

**REPORT OF THE RECONVENED COMMITTEE ON
SUBSTANTIAL ACQUISITIONS OF SHARES AND
TAKEOVERS UNDER THE CHAIRMANSHIP OF
JUSTICE P. N. BHAGWATI**

MAY 2002

SECURITIES AND EXCHANGE BOARD OF INDIA

PREFACE

The previous report of the Committee while making its recommendations had concluded by observing that no Rule, no Regulation, indeed no Law, which deals with dynamically evolving economic situation and circumstances and seeks to resolve constantly varying economic interests and problems in -a fast growing economy, can possibly hope to have a permanent – not even a long ending life. With new ideas and new experiences, the law must move forward. It cannot be allowed to stagnate, for stagnation is death. This observation was no mere rhetoric. The truth of this observation became evident within a short time of the coming into force of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 dealt primarily with issues such as consolidation of holdings, conditional offers, change in control, formation of Takeover Panel, competitive offers, and not the least important increased, investor protection. Numerous new provisions were included in the Regulations with a view to dealing with these issues. During the course of administration of the Regulations, it was observed by SEBI that by and large these provisions served well in fulfilling the object and purpose of harmonising interests of economic growth with those of investor protection. The Regulations in fact spurred takeover activity as evidenced by the large number of public offers, cases of automatic exemption and references to the Takeover Panel under the provisions of the Regulations during the years following upon the coming into force of the Regulations.

However, it was found as a result of the experience of the working of the Regulations that some provisions were open to diverse interpretations while some others were not sufficiently precise and could be used to achieve unintended results. Moreover, new challenges in the light of on-going economic reforms, which arose consequent on liberalisation, needed to be satisfactorily met. The challenges were accentuated in view of the irreversible integration of the Indian economy in general and the capital market in particular with the world markets. It was, therefore, realised that in order to make the Regulations efficient and effective for achieving the object and purpose for which they were made as also to meet the challenges resulting from economic reforms and liberalisation, it was necessary to take a fresh look at the Regulations and make a dispassionate, well informed review of the provisions of the Regulations in the light of the experience gained as a result of working the Regulations, so as to better subserve investor interest, consistent with fostering economic growth. The need for review of the Regulations arose as early as June 1998.

SEBI, with a view to addressing these concerns, reconstituted the same Committee, which was instrumental in drafting the 1997 Regulations. The terms of reference of the Committee are:-

1. To review the working of the Regulations
2. To consider suitable suggestions for further refinement of the Regulations in the light of experience gained so far.

The Committee comprised of the following members:-

Justice P.N. Bhagwati – Chairman

Chambers of Commerce & Industry were represented by:-

Shri Bipin Jhaveri, representing Associated Chambers of Commerce and Industry (Assocham).

Shri Adi B. Godrej (upto December 2000) and Shri N. A. Soonawala (from December 2000) representing Confederation of Indian Industry (CII)

Shri R.S. Lodha, representing Federation of Indian Chambers of Commerce and Industry (FICCI)

Institute of Chartered Accountants of India was represented by its President, Shri Rahul Rai (upto February 1999), Shri S P Chhajed (from March 1999 to February 2000), Shri G Sitharaman (from March 2000 to February 2001), Shri N D Gupta (from March 2001 to February 2002) and Shri Ashok Chandak (from March 2002).

Stock Exchanges were represented by the Executive Director of The Stock Exchange, Mumbai, Late Shri M G Damani (upto January 2000), Shri A Rathi (from January 2000 to March 2001) and Shri A.N. Joshi (from April 2001).

Legal Experts were represented by:-

Shri J.R. Gagrat of Gagrat & Co.

Shri R.A. Shah of Crawford Bayley & Co.

Shri Shardul S. Shroff of Amarchand & Mangaldas & Suresh A. Shroff & Co.

Investors Associations were represented by:

Prof. Manubhai Shah, representing Consumer Education and Research Centre

Prof. M.D. Limaye representing Lokmanya Seva Sangh (Shri Limaye however did not attend any of the meetings citing personal reasons).

Merchant Bankers were represented by

Shri Nimesh Kampani, Chairman, JM Morgan Stanley Pvt. Ltd.

Shri Shitin Desai, Vice Chairman & Managing Director, DSP Merrill Lynch Ltd.

Shri Udayan Bose, Chairman, Lazard India Limited

Shri Vallabh Bhansali, Enam Financial Consultants Pvt. Ltd.
(Special Invitee)

SEBI was represented by:

Shri O.P. Gahrotra, Ex Senior Executive Director (upto February 2001)

Shri Pratip Kar, Executive Director

Shri R.M. Joshi, Executive Director

Ms. D.N. Raval, Executive Director and Member Secretary

The Committee discussed and considered several issues which were initially raised before it but it did not restrict itself only to those issues. Other issues which arose while the deliberations of the Committee were going on were also considered by it. Further, the Committee also had an intensive and wide ranging interaction with a variety of market participants such as parties who made hostile bids as also those who responded to such bids, Financial Institutions, Regional Investors Association, etc. to understand their perspective and obtain the benefit of their opinions on the various issues considered by the Committee.

The incredibly large variety of views of number of participants compelled the Committee to extend its original time schedule. This, combined with an ever increasing number of contemporary issues raised in various fora called for serious consideration and necessarily involved that more time would be required by the Committee for completion of its deliberations and submission of its Report. However, the Committee noted with satisfaction that while its Report was awaited with eagerness, there was a general feeling that it would contribute greatly to the value of the Report if all participants were heard and the report took into consideration their views and opinions. This would go a long way in guaranteeing that the Regulations, while having a strong base, would also be inherently flexible so as to be able to meet the challenges thrown up by vibrant pulsating economy and ever changing scenario. It is with this objective in mind that the Committee has drafted this Report and the amendments to the Regulations.

Mumbai
May 7, 2002

Justice P N Bhagwati

1. Takeover Panel

1.1 The Committee was informed that The Panel set up by SEBI in terms of Regulation 4(1) for examining applications for exemption and to give recommendations has been in operation since April 11, 1997. The Panel consists of eminent people drawn from various fields who meet regularly and have given valuable inputs to the decision making process of SEBI on exemption cases. The Panel had as on 31.3.2002 considered and given recommendations in 120 cases and SEBI had in almost all cases accepted the recommendations of the Panel. The Panel has thus helped in setting healthy precedence.

1.2 The Committee was further informed that certain issues have been raised with regard to the procedure being followed while granting exemption. These relate to, inter alia, request for hearing by the Panel, right of SEBI to remit the case back to the Panel either in the light of fresh facts brought before SEBI at the time of hearing or otherwise etc. The members of the panel have expressed an opinion that there should be some provision in the Regulations requiring certification of the facts given in the exemption application. This is required so that the Panel could satisfy itself that the statements made in the application are true. Further, during the course of the Committee's meetings, issues such as whether the Panel could consider cases which may not fall within the parameters given in the Regulation 3, whether the Panel should include representatives of investors / industry associations, whether the Regulations should provide for reference to the Panel in matters of application / interpretation of the Regulations etc. came up for deliberation.

1.3 The Committee considered the various issues raised. The Committee noted that there are certain issues which are purely procedural and others which require consideration by the Committee. While opining that the existing procedure may continue, the Committee recommended certain changes. The decisions of the Committee in this regard as well as the rationale are as follows:

1.3.1 Constitution of the Panel

The Committee noted that the Panel comprises of eminent persons appointed from amongst persons referred to in subsection 5 of Section 4 of SEBI Act. This ensures that the objectives of the SEBI Act, more particularly investor protection, are taken care of. The Committee also noted that currently the Panel comprises of a former member from the judiciary.

On behalf of Consumer Education and Research Centre, Shri Manubhai Shah submitted that the Panel shall have adequate representation from investor protection groups i.e. not less than 1/3rd of the total strength of the Panel.

The Committee recommends that the constitution of the Panel may be left to SEBI. The Committee also recommends that the present practice of including a former member of the judiciary in the Panel be continued. As regards the terms of appointment, the Committee recommends that the term of each member shall be for 3 years and the member will be eligible for reappointment.

1.3.2 Scope of the Panel

The Committee discussed the issue regarding grant of exemption in circumstances not covered under clause (a) to (k) of sub-Regulation 1 of Regulation 3 of the Regulations.

The Committee recommends that the scope of the Panel may be enhanced by deleting the word “*such*” appearing in Regulation 3(1)(I). However, the Committee also recommends that the scope of the Panel cannot be extended to relax the conditions which are stipulated as part of regulatory provisions.

On seeking the recommendation of the Panel in matters of application/interpretation of the Regulations, the Committee is of the opinion that it will be beneficial to seek the opinion of an expert and independent body before passing appropriate directions. Since the Regulations already have the mechanism of a panel in place, the role of the panel may be expanded towards this end.

The Committee, therefore, recommends that the Regulations may be amended to make a provision for enabling SEBI to make reference to the Panel for interpretation of the Regulations.

1.3.3 Hearing by the Panel

The Committee held discussions with the members of the Panel. The Panel stated that wherever information provided by the applicant is found to be insufficient or where additional information is required, the Panel seeks necessary information from the applicant through SEBI and arrives at a recommendation only when sufficient facts are made available. The Panel also opined that since the Panel is recommendatory in nature and SEBI, before passing final orders, gives an opportunity for hearing to the applicant, and also remits back the application where considered necessary, the need for giving a hearing by the Panel may be superfluous and could lead to delay. The Committee recommends that the Panel may not be required to grant hearing to the applicant but may seek further information where considered necessary.

1.3.4 Remitting back the applications to the Panel

The Committee was of the opinion that where fresh facts are made available to SEBI at the time of hearing, it would be in order for SEBI to remit the case back to the Panel for reconsideration in view of the fresh facts.

While the SEBI may not give their views on each proposal, any earlier view taken by SEBI in the matter should be made known to the Panel, the rationale being the Panel should have full and complete information in the matter while considering and making its recommendations.

The Committee recommends that the Panel should have the benefit of all correspondence in respect of the matter before them for consideration.

1.3.5 Certification of facts in the application

Certification of facts is necessary as the exemption is granted based on facts as set out in the application; this needs to be certified so as to facilitate action, if any, that may be necessitated if the facts given on application are proved to be false at a later date.

The Committee recommends that the facts given in the application should be certified through an affidavit and where a company makes the application, the authority of the person making the application should be backed by a board resolution or a valid authorization by the board.

1.3.6 Communication of Panel's recommendations to the applicant

Communication of reasons for rejection of application by the Panel would give the applicant an opportunity to properly present his case at the time of hearing before SEBI and hence should be informed to the applicant.

The Committee recommends that the reasons for rejection of application in case the Panel were to recommend rejection of application should be advised to the applicant in advance of the hearing before the SEBI.

1.3.7 Rejection of applications by SEBI

The Committee was of the opinion that rejection of application on technical grounds should not be resorted to as it leads to delays.

The Committee recommends that where the applications are found to be technically deficient, SEBI may not reject but would give the

applicant an opportunity to remove the defects within the specified time period and resubmit.

2. Publishing Of SEBI's Order

The Committee was informed that SEBI follows the practice of issuing a press release giving a summary and the operative portion of the SEBI's orders. The Committee was of the opinion that unless the entire order is made public, the market may not be aware of the basis on which a particular case merited exemption, the issues which arose and how the Regulations were interpreted and applied in a particular case etc. In the Committee's opinion, these are essential to develop jurisprudence. This would also have the effect of ensuring greater transparency.

The Committee recommends that the SEBI's order should be posted on SEBI's website.

3. Consolidation of holdings

3.1 Creeping acquisition in professionally managed companies

The Committee noted that consolidation of holdings is one of the major issues on which there has been a lot of debate and is of major concern. SEBI often receives request for allowing creeping acquisition to the promoters or persons in control beyond the specified creeping acquisition limit, on the ground that the Regulations should permit quicker consolidation of holdings especially in view of the changes expected in the Indian industry due to liberalisation/ globalisation. There were also suggestions that creeping acquisition may not be permitted in professionally managed companies with no identifiable promoter group.

The Committee took into account the points put forth by the various groups and also held meetings with Industry/Investor associations to elicit their views in the matter. After considering all the relevant facts, the Committee was of the considered opinion that any differentiation among a group of shareholders militated against the principle of "equality of treatment and opportunity to all shareholders", which is the corner stone of the Takeover Regulations. In view of the above, the Committee was not in favor of any special treatment to professionally managed companies.

As regards the fears expressed that in the absence of any protective clause in the Takeover Regulations, professionally managed companies with no identifiable promoter group could be easy targets for foreign companies with unlimited resources, the Committee felt that these are matters of Government policy and cannot be regulated through the Regulations. The Committee, however, noted that foreign companies (excluding NRI OCBs) are permitted to avail of creeping acquisition limit, only with the specific approval of the board of the target company and the Government.

The Committee recommends that the requirement of approval of the Board of the Target company / Government for any acquisition by foreign companies (excluding NRI OCBs) may be included in the Regulations.

3.2 Creeping acquisition by acquirers holding 15% and above but less than 75%

The Committee also noted that the SEBI Regulations have since been amended to provide for consolidation of holdings upto 10% in any period of 12 months which should take care of the interest of the promoter group. The Committee, however, noted that the creeping acquisition of 10% which was originally allowed upto March 2002 has since been extended by SEBI only up to September 2002. In this connection some of the members opined that in view of the changes expected in the Indian industry due to the WTO provisions, an opportunity of quicker consolidation be given to the industry at least upto March 2004. Others, however, were of the opinion that the creeping acquisition of 10% should not be permitted beyond September 2002 and should be rolled back to the 5% level.

Shri Manubhai Shah, CERC was of the firm opinion that creeping acquisition should be allowed only upto 5% in a period of 12 months till the acquirer / promoter shareholding reaches 51%.

The Committee recommends that the creeping acquisition limit of 10% should be retained upto March 2004.

3.3 The Committee noted that SEBI has received queries on the manner of computation of “any period of 12 months” for the purpose of creeping acquisition. For putting the matter beyond doubt and avoiding inadvertent breaching of the Regulations, it was felt that the creeping acquisition limit may be reckoned with respect to financial year ending March 31 (i.e. from 1st April to 31st March).

The Committee recommends that the creeping acquisition limit may be reckoned with respect to financial year ending March 31.

3.4. Creeping acquisition by acquirers holding 75% and above

The Committee noted that the continuous listing norms require a 25% or 10% public shareholding at all times, depending on the listing requirements. Presently, persons holding 75% and above can consolidate further by making an open offer of any size. The Committee opined that permitting a person to consolidate beyond 75% would bestow absolute control over the company to the acquirer and the company for all practical purposes would lose the characteristics of a publicly listed company as

envisaged by the listing requirements. Hence, the Committee was of the view that it is desirable to restrict the persons in control from acquiring beyond 75% without making a public offer of minimum 20% to the shareholders.

Shri Manubhai Shah, CERC specifically stated that beyond 51%, no further consolidation should be permitted either by way of creeping acquisition or by the route of public offer whatsoever.

The Committee recommends that any acquisition by acquirers holding 75% and above should be in a transparent manner through open offers for minimum 20% and accordingly proviso to Regulation 21(1) may be deleted.

4. Control

- 4.1** The Committee was informed that though the intent of the Regulations is to provide the shareholders an opportunity to exit in case of change in control, the purpose is not achieved because the proviso and the explanation to Regulation 12 provide for certain exceptions. Further, change in control brought about through interse transfers and/or preferential allotments are exempt automatically under Regulation 3 and the investors have complained about lack of exit opportunity. An issue has been raised from time to time as to what constitutes change in control. It has been suggested that control should be more precisely defined, which may be in terms of a specific percentage of holdings.

The decisions of the Committee with reference to issues regarding “control” and the rationale therefor is as follows:

4.2 Acquisition of control

The Committee noted that the Regulation 12 was introduced to include change in control even when there is no acquisition of shares. The Committee also noted that so far hardly any offer has been made under this Regulation possibly in view of the fact that the proviso and the explanation to the said Regulation has provided certain exceptions. The Committee also noted that bringing about change in control requires passing of a simple resolution in terms of the Companies Act, which does not provide for adequate safeguard. The Committee considered alternatives such as requiring the passing of a special resolution, debarring the interested parties from voting on the resolution, postal ballot and deletion of the proviso and explanation to Regulation 12 etc. The Committee was of the opinion that having regard to corporate and shareholders democracy, it may not be appropriate to totally disallow change in management brought about after due process of law. If the

provisions relating to obtaining shareholder approval are strengthened, it would be enough safeguard to protect the interest of the investors.

Shri Manubhai Shah, CERC strongly put forth that any acquisition of control shall be only through the route of public offer. He also stated that if more than one person is to be appointed as director at a time in pursuance of any arrangement or understanding, the same shall be done only with due compliance of the provisions of Regulation 12.

The Committee recommends that change in control can be brought about only pursuant to a special resolution passed by the shareholders in a General Meeting and postal ballot should be allowed in respect of such meetings.

- 4.3 The Committee feels that the explanation as to what constitutes change in control which is presently appearing under Regulation 12 and modified as under may be shifted to Regulation 2 which contains the definition of the word "Control".

The Committee recommends that the modified explanation to the word "control" which should appear in Regulation 2 shall read as under:

- ? **Where there are two or more persons in control over the target company, the cessor of any one such person from such control shall not be deemed to be a change in control of management nor shall any change in the nature and quantum of control amongst them constitute change in control of management.**

Provided that a transfer from joint to sole control shall not constitute change in control subject to such transfers being effected in accordance with Regulation 3 (1)(e) relating to interse transfer.

- ? **Where any person or persons are given joint control, such control shall not be deemed to be a change in control -**
- a) **if the control given is equal to or less than the control exercised by person(s) presently having control over the company, and**
 - b) **such change in control is effected in accordance with Regulation 3.**

4.4 Acquisition of control through preferential allotment

The Committee was informed that quite often the disclosures in the notice to the EGM convened for obtaining approval of the shareholders for the preferential issue are found lacking in many respects like identity of persons (it is referred only as a class); pricing is stated to be as per SEBI

Guidelines (exact or indicative price not stated); emerging share holding pattern not disclosed etc. The Committee was also informed that while the Regulations provide that the Board resolution is to be sent to the stock exchanges, it has not been specified which of the Board resolutions is to be sent i.e. the Board Resolution before the EGM in which the decision to call the EGM for passing the Resolution; or the Board Resolution after the EGM which decides about issue of shares on preferential basis. The Committee was also apprised that preferential allotment route is often used for bringing about change in control by the existing persons in control, who can get the desired resolution passed on the strength of their shareholding, coupled with low turn out at the meetings.

The Committee noted that a majority of the automatic exemption cases are pursuant to acquisition through preferential allotment. While such allotments can be made only with the shareholders' approval, having regard to the low turnout of the minority shareholders in these meetings and the fact that effectively there is no exit option to the shareholders, the Committee felt that a re look is required at the automatic exemption in such cases. The Committee also took into account that any change made in this regard should not adversely affect the induction of strategic partners who often enter the company through acquisition of stake under preferential allotment.

Some members expressed reservation about continuing the exemption for preferential allotment. Shri Manubhai Shah was of the opinion that interested parties should not be allowed to vote on a resolution for preferential allotment.

The Committee recommends that the present exemption for preferential allotment be continued subject to the condition that any resolution for preferential issue should provide for postal ballot to enable greater shareholder participation.

4.5 Inter-se transfers

The Committee noted that the Regulation 3 exempt acquisitions through inter se transfers among group companies, relatives and promoters. There may not be any cause for concern in respect of inter se transfers amongst group and relatives as in such cases, the control continues to remain with the group. However the issue assumes significance when it involves interse transfers amongst promoter groups such as between a foreign collaborator and an Indian promoter or between two groups of Indian promoters. In such cases, there is bound to be perceptible change in control. The Committee noted that the arguments raised in such cases are that while the shareholder with substantial holding gets an exit, sometimes at very high prices, the other shareholders are denied such benefit. It is also possible that in such cases, the investment was made by

the shareholder on the strength of the exiting shareholder with substantial holding. There was a strong feeling that in such cases of transfers, there should be a requirement of compulsory open offer.

The Committee, however, observed that this clause was introduced essentially to facilitate entry/exit of strategic partners, group restructuring etc. Quite often the foreign collaborators enter and remain with the company till such time that technology transfer is complete and may want to exit when their presence is no longer felt necessary. A minimum holding of 5% for 3 years period has also been prescribed under the Regulations in order to avail exemption in respect of acquisitions through inter se transfers amongst two groups of promoters. The Committee also noted that a number of companies have taken advantage of this clause to restructure the business. The Committee appreciated the concerns expressed that this clause could be used for giving exit at high price to a shareholder with substantial holding in a company without an offer. The Committee was also apprised that studies conducted by SEBI indicated that approximately 46% cases of inter se transfers were at a price higher than market price, which benefited only the shareholders with substantial holding.

While accepting that it is necessary to place certain restrictions on such automatic exemptions, the Committee noted that in cases of inter se transfers leading to acquisition of sole control from joint control, the outgoing person in control may demand a premium over the market price for ceding control. The Committee felt that it would be necessary to take cognizance of such business expediency and permit a certain premium or discount over the market price for such interse transfers. In this connection, the Committee noted that a premium of upto 25% is considered normal.

Regarding the definition of the word “group”, the Committee noted that in the absence of any precise definition of “group”, definition as given in the MRTP Act was adopted; but the definition has widened the scope of exemption and has also led to interpretational problems. The Committee also discussed at length whether for the purpose of exemption of interse transfers, “group” may be defined to include entities falling under the scope of “related parties” as per Accounting Standard 18 of the Institute of Chartered Accountants of India. However, on indepth examination, it was felt that inter se transfers among related parties as per the said accounting standard would further widen the scope of exemption.

The Committee recommends that

- ? **As regards interse transfer amongst the relatives, the existing provisions may continue.**

- ? **Regarding group, interse transfer amongst constituents of the group as disclosed to the stock exchange atleast a month before the date of proposed acquisition and falling within the definition of the word "group" as defined in the MRTTP Act may be exempt.**
- ? **While the minimum 3 year holding period may be retained for transfers amongst 2 different groups of promoters, the 5% holding as a condition for such transfers may be deleted.**
- ? **interse transfer amongst different promoters or groups of promoters made at a price not exceeding 25% price as determined in terms of Regulation 20(2) or Regulation 20(3) alone would merit automatic exemption. Other cases may be referred to the panel.**

Illustration

Assume the price as per Regulation 20 is Rs. 100/- per share (OP) and the offer is triggered pursuant to agreement / understanding between the acquirer and person A for acquisition by acquirer of 1,00,000 shares (S) of the target company. Suppose the acquirer has also entered into a non compete agreement with A in terms of which the acquirer has to pay A a sum of Rs. 5,00,000/-(X). Thus, the non compete payment per share (NCP) works out to X divided by S.

If NCP is greater than or equal to 25% of the OP, then the excess of NCP over 25% of the OP would be required to be added to the OP.

In the current example, when X = Rs. 5,00,000, 25% of the OP is Rs. 25.

The NCP works out Rs. 5/- Since NCP is less than 25% of the OP, the acquirer would not be obliged to add NCP to the OP.

Now, if X= Rs. 1,00,00,000, then NCP = Rs. 100/-. NCP is greater than 25% of OP by Rs. 75. Therefore Rs. 75/- is to be added to the OP. The new offer price is now Rs. 175/-

5. Minimum offer size

The Committee was informed that the 20% offer size does not provide exit opportunity to all shareholders especially in case of offers where the offer price is at a premium to the then prevailing market price. This has led to complaints and demand for increasing the offer size. On offer size, the Committee noted that there were many options such as whether the offer size should be such as to enable the potential acquirer to hold a minimum of 40% or 51% after the offer, provision for 100% exit option to small shareholders even when retaining the 20% minimum offer size, a 100% offer etc.

The Committee was apprised that as on 31/12/2000, a majority of the offers (approximately 70%) were of minimum size i.e for 20%. Further 94% of the open offer did not elicit full acceptance. The Committee also noted that the acquirers still have to largely rely upon their own source of funding for acquisitions through public offers, given the absence of institutional / organised source of funding for takeovers. The Committee, therefore, felt that any increase in the minimum open offer size may adversely affect the number of public offers. Hence, under the present conditions, the current minimum offer size of 20% seems to be adequate. The Committee further noted that the extant Regulations permit the acquirer to make an offer for a higher percentage of shares, if the acquirer so desires.

The Committee recommends that no change in the minimum offer size is required to be made at this juncture.

6. 100% exit to small shareholders

On the question of whether there should be a 100% exit option to small shareholders even while retaining the 20% minimum offer size, the Committee felt that it would be difficult to determine who can be considered as a small shareholder. Further, where the acceptance level from the small shareholders alone comes close to the offer size, the other shareholders including mutual funds (which represent the small shareholders) stand to lose as they would be deprived of an equal exit opportunity. This militates against the cardinal principle of equality of treatment and opportunity to all shareholders which is the basic principle of the Regulations.

The Committee recommends that it would not be equitable to have a 100% exit option to one class of shareholders alone.

7. Institutional funding for takeovers

In the context of lack of institutional funding for takeovers, **the Committee recommends that banks /financial institutions should be encouraged to consider financing takeovers. The Committee desires that SEBI may consider taking up the matter with the Reserve Bank of India for facilitating such funding.**

8. Offer Price

8.1 The Committee was informed that while administering the Regulations in the past few years many issues relating to the provisions of offer price came up for consideration for example whether the term “price” referred to in the Regulations includes mode of payment, can the mode of payment be changed, will change in mode amount to change in terms of the offer, whether the provisions of the Regulations are intended to cover only minimum offer price or the actual offer price etc.

Issues such as whether the offer price should be historical or it should have some relevance to the market price prevailing prior to the public announcement, should it include non-compete payment etc. were also raised. It was also pointed out that the Regulations are silent on pricing for partly paid shares.

The Committee's views and recommendations on the various issues are:

8.2 Minimum offer price v/s offer price

The Committee was informed that the word "minimum" used with reference to offer price in Regulation 20 is being interpreted to mean that the SEBI Regulations are applicable only with reference to the minimum offer price as may be worked out in terms of the Regulation 20 and any compensation offered over and above the minimum offer price would not be governed by the Regulations. The Committee felt that such an interpretation is unwarranted.

The Committee recommends that the word "minimum" appearing in the title and body of Regulation 20 be deleted. The Regulations should be amended so that

- ? **obligations under the Regulations with regard to payment of consideration are applicable to the total consideration offered and**
- ? **the offer price shall not be lower than the price determined in accordance with Regulation 20.**

8.3 Parameters for determining offer price

Various suggestions were made in this regard such as the offer price may be calculated as an average of 13 weeks instead of 26 weeks; the price paid for any acquisition by the acquirers during the period of 52 weeks may be taken; non-compete payment upto 25% of consideration may be excluded etc. The Committee also noted that as per the extant Regulations, the period for determining the offer price has been uniformly taken as 26 weeks except for the price paid by the acquirer under a preferential allotment which is 12 months. The Committee considered the various issues. The Committee noted that while it may be appropriate to factor in market price as close to the public announcement as possible, extending the period beyond 26 weeks for any acquisitions by the acquirer may result in hardship to the prospective acquirer. The problem would be more acute especially if the acquirer wants to make a counter bid.

Shri Manubhai Shah however was of the view that the acquirer himself has acquired shares during the past 52 weeks, the offer price shall not be less than the price at which he has acquired the shares.

The Committee also noted that the current provision of having 26 weeks average for the market price covers a relatively extended period of time, which does not adequately reflect the events and market fluctuation just prior to the public announcement. In the Committee's opinion, a lesser period for the purpose of working out average market price would be more appropriate. On non-compete payment the Committee noted that there is a need to address the situation specially where the acquirer passes on a significantly large portion of the consideration to the out going promoter in the form of non-compete fee and only a token amount is shown as negotiated price for acquisition of shares under the agreement. The Committee felt that in such cases the offer price does not truly reflect the actual consideration paid and this could be used as a ploy for reducing the cost of acquisition through public offer.

The Committee recommends that

- ? **the average market price in terms of Regulation 20(2)(d) may be calculated on the basis of 26 weeks or 2 weeks average, whichever is higher, preceding the date of public announcement.**
- ? **price paid by the acquirer for any acquisitions during 26 weeks period may be considered.**
- ? **Any payment in respect of non-compete agreement in excess of 25% of consideration paid to persons other than the target company shall be deemed to form part of the consideration paid for acquisition of shares and should be factored in for the purpose of reckoning offer price.**
- ? **The offer price for partly paid shares may be calculated as per difference between the offer price less the amount unpaid/ calls in arrears together with interest, if any, payable on the amount called up remaining unpaid.**

8.4 Mode of payment

The Committee noted that at times an acquirer may want to change the mode of payment, especially when there is a revision in offer price and /or the quantity. Where the amount of consideration payable stands substantially increased following such revisions, the acquirer may be required to resort to other sources of funding such as issue of fresh securities etc. If we were to restrict change in mode altogether, it may constrain the acquirer's ability to revise the offer price/size depending upon subsequent developments, especially where there is competitive bid. It may, therefore, be necessary to permit change in mode of payment. The Committee also noted that the extant Regulations provide only for

exchange and, or transfer of shares and does not provide for issue of securities.

The Committee, however, noted that suitable safeguards should be provided so that the acquirer does not indulge in reckless revisions without adequate preparation and without ensuring the possibility of carrying through the revisions. Permitting change in mode at a later date may entail additional approvals etc. leading to uncertainty and consequent delay in completion of offer formalities. Further, to facilitate comparison of competing offers, the investors should be aware of not only the price but also the manner in which such price will be paid so that an informed decision can be taken in time. In view of the above, the Committee felt that while it may not be appropriate to restrict change in mode, it should be made clear to the acquirer as well as to the investors that if, for any reason, the acquirer was not in a position to fulfil the conditionalities flowing out of such change in mode, the acquirer shall be required to pay the entire amount of consideration in cash.

In this context, the Committee noted the issues which arose such as whether the mode of payment can be changed following a revision in the offer, whether change in mode amounts to change in terms of the offer etc.

The Committee recommends that

- ? **The offer price may be paid by issue of securities.**
- ? **Change in mode of payment may be permitted only in case of upward revision in offer price/ size**
- ? **Following an upward revision, where the mode of payment is changed to cash cum security, composition could be allowed to be changed as long as the cash component is not reduced by subsequent changes.**
- ? **Where mode of payment is changed subsequently, if, for whatever reasons, the acquirer is unable to fulfil the conditionalities flowing out of such change in mode, the acquirer shall be required to pay the entire amount of consideration in cash.**
- ? **Where the mode of payment involves issuance of securities, the approval of the shareholders should be obtained within 21 days from the date of closure of the offer, so that the merchant banker can ensure that the special account is funded in cash in case the shareholders approval has been refused.**

9. Infrequently traded shares

The Committee noted that the definition of infrequently traded shares i.e. having trading volume of less than 2% appears to be extremely liberal. The Committee was informed that it has been observed that it is easy to put through a trading volume of 2% thus bringing the shares into the classification of frequently traded shares. Thereafter, the market price average as provided in Reg.20 (2) is used for the purpose of determining the minimum offer price. This price is generally very low as compared to the fundamentals of the company. The Committee noted that the above is possible because only 2% of the entire listed stock of the company is reckoned for the purpose. If the definition is strengthened, it would be difficult to manage to show an illiquid stock as frequently traded.

The Committee recommends that

- ? **The shares of the target company may be deemed to be infrequently traded if on the stock exchange, the annualized trading turnover in that share during the preceding 6 calendar months prior to the month in which the Public Announcement is made is less than 5% (the number of shares) of the shares listed on the stock exchange.**
- ? **As regards SEBI seeking independent valuation wherever considered necessary, while the Committee had no objection in SEBI doing so in respect of infrequently traded shares, the opinion of the Committee was divided in respect of the shares which were to be classified as frequently traded. Majority of the members of the Committee had objection to SEBI seeking independent valuation for shares classified as frequently traded.**

10. Conditional offers

The Committee was informed that currently the Regulations provide for making an offer conditional upon level of acceptances only. Queries are being received regarding conditional offers under other circumstances also e.g. success of restructuring by the parent company certain other aspects of conditional offers such as implementation/ rescission of MOU in case the desired response is not received, whether conditional offer can be for less than 20% etc. also required consideration.

The Committee considered the various issues. The Committee felt that pursuant to an acquisition under a MOU, the acquirer is required to make an offer to the public and hence such a public offer cannot be conditional, unless of course the MOU itself is rescinded and not acted upon if the public offer does not elicit the required acceptances.

As regards requiring a domestic offer resulting from change in control/ restructuring abroad, the Committee was of the opinion that it is not logical to impose open offer requirements if the overseas offer / restructuring (which might result in indirect change in control in Indian target company) fails.

Regarding conditional offer for less than 20%, the Committee felt that as a general principle, an offer should always be for minimum 20% and therefore there is no need for allowing a conditional offer for less than 20%, though the acceptance level may be less than 20%.

About the need to differentiate between obligated and non obligated offers, the Committee remarked that owing to practical difficulties that may arise in distinguishing between an obligated and non obligated offer, it would be advisable not to make any distinction between the two types of offers. Further, non obligated offers of small size could be used for price manipulation by unscrupulous elements.

In view of the above, the Committee recommends that –

- ? **An offer should always be for 20% or above; but the offer may be subject to an acceptance level of less than 20%**
- ? **An offer can be conditional upon the success of restructuring by parent or holding company.**
- ? **When the offer is pursuant to a MoU, the acquirer may be allowed to make an offer conditional as to level of acceptances, only if the acquirer binds himself to rescind the MoU in case the desired level of acceptances is not received.**
- ? **There is no need to distinguish between obligated and non-obligated offers.**

11. Obligations of target company

The Committee was informed that the Regulation 23 precludes the target company from issuing un-issued capital with intent to discourage the target company from surreptitiously increasing the capital base of the company so as to frustrate the offer of the acquirer. However, the intended objective is sometimes frustrated when the company allots shares on the strength of a resolution which was passed earlier. The capital of the company could also rise due to public/rights issue in process. The issues which had arisen in this regard are when can an issue of capital be set to have been made i.e. the date of the AGM resolution authorising the issue of capital or the date of Board resolution

etc. and how does one preclude the target company from issuing shares as would foil the bid or frustrate it.

The Committee noted that in public/ rights issue, the facts of the proposed issues are known to the market and in any case, once the issue process is begun, it may not be possible to withhold allotment. The Committee further noted that in case of preferential allotment also, the validity of the resolution is restricted to 3 months. Thus in the above situations, the acquirer is put on guard that the capital of the company is likely to increase and should do due diligence to find out the actual issued and paid up capital of the target company. As regards what constitutes an issue, the Committee observed that there are well settled case laws in the matter. However, it may be advisable to amend the Regulations precluding the target company from not only issue of capital but allotment also.

The Committee recommends that the public/rights issue for which the offer document has been filed with the Registrar of Companies/ the Stock Exchange(s) should be allowed to be proceeded ahead with. The Regulation 23(1)(b) may be amended to include not only issue but also allotment.

12. Competitive bids

12.1 The various issues which have been raised for consideration are: the minimum size of a competitive bid vis a vis the original bid, whether the competing offer could open subject to various approvals and should the competitive bidder be allowed to withdraw the offer after the first bidder had withdrawn or revised the offer following the competitive bid.

12.2 Size of competitive bid

The Committee noted that the extant Regulations provide that the competitive offer shall be for such number of shares which when taken together with the shares already held by him at least equals the number of shares for which the first public announcement has been made. This provision while reckoning the pre offer holding of the competitive bidder excludes the pre offer holding of the original bidder. In order to ensure that the targeted quantity of the shares at the time of making the first public announcement/competitive bid is equal, it would be necessary to include the pre offer holding of both the original bidder and the competitive bidder.

The Committee recommends that the competitive bid shall be for such number of shares which, when taken together with shares held by competitive bidder along with persons acting in concert with him, shall be at least equal to the post offer target of the original bidder.

This stipulation may be complied with at least at the time of making a first competitive bid

12.3 Approvals for competing offers

The Committee felt that requiring the competing acquirers to get all approvals before the offer opens may not be desirable since the external (statutory) approvals required to be obtained may not be within the control of the acquirers. This may also lead to indeterminate delay in opening of the offer. Hence the Committee was of the opinion that as long as full disclosures are made in the offer document about such approvals, the opening of the offer may not be held up.

The Committee recommends that except for shareholders approval, (which in any case has to be obtained within 21 days from the date of the closure of the offer) the open offer could be made which is subject to statutory approvals. There is no need for the acquirer to defer the open offer till the statutory approvals are obtained.

The Committee further recommends that in case the acquirer fails to obtain the shareholders approval within 21 days from the date of closure of offer, the escrow amount may be forfeited.

12.4 Withdrawal of offer following competitive bid

The Committee noted that the extant Regulations provide for withdrawal of offer by the original acquirer following a competitive bid. When the original bid which gave rise to the competition is withdrawn, a question arose as to whether the competitive bidder can also withdraw his offer. The Committee discussed the matter and was of the opinion that rather than allowing the competitive bidder also to withdraw which would mean that no offer ultimately subsists, one should not allow withdrawal of offer by the original bidder also because an acquirer while making a bid for any company should be fully prepared for the consequences including the possibility of a counter offer. The shareholders of the target company should have the option to decide which of the offer(s) should succeed. This will also provide double exit option to the shareholders which is in their interest.

The Committee recommends that the provision relating to withdrawal of offer following a competitive bid contained in Regulation 27(1)(a) be deleted.

13. Payment of consideration through exchange of shares

The Committee was informed that a number of issues have arisen in this regard such as what kind of securities can be offered in exchange, what happens to the bid if the shareholders of the company do not approve of the acquisition, or whether the offer should be only for cash, etc.

The Committee was of the opinion that permitting the acquirer to offer shares of the third company as consideration for shares tendered would increase the flexibility available to him in the funding of the offer. But such permission should be with certain checks and balances to ensure that the shareholders are not saddled with illiquid shares thereby depriving them of an exit option. The Committee also felt that the requirement that all offers can be made in cash only would be a retrograde step and would also make public offers for large companies difficult. A suggestion was made that in the case of an exchange offer, the shareholders should be given an option to opt for cash payment. However, it was pointed out that in that event the acquirers would be in no position to know, till the date of closure, the quantum of cash that would be required to meet his obligation under the offer. Such an offer would effectively make the offer a cash offer since given an option invariably the shareholders would opt for cash.

Shri Manubhai Shah strongly opined that in any public offer, option must be available to the investor to obtain payment of consideration only in cash if he so desires.

The requirement of shareholders approval for issuance of fresh securities was discussed. Should the company which wants to issue securities and then offer them in the public offer be required to obtain shareholders approval prior to the public offer? The Committee was of the opinion that uncertainty over such matters should be avoided at all costs as it may not be in the interest of the investors and the acquirer should be reasonably certain of obtaining the requisite approvals of its shareholders for successful implementation of the offer. The acquirer should also be obliged to make payment of consideration in cash if the approvals do not forthcome. The Committee felt that unless stringent provisions are made, there might be frivolous offers, which are undesirable.

As regards applicability of SEBI Guidelines in case of offer involving fresh issue of capital by the acquirer company, the Committee was of opinion that the issue of any security by an acquirer company to the shareholders of a target company can neither be termed a public issue nor a right issue. Hence, the logical inference would mean that the said issues should be in compliance with preferential issue guidelines of SEBI.

On the issue of the type of securities that can be issued, the Committee noted that the Regulations provide for payment of consideration through exchange and or transfer of shares. Shares have been defined in the Regulations as shares carrying voting rights and includes any security which would entitle the holder to receive shares with voting rights. Preference shares normally do not carry voting rights. Further if it is redeemable, it partakes the nature of a debt instrument. The Committee also noted that generally preference shares are not rated. The

Committee noted that the Regulations require discharge of obligations either by exchange of shares or a 'A' rated debt instrument. Since preference shares do not fall in either category, they may not be permitted to be issued.

Considering the above, and keeping in view the shareholders interest the Committee recommends that

- ? **The acquirer may be permitted to offer shares of a third listed company, subject to the condition that the shares of that company are included in the list of A Group / specified shares of the Stock Exchange, Mumbai or shares grouped under S&P CNX Nifty of the National Stock Exchange.**
- ? **Shareholders approval should be taken within 21 days from the date of closure of the offer. If, for whatever reasons, the shareholders approval cannot be obtained, the acquirer shall pay the entire consideration in cash.**
- ? **If the process involves fresh issue of capital by the Acquirer Company, such fresh issue should conform to the Preferential Issue Guidelines of SEBI.**
- ? **Preference shares shall not be allowed to be issued.**

14. Open offer process

The Committee was informed that the Regulations require the acquirer to make a public announcement within 4 working days of entering into an agreement. The words "working days" have not been defined. This leads to certain ambiguities and non-compliances. Further, at times SEBI is required to call for a revised filing of an offer document, inter-alia, because there are complaints requiring detailed investigations, inadequate disclosure etc. Should SEBI have the power to call for refiling and as a consequence if the open offer process is required to be rescheduled, can SEBI do so? Further, the Regulatory requirement cast on the acquirer to file a copy of the public announcement with SEBI, the Stock Exchange and the target company two working days before its issuance to the public might lead to opportunities for insider trading, asymmetry of information etc.

The Committee recommends that

- ? **Working days mean working days of SEBI.**
- ? **there is no need for the copy of public announcement to be submitted to anyone at all. It would suffice if the public**

announcement is given simultaneously in newspapers/ stock exchanges/ target company and SEBI.

- ? **SEBI should have the power to call for submission of revised letter of offer etc. but the Regulations should clearly specify the circumstances under which a resubmission would be called for.**
- ? **SEBI should convey its comments on the letter of offer within 7 days of the date of receipt of additional information / resubmission.**
- ? **SEBI should also have the power to reschedule date of opening/ closure, in cases where the offer becomes subjudice or involves some investigation by SEBI etc. or as a consequence of any revised resubmission.**

15. Disclosure requirements

The Committee appreciated that periodic disclosures help in monitoring compliance to the Regulations. This also increases transparency in the dealings of the acquirer apart from providing a warning system to the existing management of the target company. The Committee also recognises that there should be transparent and purposeful dissemination of information.

Following aspects of the requirements in the current Regulations were considered by the Committee:-

- ? Lack of requirements for disclosure in case of acquisition/ sale by an acquirer holding 5% or more shares / voting rights
- ? Changes in shareholding are required to be reported at the end of the financial year and the record date and not at the point of time when the change in shareholding actually occurs.
- ? Lack of explicit requirement for the stock exchanges to disseminate the information received by them from the company
- ? Need for revising the current requirements of disclosure by the acquirer to the target company and by the target company to the stock exchange
- ? Penalty for non-compliance with the requirement of disclosures and its consequences

The Committee also noted that doubts have been expressed by certain people regarding applicability of the disclosure requirements under the Regulations to the financial institutions, mutual funds, foreign institutional investors etc. The acquisitions /sales by major shareholders including the financial institutions, mutual funds, foreign institutional investors and persons in control is market sensitive information and should be disseminated immediately as and when such changes occur. The Committee therefore thought it fit to re-iterate that the obligations cast

upon an acquirer to disclose his shareholding as and when it exceeds 5% are binding on every person including the financial institutions, mutual funds, foreign institutional investors, etc and there is no relaxation whatsoever from the reporting requirements, even where the acquisition per se may be exempted.

While recognizing operational difficulties involved in reporting of holding/change in holding to the company /stock exchange at too frequent an interval, the Committee agreed that the present reporting requirement which require reporting only at 5% level and not thereafter, especially for acquirers holding less than 15%, requires to be modified.

The Committee recommends that

- ? **Disclosures should be made at every stage when the acquirer crosses the limit of 5%, 10% and 14%;**
- ? **For acquirers holding 15% and above, purchases or sales at every 2% level should be disclosed.**
- ? **The reporting of acquisitions/ sales should be made to the stock exchanges and the target company within 2 days.**
- ? **The acquirers are obligated to ensure that the necessary disclosures reach the company and the stock exchanges.**
- ? **The exchange shall immediately flash the information received on the trading screen/ notice board and also post such information on its website. Such information should be retained on the website for a period of atleast one year.**
- ? **The percentage level referred to should be computed on a gross purchase basis at any point of time to decide whether the Regulations are attracted.**
- ? **Any non-compliance of the requirement should be viewed seriously and appropriate action should be initiated.**

16. Applicability of the Regulations

16.1 Acquisition by pledgees other than banks and financial institutions

The Committee observed that advance against pledge of shares is a well accepted commercial business activity. However, at the same time, care should be taken to ascertain that there is no surreptitious acquisition or takeover of a company in the guise of enforcement of pledge. Towards this end, disclosures should be ensured whenever shares were acquired by way of pledge by persons (other than banks and financial institutions)

at the point of time when the pledge was created. In this connection, the Committee noted that the Regulation 7 requiring disclosure of acquisition covers acquisition under pledge also and this may be suitably clarified in the format of disclosures. The Committee was, however, not in favor of granting automatic exemption for acquisition through pledge.

The Committee recommends that

- ? **In case of acquisition through pledge, Takeover Panel may decide if exemption should be granted based on the facts of each case.**
- ? **At the time of creation of pledge, disclosures should be made by the pledgees to the company and the stock exchanges so as to keep the public adequately informed.**

16.2 Acquisitions pursuant to a scheme of arrangement

International acquisitions that lead to indirect acquisition of shares/ voting rights or control over an Indian target company through various layers of subsidiaries situated in various jurisdictions have become commonplace. In such cases, the Indian target company and its shareholders are not directly involved in the said proposal. Under Indian law, any scheme of arrangement, reconstruction etc. is subject to orders of the Court and shareholders approval. However, the Committee noted that the term “scheme of arrangement” is not very well defined, causing apprehensions that the word ‘arrangement’ used in the Regulations could be loosely interpreted leading to dilution of the spirit of the Regulations.

The Committee also felt that adequate care should be taken to avoid grant of exemption to cases of mergers or amalgamations abroad where there is a clear agreement for sale and purchase of shares of the Indian company. Such acquisition shall not be considered as a part of the merger proposal.

Shri Manubhai Shah advocated that acquisitions through the route of mergers and amalgamations done under the orders of the Courts in India alone should be exempted as these take place with the approval of the shareholders of the Indian company. Mergers and amalgamations of companies which have taken place outside India should not necessarily be valid and binding in India and should not be exempted.

The Committee recommends that the words 'of arrangement' appearing at Regulation 3(1)(j)(ii) may be deleted .

16.3 Acquisition of shares by Government Companies

Due to the exemption available under the current Regulations a Government company is not required to make an open offer pursuant to acquisition of shares of another listed Government company from the

Government, while a private sector company acquiring a Government company may be required to make a public offer causing distortion of level playing field. This also adversely affects shareholders' interest as Government, being major shareholder, gets an exit but not the minority shareholders.

The Committee was informed that based on the proposals received from the Ministry of Disinvestment, and approved by SEBI, suitable amendments in the Regulations have already been made.

16.4 Transfers by acquirers after open offer

16.4.1 Interse transfer of shares amongst acquirers who have made the open offer

Issue relating to transfer of shares between the acquirer who has completed the open offer process and persons acting in concert with him were raised in the Committee. The Committee agreed that these transfers are akin to interse transfers amongst promoters and therefore, in principle, merit consideration of exemption. However, the Committee noted that even in case of interse transfer among promoters, such transfers are automatically exempted if the transferors/ transferees were holding the shares for a period of at least 3 years. A similar period of holding is desirable in the case of transfers between the acquirer and persons acting in concert with him.

The Committee recommends that automatic exemption may be considered in respect of interse transfer amongst the acquirer and persons acting in concert with him only where the proposed acquisition takes place after 3 years from the date of closure of open offer. In other cases, reference may be made to the Panel.

16.4.2 Transfer of shares from SFCs to acquirers after open offer

The Committee noted that where the promoter of a company exits by selling his substantial/controlling stake, the acquirer gains control after due process of law including an open offer and hence is a successor to the promoter. Since the definition of the word "promoter" includes persons in control, a person gaining control of the company after an open offer should, for all practical purposes, be considered as promoter from the date of successful completion of the open offer formalities. The acquirer has effectively stepped into the shoes of the promoter and assumes all the rights and obligations of the promoters vis a vis the financial institutions; for e.g. the financial institutions insist on personal guarantee of the incoming management, the SEBI lock-in provisions are made applicable to the acquirer etc. Similarly, he may be required to fulfil any contractual obligation that the erstwhile promoter may have entered into with a state level financial corporation.

The Committee recommends that the automatic exemption currently available under Regulation 3(1)(i) for transfer of shares from state level financial institutions; including their subsidiaries, to co-promoters of the company pursuant to an agreement between such financial institution and such co-promoter(s) should be extended to include successors / assignees of the co promoters of the company.

16.5 Applicability of the Regulations to Foreign Institutional Investors

The current Regulation 2(1)(e) defines persons who will be deemed to be persons acting in concert with other persons in the same category. This term includes ' Foreign Institutional Investors with sub-account(s)'. The issue regarding the continuance of the said provision was referred to the Committee as it was felt that each sub account is an independent account and hence, the sub-accounts should not be deemed to be acting in concert with the Foreign Institutional Investors.

The Committee was of the opinion that the present provision deeming the Foreign Institutional Investors to be acting in concert with the sub accounts may continue as it is in line with international practices. The Committee, however, noted that this presumption is rebuttable. The Foreign Institutional Investors can thus give a rebuttal whenever they are not acting in concert and such a rebuttal can be in the form of a specific declaration /undertaking.

The Committee recommends no change in the existing provisions.

16.6 Miscellaneous exemptions

The Committee was informed that under the current Regulations the acquisition of shares by

- ? persons in exchange of shares tendered under an open offer
- ? in excess of creeping acquisition limit pursuant to offer of safety net for acquisition of shares by promoters/ merchant bankers
- ? international development organisations such as Asian Development Bank (ADB), Commonwealth Development Corporation (CDC), International Financial Corporation (IFC) and other international organisations

are not exempt under the automatic route from the requirement of making an open offer.

The Committee felt that the above referred acquisition arising as a result of receipt of consideration for open offers in terms of the Regulations are passive acquisitions and hence require to be exempted from the applicability of the Regulations.

It was also felt that safety net i.e. acquisition by a promoter or through a merchant banker is for the benefit of investors and therefore anyone providing safety net and thereby crossing the threshold limit, should not be burdened with open offer obligations. This may also encourage promoters /merchant bankers to offer safety net to investors.

Regarding the acquisitions by International financial organisations like IFC, ADB etc., it was felt that these organisations have an important role to play and are akin to Indian financial institutions. Since such institutions may not have an interest in gaining control, their acquisitions may be exempt from the Regulations.

While on the subject of exemption, Shri Manubhai Shah, on behalf of CERC, strongly stated that granting of exemption to the acquirers from making public offers is overwhelmingly anti small investor and it defeats the very purpose of the Regulations. He, therefore, opined that as far as possible, there should be no room for exemption or any contingency or any possible permutation or combination where exemption should be allowed whereby acquirers are not required to make public offer to the shareholders. He stated that the obligation of the acquirers to make public offer should be the rule and not the exception.

The Committee recommends that the scope of Regulation 3 i.e. the exemption provisions should be expanded to cover acquisitions

- ? **by a person in pursuance to an open offer for exchange of shares**
- ? **in excess of creeping acquisition limit pursuant to offer of safety net made by promoters/ merchant bankers**
- ? **by international development organisations such as IBRD, ADB, CDC, IFC.**

17. Reporting to SEBI

Under the current Regulations, certain acquisitions which are exempted under the Regulations are to be reported to SEBI within 21 days of the acquisition. The Committee deliberated on whether this requirement should continue.

The Committee recommends that there is no need to dispense with the present requirement of reporting.

18. Date of proposed acquisition:

The Committee deliberated on what should be the reference date in case of securities which are convertible.

The Committee recommends that the date of conversion of the securities should be the reference date for determining the applicability of the Regulations.

19. Definitions

19.1 The Committee stated that It must be understood that while definitions should be clear, precise and unambiguous, there may not be definitions which cover each and every aspect of the terms defined therein. The Committee was informed that despite the clarity that the current Regulations provide, certain operational difficulties have been faced by SEBI while dealing with certain terms. For example, in a situation where X acquires certain % in the target company pursuant to a MOU which triggers an open offer and Public announcement is made by Y, which may be a connected party to X or a totally independent person. Y is shown as the acquirer because under the open offer X is not going to acquire any shares. Some doubts were expressed regarding the liability of X in such a situation if Y fails to fulfil obligations. In other words questions arose regarding the definition and obligation of the “acquirers”, “persons acting in concert”, “persons in control” etc.

The Committee also observed that many of these terms have been discussed thread bare in the orders passed by SEBI, Securities Appellate Tribunal and High Court and thus, the ambiguity regarding the terms like 'acquirer', 'persons acting in concert', 'control' have been reduced to some extent.

As most of the issues referred to the Committee were clarificatory in nature, **the Committee after discussions and experience shared by SEBI, recommends that the following may be clarified:**

- ? **The term acquirer also includes 'persons acting in concert'.**
- ? **The acquirers /persons acting in concert are all jointly and severally responsible for fulfillment of obligations under the Regulations.**
- ? **The term 'voting rights' which is not defined in the Regulations would carry the meaning as per definition in the Companies Act, 1956.**

19.2 Offer period :

The Committee was informed that certain restrictions placed by Regulations like induction of directors etc. during offer period are circumvented by inducing directors on or after the date of MOU but before Public Announcement. The Committee felt that the intention of the

Regulations while placing such restrictions is to ensure that the acquirers do not take control of the target company till all formalities are completed.

In the light of the above, the Committee recommends that, 'Offer period' may be reckoned to be from the date of the MOU, if any, to the date of completion of all formalities.

19.3 Promoter

In the current Regulations exemption is given from the applicability of Regulations to inter-se transfer amongst promoters as defined in the Regulations. The Committee was informed about the general apprehension expressed by various quarters regarding the misuse of this provision due to the definition of promoters being too wide. For example, a company with only 7 qualifying shares of which two are held by a promoter would fall within the definition but actual acquisition through such company may be done by the remaining 5 shareholders through financing arrangements.

The Committee agreed that the Regulations need to be tightened by amending the definition of 'promoter'. The adoption of the definition of 'promoter' in the Regulations from the Malegam Committee report has widened the scope of exemption. Since the exemption under the Regulations is automatic and subject to only a reporting requirement, such a wide definition is susceptible to misuse. The Committee, therefore, felt that the definition may be suitably reworded and adapted for the purposes of the Regulations.

The Committee recommends that the definition of 'promoter' may be redrafted as under :

"Promoter" means -

- (i) the person or persons who are (in control of the company) directly or indirectly whether as a shareholder, director or otherwise, over the company; or
- (ii) person or persons named in any offer document as promoters.
- (iii) where the promoter is an individual –
 - (a) a relative of the promoter within the meaning of section 6 of the Companies Act, 1956 (1 of 1956);
 - (b) any firm or company, directly or indirectly, controlled by the Promoter or a relative of the Promoter or a firm or Hindu undivided family in which the Promoter or his relative is a partner or co-parcener or a combination thereof;

Provided that in case of partnership firm the share of the promoter or relative of the promoter is not less than 50%.

- (iv) where the promoter is a corporate body :-
- (a) subsidiary or holding company of that body; or
 - (b) any firm or company, directly or indirectly, controlled by the Promoter of that body corporate or his relative or a firm or Hindu undivided family in which the Promoter or his relative is a partner or co-parcener or a combination thereof."

Provided that in case of a firm, the share of a promoter or relative of a promoter is not less than 50%.

19.4 Public shareholding

Public shareholding is an important term as it denotes the shares that can be considered eligible for acceptance under the offer. While the definition covers shareholders other than acquirer and persons acting in concert, Regulation 22(3) excludes the participation of parties to agreement in the open offer. The Committee's views were sought on whether this definition would hold good in a situation of a hostile bid or when certain persons in the existing management are not included as parties to MoU either deliberately or otherwise. The Committee was of the opinion that this may have to be considered based on the facts of each case.

The Committee recommends that in a particular situation, if the definition is not found to hold good, SEBI may intervene and issue suitable directions

19.5 Shares

The current definition of shares includes any security which would entitle the holder to receive shares with voting rights. The issue of whether this definition of 'shares' would include redeemable preference shares as they would carry voting rights under certain circumstances was deliberated by the Committee.

The Committee was of the opinion that redeemable preference shares, per se, do not carry voting rights and such share holders are permitted to vote under certain special circumstances only. Hence it may not be appropriate to equate them with shares.

The Committee recommends that for the purpose of these Regulations, the term 'shares' would not include preference shares.

19.6 Date of Acquisition

The term 'acquisition' has not been defined in the current Regulations. In the current Regulations, all the reporting requirements are linked to date of acquisition. While as an established practice in case of preferential allotment the date of allotment is taken as the date of acquisition, there is a lack of established norm in case of purchases from the open market. There is a need to clarify whether the date of acquisition in case of open market purchase is the date of delivery of shares with blank transfer forms or the date of transfer and registration in own name.

The Committee noted that in a demat environment, the issue may not have much relevance. The Committee also noted that the Regulations are also applicable in case of intention to acquire shares which would imply that registration of shares is not a prerequisite for determining acquisition of shares.

20. Asset Stripping

The Committee noted that the Regulations do not have substantive and explicit provisions to cover situations where after the public offer, the acquirer proceeds to strip the assets of the company. The extant Regulations have certain restrictions on sale of assets during the offer period and also require certain disclosures about the intentions of the acquirer in this regard. The Committee noted that the disclosures in the offer document in this matter are generally vaguely worded as the acquirers usually take shelter under the pretext that they can decide about such things only after they gain control and take stock of the situation. While this is not disputed, there should be certain safeguards to ensure that any asset stripping which is substantial in nature is done with the approval of the shareholders to protect their interests. The Committee noted that the Companies Act provisions require an approval of shareholders only in the event of sale of undertaking and not when there is sale of assets, even if it is substantial. The Committee considered what safeguards should be imposed to ensure shareholder protection and sanctity of disclosures made in the offer document. The Committee felt that disclosures should be made in the offer document regarding asset stripping. Such disclosures are necessary to enable the investor to take an informed decision on the offer.

The Committee recommends that:

- ? The offer document should include an undertaking from the acquirer not to strip substantial assets except with the prior approval of the shareholders of the target company.**

- ? **Any non compliance thereto should be treated as a mis-statement in the offer document inviting appropriate action by SEBI.**
- ? **As a measure of investor protection, SEBI may consider extending the same principle to the listed companies in general by making such an undertaking as a part of listing agreement.**

21. Indirect acquisition of a company through chain principle

The Committee was of the opinion that the public offer for the company which gets acquired as a consequence of the takeover of the target company is triggered only upon the successful completion of the acquisition of the target. At the time of making the offer for the target company, such a takeover or rather its success is contingent and prospective and in the event of its failure, the consequent offer does not arise. Though the public announcement for the consequent offer could be made simultaneously, it would be conditional upon the successful completion of the first offer. Such conditional offer has its own impact on the market and is not without practical and procedural difficulties. Hence the public announcement for the consequent offer can be allowed to be made within a pre- specified time period of say 3 months from the date of closure of the first offer.

However, the investors of the 2nd company should get benefit of the best price available and for the purpose the reference dates of the public announcement for the first as well as the second offer may be taken for determining the offer price.

The Committee recommends that

- ? **The offer for a company which gets acquired as a result of acquisition of a target company can be subsequent to the successful completion of the takeover of the target by the acquirer. It should be made within 3 months of consummation of restructuring or arrangement by parent or holding company.**
- ? **The price shall be determined as highest of the two prices determined as per the provisions of the Regulations, with reference to the date of the public announcement for the target company and the date of public announcement for the company which is consequently acquired.**

22. Acquisition of Indian listed company by virtue of acquisition of an Overseas Company

In the case of acquisition of Indian listed company by virtue of acquisition of an overseas company; the Committee was of the firm view that the interest of Indian shareholders should be protected. Such interest should

not be allowed to be compromised simply because the acquisition takes place through complex /multi-tier organisation structures. The Committee pointed out that specific amendments and explanation were incorporated in the 1997 Takeover Regulations to cover such acquisitions.

As regards enforcement of the obligations, the Committee was of the opinion that the company immediately above the Indian listed company would be obliged to comply with the Regulations since as part of the chain, it is in immediate control/command of voting rights.

The Committee also desired that in such cases apart from the parameters as specified in the Regulations for determination of the offer price, the 2 weeks average market price prior to the public announcement may also be taken into account. This is in appreciation of the fact that in many cases, the date when the obligation actually crystallises is not clear. The Committee noted that the extant Regulations already cover cases of acquisition of Indian listed company by virtue of acquisition of an overseas company.

The Committee recommends that it may be clarified that the obligation to make an open offer would rest on the entity one level above the Indian listed company.

23. Permitting change in management pending completion of offer formalities

The Regulations permit change in the Board of Directors which would give the acquirer control over the company only upon fulfillment of all obligations by the acquirers under the Regulations and certified by the merchant banker. However, where 100% of the amount of consideration payable is deposited in the special account, changes in the Board were allowed to be effected after the closure of offer. The Committee was of the opinion that this clause might prove onerous at times considering the time involved for completion of formalities. The Committee however noted that the said provision was introduced in order to provide for level playing field in competitive bids and to maintain status quo till the closure of the offer. The Committee was of the opinion that since the competitive bid can be made only within a particular period from the date of public announcement, it may not be inappropriate if the acquirer were allowed to enter the management after such period for competitive bidding is over.

The Committee recommends that

? acquirers may be allowed to enter the management after the period of competitive bidding is over ;

? **such changes may be allowed only when 100% of consideration payable, assuming full acceptances, is deposited in escrow in cash where the consideration payable is in cash; or in the form of securities where the consideration payable is by way of issue, exchange and/or transfer of securities.**

24. Withdrawal of acceptances tendered

One of the issues raised before the Committee was whether the investors should have the right to withdraw acceptances once tendered. The Committee was informed of SEBI's consistent stand in the matter that acceptances once tendered cannot be withdrawn. Such a stand had been taken in the light of practical difficulties in allowing withdrawal and re-tendering as also the fact that the acquirer may not be in a position to determine with a reasonable amount of certainty the level of acceptances that his offer has elicited which is essential for him to plan his strategy like revision in offer price or offer size etc. Such problems would become acute if there are competitive bids.

The Committee, however, noted that in other jurisdictions the facility for withdrawal is permitted and also it may not be legally tenable to disallow withdrawal by investors when the contract is yet to be completed. Further, allowing withdrawal would be in the interest of investors. This is more relevant in case of competitive offers. The Committee felt that the investor should be allowed to withdraw till such time the final price has been fixed and made known to the investors. In this context the Committee noted that the Regulations permit revision in offer price upto 7 working days prior to the date of offer. Allowing 3 to 4 days thereafter for investors to exercise their judgment, the Committee felt that withdrawal by investors may be permitted upto 3 working days prior to the date of closure of offer.

The Committee recommends that the investors may be allowed to withdraw the form of acceptance tendered upto 3 working days prior to the date of closure of offer.

25 Acquisition during and subsequent to public offer

The present Regulations required disclosures in respect of acquisition during offer period. The Committee was informed that such disclosures are, however, made only in respect of acquisitions at a price higher than offer price. The Committee noted that the acquisitions during offer period, irrespective of the price at which it was acquired, is a price sensitive information and should be disclosed.

The Committee recommends that acquisitions during offer period, irrespective of the price at which it was acquired must be disclosed to the stock exchanges. The Committee also recommends that the

information received by the stock exchanges shall be immediately posted on the trading screen for information of the public.

As regards acquisitions subsequent to closure of public offer by the acquirer, the Committee noted that while there may not be any objection to market purchases, it would be reasonable to restrict negotiated purchases, at prices higher than offer price immediately following the offer, so as to avoid misuse.

The Committee recommends that the acquirers may not be permitted to acquire shares at a price higher than offer price for a period of six months. This restriction however will not apply to market purchases.

26. Delisting pursuant to an offer under the Regulations

The attention of the Committee was drawn to the recent trend of offers being made with intention to delist. Such offers are made at a time when the general market conditions are depressed, thereby taking advantage of the low market price. Delisting through these offers has the effect of reducing good quality paper from the market. This is also perceived by the investors as unfair as they are left with no choice but to accept the offer or face the consequences of remaining as a shareholder of an unlisted company with no exit option. Some members were of the opinion that the formula for arriving at the offer price for such offers should be more stringent and should take into account the book value, market price over a period etc. In this connection, the Committee was informed that SEBI is already seized of this issue and has already set up a committee to look into all aspects of delisting.

The Committee recognizes that delisting is an issue which is detrimental to the investors and feels that the Takeover Regulations should not be used to achieve the objective of delisting by circumventing the provisions laid down for delisting in the listing requirements.

The Committee recommends that a suitable clarification to this effect may be incorporated in the Regulations.

27. Compression of time taken for open offers.

The members of the Committee were of the opinion that there is scope to reduce the time prescribed for various activities under the Regulations so as to enable faster completion of offer process. This will be in the interest of investors, acquirers and also the target company.

The Committee recommends that suitable amendments may be made in the Regulations wherever possible.

28. Penalties

The Committee deliberated on the various penalties that could be levied on the acquirer in case of violation of the provisions of the Regulations especially in case of an acquirer who has acquired shares /control in violation of the Regulations 6,7, 8, 10, 11 & 12 - whether he should be allowed to retain the benefit of such illegal acquisition; or should the acquirer be directed to make a public offer and separately be subject to action for violation in terms of the Regulations.

The Committee was apprised of the extant practice followed by SEBI to deal with violations, which is generally directing an acquirer to make an open offer and separately referring the case for adjudication and levy of monetary penalties. The Committee was informed of the grounds for such practice namely the following, -

- (i) Directing an acquirer to disinvest may not serve the intended purpose of the Regulation i.e to provide an exit opportunity to the shareholders. Hence mandating an open offer seemed a better alternative.
- (ii) The acquirer may not be in a position to disinvest especially in case of illiquid shares. Further mandating disinvestment may have its own impact on share price to the detriment of the shareholders for no fault of theirs.
- (iii) Penalty is visited through adjudication.

While the Committee appreciated the concern of SEBI, it was of the firm view that the acquirer should not generally be allowed to reap the benefits of any acquisition in breach of Regulations. Directing such an acquirer to make an open offer in some cases may enable the acquirer to further consolidate his ill gotten acquisitions. The Committee was of the firm opinion that any acquisition in breach of Regulation 10, 11 or 12, including where an exemption under Regulations 3 is not available due to non compliance with any of the conditions on which the exemption is granted under Regulation 3 leading to acquisition in breach of Regulations 10,11 or 12 is bad in law and therefore is null and void ab initio. The Committee opined that the remedies for violation are made known so that the acquirer is aware of the repercussions. The Committee therefore suggested that a separate provision be incorporated in the Regulations clearly specifying that acquisition of shares in breach of Regulations 3, 10,11 or 12 shall be null and void. The Committee further suggested that SEBI should also be empowered to make consequential directions such as cancellation of shares, freezing of transfer and voting rights etc. in such cases.

The Committee, in the light of above discussions, recommends as follows:

- ? **A new Regulation 12A may be inserted clearly spelling out the following:**
 - i) **Any acquisition of shares in breach of Regulation 10, 11 or 12 of the Takeover Regulations shall be null and void.**
 - ii) **So also, where exemption under Regulation 3 is not available for any reasons whatsoever and an acquisition is made in breach of Regulations 10,11 or 12, such acquisition shall be null and void.**

- ? **Where it is not possible to restore status quo ante for any reason, SEBI should direct appointment of a merchant banker for the purpose of causing disinvestment of shares acquired in breach of Regulations either through public auction or market mechanism, in its entirety or in small lots, or through offer for sale.**

- ? **Any profit made in the process should be put in the Investor Protection Fund.**

- ? **Where an acquisition of shares pursuant to an allotment is null and void due to breach of Regulations 3, 10, 11 or 12, SEBI shall report the same to the target company, and the stock exchanges. The target company shall cancel the shares which are null and void and shall report to SEBI and stock exchanges about the cancellation of such shares. The depository shall freeze further transfer of such shares.**

- ? **Where SEBI is satisfied that as a result of acquisition of any shares, violation of Regulations 10, 11 or 12 is likely to take place, SEBI may direct the target company or the depository not to give effect to transfer of any such shares and not to permit the acquirer or any nominee or any proxy of the acquirer, to exercise any voting or other rights attaching to such shares.**

- ? **Violators and their associates may be debarred from accessing or dealing in the capital market for such period as may be determined by the SEBI.**

- ? **For non compliance with the disclosure requirement in Regulation 6,7 & 8, the SEBI may have the power to direct disinvestment of such shares as are in excess of the trigger point for reporting requirement, as well as to impose monetary penalty.**

? **In exceptional cases, such other remedies as considered appropriate may be granted by SEBI.**

? **This is without prejudice to any other penalty as may be levied by SEBI**

29. Power to remove difficulties

It has been observed that public offers of Indian listed securities are being made not only in India but also outside the jurisdiction of India. It is, therefore, important to empower SEBI to issue directions for the purpose of resolving the conflict of laws.

The Committee, therefore, recommends that the Regulations be amended so that if any difficulty arises from certain offers being subject to more than one jurisdiction, SEBI is empowered to issue directions for the purpose of resolving the conflict of laws, if any.

The Committee thanks the Secretariat and the officers of SEBI who helped the Committee throughout in its deliberations. The Committee records its deep appreciation of the valuable contributions made by Smt. Usha Narayanan, CGM, Investigation Department of SEBI and the assistance provided by her in the preparation of the Report. We would particularly like to place on record the untiring efforts, dedication and zeal with which the staff of SEBI and particularly Shri O P Gahrotra, the then Sr. Executive Director of SEBI, Kum Dharmistha Raval, Smt. Usha Narayanan and Shri Ananta Barua placed themselves at the disposal of the Committee, assisting the Committee in its deliberations and in the preparation of the Report and draft amendments to the Takeover Regulations.

The Committee would like to thank the large number of individuals and institutions who readily responded to the Committee's request for their views and comments and also for giving in writing their views on specific issues. The Committee thanks the media, in particular the financial and economic newspapers and magazines, for widely publicising the deliberations and for offering constructive comments by way of news reports and editorials and publication of articles and letters from the readers and thus generating large public debate and interest in the subject and thereby assisting the Committee in arriving at its recommendations.

The Committee also wishes to express its grateful thanks to Shri D.R. Mehta, the then Chairman of SEBI for constituting the Committee and giving the members full freedom in drafting the Report and the Regulations. The Committee also would like to express its grateful thanks to Shri G.N. Bajpai, present Chairman of SEBI for facilitating the completion of the work of the Committee.
