 1st April then he will be in a position to acquire 10% shares or voting rights within 2 days without triggering the open offer requirement. Certainly this is not the intention of the regulation.
8.	Reg 4 - Acquisition of control	The prevalent ambiguity can be removed by changing the definition. Suggested rephrasing of the regulation 4 is *"Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company or substantial part of its business/ plants/ undertaking/ facilities/ employees unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance within these regulations."*	Currently, open offer is not triggered when control is acquired by not purchasing shares but through acquisition of substantial or almost the entire operations of the company, undertaking/ plants etc. The aim of any "Takeover" is the Acquisition of "Control" and acquisition of shares is only one of the means by which the objective of Acquisition of Control can be achieved. Control can be acquired without acquiring shares. This fact has been recognised by both the SAST 1997 (Regulation 12) and SAST 2010 (Regulation 4) which covers cases of takeover of companies without acquisition of shares.

			Further, the TRAC itself in its deliberations observed (Page 29, 3.6) "that it was desirable to underline and emphasize that acquisition of *de facto* control, and not just *de jure* control should expressly trigger an open offer obligation."
9.	Reg 7 (1) - Open offer for 100%	Size of open offer could be linked to size of acquisition and could be a percentage fixed in a manner that public holding is not impacted - minimum size of at least 20% and a maximum size of such number of shares as would not result in a breach of the maximum permissible non-public shareholding.	TRAC itself recognised the need of encouraging takeovers. However, having raised the size of Open offer to 100% the takeover activity would be much more difficult. Some points against 100% offer size that may be considered are: ➢ Very few offers get oversubscribed, no need to increase the size. ➢ TRAC admitted takeovers play an important role in the economic development of a country – so encourage more takeovers by keeping the offer size reasonable, ➢ Very few offers get oversubscribed, no need to increase the size. ➢ Funding is not easily available in India for purchase of shares ➢ It oversteps other regulations — delisting regulation ➢ Delisting exercise is rewarding for the investors and painful for the promoters. The investors will lose this edge. ➢ If more companies get delisted, the market cap of India Inc. will get reduced and investors will have lesser investment opportunities. ➢ This change can be implemented, once the corresponding change is carried by the RBI, for lending for takeover purposes.
10.	Reg 7 (2) - Voluntary	Remove the minimum 10% limit for making voluntary	Under the creeping offer provisions a promoter is allowed

	Offer size	offer.	to acquire 5% in each financial year (Reg 3(2) of SAST 2010). This means that in actual terms within a period of less than 12 calendar months or may be as less as 2 calendar months he can acquire 10%. There is no need for this special provision. Further, in case of acquirer or persons acting in concert with him are already holding more than 65% but less than 75% of shares or voting rights then this minimum requirement of 10% will result into a situation in which his holding will be more than maximum permissible non-public shareholding and again acquirer will come under obligation to reduce his holding to 75%.
11.	Reg 8 (6)- Offer price	Rephrase it to say "Where the acquirer has ***transacted in any manner*** or acquired or agreed to acquire whether by himself or through or with persons acting ….."	This is considered necessary to suitably reward the public shareholders and will act as a deterrent against the acquirer indulging in speculative & trading activity in the shares of the target co.
12.	Reg. 8 (2) (a), (b) and (c) Offer price	➢ Offer price shall be based on only delivered shares and not all transactions. ➢ The offer price should not only be the highest of negotiated price, volume weighted average price, or price paid/payable for acquisition, but also the highest price at which the acquirer has sold the shares or the Company has issued the shares during the offer period. ➢ The 2 week period as one of the criteria must be retained.	➢ The transparent availability of this data could be an issue; ➢ With a view to provide best price to the shareholders. ➢ It acts as a check on the clandestine activity of the acquirer or insider. It has been observed that the 2 week price is, in majority of the cases,

			higher than 26 week price, indicating some insider trading or any clandestine activity.
13.	Reg 8 (6)- Offer price	After subclause (6) insert a new clause stating "In case of an Offer where the Acquirer has failed to come out, the Offer price shall be computed as of the date of the action that triggered Open offer and as of the date of public announcement for the target company, whichever is higher, shall be payable".	**In the recent past there have been several cases where the defaulter acquirer kept on delaying the offer for years and when the market price became higher than the price he was liable to pay even after adding interest, he announced the offer just to legally fulfill his obligation. Thus instead of punishment, the defaulter got rewarded.**
14.	Reg 8 (7)- Offer price	(a) The line of first para needs to be changed to "The price parameters…till the of date payment under the offer." (b) add a clause that 'all the benefits of corporate action till the time payment under the offer has been completed shall accrue to the benefit of the shareholder' (c) Change the last para to "Provided that no adjustment shall be made if the dividend declared is less than 10% of the closing market price on the previous day of the record date."	(a) The language in its present form means that if there is a corporate action - say (as announced recently by Resurgere mines 2 bonus shares for 1 share and Face Value to be split from 10 to 1, 1 share will become 30 shares) record date for which falls, 2 days prior to commencement of the tendering period, the investor will be able to tender 30 shares instead of 1 and get paid at the pre bonus price!! This cannot certainly be the intention of the regulation. (b) Since as suggested price will be adjusted for corporate action till payment is made, the benefit thereof should naturally go to the shareholder. (c) The impact less than 10% of the market price should be ignored is a well accepted norm prevalent in the F&O segment of the market. The same has been suggested here.
15.	Reg 8 (8) Offer Price	(a) The methodology for calculating the new lower price has not been provided.	Shareholders will suddenly come to know at the end of the tendering period that they will get a price lower than the price

		(b) Proving option to change the open offer price subsequently does not appear to be equitable.	arrived at on the basis of the accepted method of pricing. In other words, shareholders would suffer a double-whammy – once when they are kept in the dark about differential pricing and next when they bear the impact of getting the price lower than their expectation and what had been declared earlier by the company while making the open offer.
16.	Reg 8 (9) - Offer price	Add a para "similarly, in case of default in announcing an Open offer, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period between the date on which the primary acquisition is contracted, and the date on which payment is actually made after the delayed announcement of the offer. And in case of offer announced in time but yet delayed beyond 3 months, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period after 3 months from the originally scheduled date of payment and the date on which payment is actually made."	It has been observed that even after regulation 44(i) was amended in 2002, there is no strict implementation of that regulation. In case of Falcon tyres, interest was not paid to all the shareholders, whereas in almost all other such cases interest was paid to all the shareholders.
17.	9(5) – Mode of payment	The basis of valuation of listed securities offer may be kept same as has been provided in 8 (2). The valuation transparency and compliance of Business Valuation Standards issued by ICAI is necessary. The valuer to be appointed independently with detailed guidelines regarding assumptions and basis.	➢ This will maintain uniformity ➢ Reduce chances of price manipulation ➢ Is fair to all

18.	Reg 10(1)-General Exemption	Suitable clauses may be added to include the following under general exemptions: ➢ Inter se transfers among group companies of same promoter(s) and Persons acting in Concert. ➢ Scheme of Mergers and Restructuring under Section 391 and 394 of The Companies Act, 1956. ➢ Debt restructuring by BIFR or by CLB or by NCLT. ➢ Acquisition of voting rights or proxies not on permanent basis but for specific meeting or resolution.	➢ In line with the exemption given to the inter se transfer of shares amongst a company, its subsidiary, holding company, other subsidiaries of such holding company etc. Indian promoters holding method is different as compared to international pattern. ➢ With a view to allow restructuring of the company without triggering the open offer requirements. ➢ With a view to allow restructuring of the company without triggering the open offer requirements. ➢ No obligation should be cast on a shareholder or a group of shareholder who, without the intention of acquisition, may join hands to defeat some specific resolution, by collecting voting rights or Proxies.
19.	Reg. 11 (1) Exemptions by the Board	The Board may not be given discretion to decide as to which exemptions requests falling under this category shall be forwarded to Takeover Panel for their approval.	In order to maintain uniformity in the decision making process it would be appropriate to continue to maintain the existing procedure for referring all such cases to the Takeover Panel. The process of takeover panel and its constitution should be transparent.
20.	Reg. 13(2) (a) - Timing, Public announcement	The first line may be redrafted as "in the case of market purchases shall be made ***next day of*** placement of the purchase order."	Public announcement prior to placement of order may not be practical. Because of such announcement the acquirer may fail to get any share at all.
21.	Reg. 14 (3) - Publication	Clause may be revised to include that e-mail notification will be sent to all the shareholders of the company or all the DP a/c	E-mails will be more effective & environment friendly.

		holders in the country	
22.	Reg. 15 – Contents	The format of public announcement (PA) presently in existence is serving the purpose well. The same may be retained and the following may be considered for addition: (g) Separate PA for each company should be issued (h) PA should not contain any matter not related to the target company.	In case of takeover of Dunlop & Falcon one common PA was issued creating a lot of confusion in reading and understanding the information. A shareholder of One co. should not be forced to read information of another co. unrelated to him.
23.	Reg. 17(1) – Provision of Escrow	Retain the old provision	➢ Old provision is serving well. ➢ One cannot recollect a case where it has failed. ➢ With the size of the offer going up, the amount will take a quantum jump. ➢ There have been many cases of long delays where such money lie idle with out any benefit accruing to either to the acquirer or the shareholder.
24.	Reg. 17(8) & 17 (10) (c) & other places – Provision of Escrow	Insert 10% - "The manager to the open offer shall not release 10% the escrow account…"	There is no point in blocking the escrow account for thirty days after completion of payment. At best 10% can be held back to take care of any contingencies.
25.	Reg. 18(1) - Other procedures	Add after the proposed clause "…Listed. Such draft letter of offer shall be available for public viewing at the site of SEBI & stock exchanges"	In this era of transparency & e-communication all information should be made available to public at the earliest.
26.	Reg. 18 (8) - Other procedures	Replace twelve business days with five business days and give an option to the shareholder deliver in advance their share in the escrow DP.	By allowing the option to shareholders to deliver/deposit their shares in advance, the time required to keep the issue open can be cut down without inconveniencing anyone.
27.	Reg. 18(11) - Other procedures	Amend the last line to "……..pay interest to ***all the shareholders who tendered & whose shares have been accepted***, for the delay at such rate as may be specified by the Board."	There have been cases when interest was not paid to all the shareholders. This suggestion will remove any ambiguity.
28.	Reg. 19(1)	Please Omit this.	This may lead to lot of misuse &

	Conditional offer		abuse. Small investors will loose money. This is akin to the present delisting where we see wide fluctuation in the prices and shareholders burning their fingers when such minimum levels are not reached. Latest example is Goodyear where prices crashed to 230 from 430 approx.
29.	Reg. 20 (1) - Competing Offers	Insert at last "…..*such target company. Or in case where the schedule of activity is delayed, within four business days of the final schedule of activities announced after SEBI observation has been received.*"	If competition is not allowed to come in till such time that the actual action has started, it will be a loss of opportunity to the business as well as investors.
30.	Reg. 20(9)- Competing Offers	In the first line of 2nd para insert 'be' as follows "Provided that the shares that may ***be*** acquired."	This seems to be a typographical error.
31.	Reg. 22 (1) Completion of acquisition	The requirement of depositing 100% of the consideration payable under the open offer in escrow seems to be too tough.	The TRAC itself observed (page 19, 1.5) that historically only a minority of open offers have been over-accepted (Only 42 cases out of total 392 open offers in the last 4 years were over-accepted). In view of the above putting a requirement of depositing 100% of the consideration payable under the open offer assuming full acceptance of the open offer will carry huge financial implications for the acquirer. This will again put the Indian acquirers at the disadvantageous position vis-à-vis their foreign counterparts as funding is not easily available in India for purchase of shares.
32.	Reg. 26 (6) Obligation of the target company	Constitution of committee of independent directors may be defined. Specific parameters on which this committee is expected to provide	At present it is not clear as to whether it would be one man committee or otherwise. Clearly defining the constitution would be helpful to the companies. In the absence of specific parameters, recommendations given by the committee on

		recommendations may be defined.	independent directors would be open to lot of deliberations and consequent litigation against the independent directors.
33.	Reg. 26(10)- obligation of target company	Replace this with old 23 (6) Upon fulfillment of all obligations by the acquirers under the Regulations as certified by the merchant banker, the board of directors of the target company shall transfer the securities acquired by the acquirer, whether under the agreement or from open market purchases, in the name of the acquirer and, or allow such changes in the board of directors as would give the acquirer representation on the board or control over the company	The proposed 26(10) has omitted the obligation of the target company to allow the acquirer make changes in Board of directors. It is necessary to allow such a right to an acquirer who has lawfully acquired a company.