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An MHRD Project under its National Mission on Education through ICT (NME-ICT)

Subject: Law

Production of Courseware

e- Content for Post Graduate Courses

Paper : Corporate Law

Module : Take over and acquisition of companies

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Q1: E-TEXT

Module ID 17: TAKEOVER & ACQUISITION

Pre-Requisites: Knowledge of SEBI (SAST) Regulations 2011, 1997 and Companies Act 2013

Learning Objectives

After reading this module you shall be able to understand:

- The concept of takeovers and acquisition
- Difference between takeover, acquisition and mergers
- Legal provisions governing takeovers in India

Subject Name: LAW
Paper Name: CORPORATE LAW
Module Id: 17

Keywords: Takeover, Substantial acquisition, Control, Offer Size, Public Announcement

Learning Outcome: The reader shall be able to understand the concept and meaning of takeover and acquisitions. The text also explains the need for a proper code and the various kinds of takeovers. The reader shall also be able to understand the legal provisions related to takeovers and acquisitions in India.

1. **Introduction**

A Takeover takes place when one company acquires controlling interest over another company. Takeover and acquisition is a form of inorganic corporate restructuring where the management of the company changes its hands. Sometimes it is done with the consent of the board of the management of the target company. This is known as friendly takeover. Sometimes it is done without the consent of the board of management , which is known as hostile takeover. There is a third category which is known as bailout takeover. In a bailout takeover, the financially weak target company is bailed out to a strong company with the interference of a financial institution or a bank.

Takeover differs from mergers and amalgamations in many ways. In case of merger or amalgamation, both the companies become one and merge with each other whereas in case of takeover, there continues to be two distinct companies, and the assets, liabilities and stock are not shared or merged.

An acquisition is another variation and brings changes in the management of the company. An acquisition of shares could result in a takeover. Acquisition necessarily involves the purchase of shares of a target company which can further lead to acquisition of voting power. When such a purchase of shares is with an intention to take control of the target company, such an acquisition becomes a takeover.

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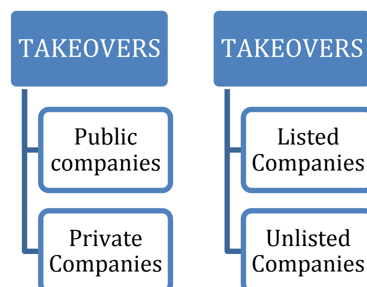
Therefore, irrespective of whether there is a takeover of a company or not, acquisition of shares occurs whenever shares of the target company changes hands.

The trend of takeovers and acquisitions in India witnessed significant regulatory changes in 2011, when the new Takeover Regulations came into force. Particularly, the new regulations[1] were brought into force to govern the public listed companies in India. The basic principles which applies to an acquisition and a takeover is that in case of takeover compliance of both the takeover code as well as that of the Act is necessary, while in case of only acquisition compliance of only the Act is required. When acquisition becomes a takeover, the provisions of the SEBI Takeover code 2011 becomes applicable. Similarly, if an acquisition results in a combination, then the provisions of the competition act 2002 also becomes applicable, and the approval of the competition commission of India is required. And if the acquisition results in either inflow or outflow of funds, to or from India, then the provisions of FEMA 1999 would become applicable.

Regulator for Takeovers & Acquisitions in India

Indian corporate sector is multi sectoral and multi regulated by various regulatory authorities. Other than the Companies Act, the major Act which governs corporate activities is the Securities and Exchange Board of India Act, 1992. Companies are also governed according to their kinds viz: public and private. Takeovers can be divided according to the kinds of companies and whether they are listed or unlisted.



[1] SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011

The unlisted companies are governed by the provisions of the Companies Act whereas the affairs of the public listed companies are regulated and governed by the SEBI to ensure that investors interests are not adversely affected. Under the Companies Act 1956, takeover/acquisition of shares of unlisted companies was dealt under section 395 which provided for both power as well as duty of the acquirer company to acquire the shares of the target company. Similar provisions have been given under section 235 and 236 of the Companies Act 2013. Section 236 of the Act provides a unique feature of the purchase of minority shareholding, if the acquirer company becomes registered holder of the ninety percent of the issued equity share capital of the company.

In case of takeover of listed companies, other than the SAST Regulations, compliance to the listing agreement is also required. The provisions of Securities Contract Regulation Act, 1957 and various rules and regulations framed there under apply in case a company has to takeover or acquire another target company. The main regulation which applies to the acquisition or takeover transaction of public companies is the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation 2011. These regulations have been amended several times before to address the needs of the business world.

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1. Need for Takeover Code

The need to govern takeovers and acquisitions emerged from the need to govern those corporate houses which made it a fashion to acquire controlling interest in other companies. Takeovers turn hostile when done without the consent of the management of the target company. There are probabilities that such an acquisition process would adversely affect the interest of the investors & shareholders of the target company. Takeover is a corporate decision and should be beneficial for the shareholders at large and not merely the individuals. The need was felt long back in 1980s when the attempts were seen to undertake hostile takeover activity.

DID YOU KNOW?
The first attempt in India to make a hostile takeover was done by Swaraj Paul when he made effots to takeover Escorts Ltd. And DCM Ltd. in 1980s.

A greater need was realized after the introduction of LPG (Liberalization, Privatization, Globalization) model in 1991 which required the Indian corporate sector to indulge in various cross border activities. The LPG model opened the gates of Indian economy for foreign investors and began a trend where in the companies wanted to restructure themselves by inorganic means such as mergers & acquisitions. The most important reason behind having a proper takeover regulation was to achieve the objective behind the SEBI Act i.e. to protect the interests of the shareholders of the target companies besides achieving the desired target of the acquirer companies.

A need was felt to have a code which could imbibe within itself the principles of corporate democracy, transparency, fairness and equal opportunity to all. With such broad objectives, SEBI enacted the Takeover Regulations 1994 which were further amended in 1997. In the light of the changing market policies and changing needs of the corporate world, there was again a need felt for new regulations to govern mergers & acquisitions. Thus, in 2009, a committee was constituted by SEBI under the chairmanship of Mr. C. Achuthan, popularly known as the TRAC (Takeover Regulations Advisory Committee) to look into the challenges and loopholes in the Takeover Regulations 1997. The Achuthan committee recommended several changes in the 1997 Regulations. The committee report was not accepted in whole by the SEBI but approved major recommendations of it. Thus, Takeover Regulations were replaced by the new SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011.

2. SEBI (Substantial Acquisition of Shares and Takeover Code) Regulations 2011

The main provisions under the Takeover Regulations 2011 are as follows:

2.1 Substantial acquisition of shares and voting rights

Acquiring shares of a target company is a decision of the company. Acquisition of shares in a substantial percentage leads to acquisition of control and finally takeover of a target company. Acquisition by a company can be of shares, voting rights or control. Acquisition of shares can be either direct or indirect. Direct acquisition is when control of a public listed company is by way of acquisition of shares of the target company directly where as indirect acquisition is done by acquiring shares of a holding company/parent company of the target company. The takeover code mandates an open offer process for both direct as well as indirect acquisition of shares, voting rights or control if such acquisition triggers the threshold prescribed under the Takeover code.

Regulation 3 of the code requires a public announcement to be made for every acquisition of shares, voting rights or control which is more than twenty five percent but less than the maximum permissible non public shareholding in a financial year. Thus, there is no requirement of going through an open offer process by making a public announcement if the acquirer acquires shares up to 24.99% within a financial year. Open offer process requirement should be fulfilled only when there is a substantial acquisition of shares, voting rights or control. Having done substantial acquisition of shares or voting rights or control by making a public announcement, if an acquirer has to acquire additional shares, entitling him to exercise more than five percent of the voting rights in a financial year, he is again required to make public announcement of an open offer.

The concept of creeping acquisition allows an acquirer to acquire additional shares every year up to five percent for which he is not required to follow the open offer process.

Under the Takeover Code of 1997, an acquirer was mandated to make an open offer if he, alone or through persons acting in concert, were acquiring 15% or more of voting right in the target company. This threshold of 15% has been increased to 25% under the Takeover Code of 2011.

2.2. Acquisition of Control

Acquisition of control substantially differs from acquisition of shares and voting power. Regulation 6 of the Takeover Code mandates making of a public announcement of an open offer for acquisition of control directly or indirectly, over a target company. This is irrespective of acquisition or holding of shares or voting rights in a target company.

2.3. Indirect acquisition of shares or control

The concept of Indirect acquisition of shares has been recognized under Regulation 5 of the Takeover Code 2011. It explains indirect acquisition as the acquisition of shares, voting rights or control over any other company which would enable the acquirer of shares, voting rights or control to exercise such percentage of voting rights, which would otherwise have triggered an open offer process over which would enable the acquirer to exercise control over a company. Certain indirect acquisitions are regarded as 'deemed direct acquisitions' if such indirect acquisition satisfy the following conditions such as:

(a) the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired exceeds 80 percent; or

(b) the proportionate sales turnover of target company as a percentage of the consolidated sales turnover of the entity or business being acquired exceeds 80 percent; or

(c) the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired exceeds 80 percent;

The 'deemed direct acquisition' has to follow the same mandatory open offer related requirements as a direct acquisition of shares, voting rights or control.

2.4. Voluntary Offer

Regulation 6 provides an option to make a voluntary offer under the Takeover code 2011, to those shareholders who already hold at least 25 percent or more but less than 75 percent of the shares or voting rights of that company, to further consolidate their existing shareholding in the company. This is a unique option which was not present under the Takeover Code, 1997. Voluntary offer enables such shareholders to acquire further shares representing at least

10 percent of the total shareholding of the company. But this flexibility is not offered to the shareholders without any restrictions, such as :

i) a person who (together with PACs) has acquired shares or voting rights in the preceding 52 weeks otherwise than pursuant to an open offer is not entitled to make a voluntary offer;

ii) during the offer period of such voluntary offer, acquisition of any shares in the target company are prohibited;

iii) the acquirer who makes a voluntary offer is not entitled to acquire any shares of the target company for a period of six months after the completion of that voluntary offer, except by way of another voluntary offer or a competing offer; and

iv) the shares proposed to be acquired under the voluntary offer should not be in such number so as to reduce the public shareholding of the target company below the minimum permissible limit, assuming that the offer is accepted in full.

2.5. Offer Size – Regulation 7

The open offer size has been fixed by the Takeover Code, 2011. Regulation 7 explains that any acquirer who has already made substantial acquisition of shares, voting rights or control can make an offer for at least twenty six percent of the total shares of the target company, within a period of tenth working day from the closure of the tendering period.

The voluntary open offer made through public announcement under regulation 6 enables the acquirer to acquire at least such number of shares as would entitle him to exercise an additional ten percent of the total shares of the target company. But the post acquisition holding of the acquirer should not exceed the maximum permissible non-public shareholding applicable to such target company. The limitation in terms of offer size is not same in case of a competing offer. If the offer is a competing offer and the acquirer has made a voluntary offer, then he is entitled to increase the number of shares within a period of fifteen working days, to such number as he deems fit. After the lapse of fifteen days, the acquirer shall not be able to increase the offer size.

2.6. Offer Price- Regulation 8

The formula for calculating offer price, in the interest of the shareholders and the target company has been determined under the Takeover Code, 2011. Any acquirer who makes an open offer, either directly, indirectly or through voluntary offer shall make it at a price in accordance with the regulations. in the case of direct and indirect acquisition of shares or voting rights in, or control over the target company, the offer price shall be the highest of,—

(a) the highest negotiated price per share of the target company for any acquisition under the agreement attaching the obligation to make a public announcement of an open offer;
(b) the volume weighted average price paid or payable for acquisitions whether by the acquirer or by any person acting in concert with him, during the fifty two weeks immediately preceding the date of the public announcement;
(c) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during twenty six weeks immediately preceding the date of the public announcement;
(d) the volume weighted average market price of such shares for a period of sixty trading days immediately preceeding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;
(e) where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters and such other parameters as are customary for valuation of shares of such companies; and
(f) the per share value computed under sub-regulation (5), if applicable.

2.7. Mode of payment- Regulation 9

The Takeover Code provides great flexibility to pay the offer price in a number of ways. It may be either paid in cash or by issue, exchange or transfer of listed shares in the equity share capital of the acquirer. It may also be paid in the form of listed secured debt instruments issued by the acquirer. Another mode of payment can be by way of issue, exchange or transfer of convertible debt securities. The code also permits a combination of the all above modes of payment.

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The shareholders have an option to make a payment in cash where the shares have been acquired during the fifty two weeks immediately preceding the date of public announcement and such an acquisition makes him exercise more than ten percent of the voting rights in the target company and has been paid for in cash.

2.8. General exemptions- Regulation 10

The Takeover Code provides a list of exempted acquisitions where the acquirers are not required to make an open offer or public announcement:

(a) acquisition pursuant to inter se transfer of shares amongst qualifying persons, being,—

(i) immediate relatives;

(ii) persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;

(iii) a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;

(iv) persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement;

(v) shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company.

2.9. Completion of acquisition- Regulation 22

The acquisition process gets complete only after the expiry of the offer period. The Takeover Code mandates the opening of an escrow account into which amount in cash equal to one hundred percent of the consideration as fixed between the parties has to be deposited. After the period of twenty one working days from the date of detailed public statement, the Code allows the parties to act upon the agreement and acquire shares, voting rights or control over the target company. The maximum period for the acquirer to complete the acquisition process is twenty six weeks from the expiry of the offer period. This time period of twenty six weeks may be extended by the Board in case there is an extraordinary circumstances. The Board before granting such extention would look into the interests of investors in general.

2.10. Withdrawal of open offer- Regulation 23

The Takeover Code 2011 allows to with draw an open offer once made only under following circumstances:

(a) statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused, subject to such requirements for approval having been specifically disclosed in the detailed public statement and the letter of offer;

(b) the acquirer, being a natural person, has died;

(c) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or

(d) such circumstances as in the opinion of the Board, merit withdrawal.

(2)If the open offer is withdrawn, the acquirer, within two working days, is required to make an announcement in the same newspaper in which the public announcement of the open offer was published. The Code also mandates the information to be given in writing to the Board, all stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

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3. Role of Independent Directors

The present times has witnessed a wave of change in the corporate world. There was a need felt for greater accountability and transparency in the corporate transactions. The legislature tried to imbibe such principles in M & A transactions in the form of the new Companies Act, 2013 and the new Takeover Regulations, 2011and various other amendments in corporate law. The role of directors, especially independent directors, has been redesigned under these regulations. The Takeover Code of 2011, makes it mandatory for the board of directors of the target company to constitute a committee of independent directors (who are entitled to seek external professional advice on the same) to provide written reasoned recommendations on such open offer, which the target company is required to publish.

4. Conclusion

The need for a change in the corporate laws was much needed. The takeover code 2011 reflects such a change which has tried to meet the interests of shareholders as well as promoters. The Code provides various unique features which were not present in the previous Code such as exit opportunities for public shareholders to exit, raising the threshold for making an open offer from fifteen percent to twenty five percent, indirect acquisition, revised list of exemptions and many more. The listed public companies are required to strictly comply with the requirements given under the code, otherwise it would result in delisting of the shares of such companies. Such strict compliance of the regulations is necessary to ensure that investors are protected from the adverse effects which takeovers, especially hostile takeover, may create on their interests. The Takeover Code 2011 focuses on the principles of corporate democracy, transparency, fairness and ensuring the interests of investors.