



Short Article

Decoding the Control Conundrum under the Takeover Regulations: Mandatory Bids Intricacies

Nehal Ahmad Nadwi¹

¹Assistant Professor, Sandip University, Nashik; LLM, National Law School of India University, Bangalore

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Abstract: *The concept of control is discussed in the Companies Act 2013, the Competition Act 2002, and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011. However, the author will prefer to discuss the concept of control in the light of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011. The qualitative and quantitative aspect of control in the light of mandatory bids is extensively debated by scholars and policymakers. In fact, the adjudicators seem to have failed in conclusively determining the concept of control. It is alarming that the consequential damage due to the strict quantitative and qualitative threshold is far more serious. One of the questions this paper seeks to address is whether the TRAC's recommendations in the form of a 25% numerical threshold are correct for adding the degree of objectivity and consistency for determining the concept of control? Eventually, a germane approach is discussed in order to tackle the issue.*

Keywords: *Takeover Code, Mandatory Bid, TRAC, SAT, SEBI.*

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1. Introduction

The promotion and maintenance of a vibrant market for the purpose of corporate control are considered as one of the fundamental roles of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Takeover Code” *hereinafter*).¹ It is incontrovertible that under the Takeover Code, the acquirer is required to make a 26% tender offer to shareholders of the target company; in case the acquisition contained 25% voting rights or even change in control. Different jurisdictions across the world including the United Kingdom (UK), South Africa, Spain, and other European Union (EU) members, Russia, and Singapore have mandated making an offer, though they largely rely upon the numerical threshold.² To substantiate the point, the author shall refer to the UK Takeover Code which defines control in terms of 30% interests or voting rights of company.³ Hence, exceeding 30% threshold by the acquirer would mandate him to make an open offer as per the UK Takeover Code. So far as the Indian condition is concerned, the conception of control has been done both qualitatively and quantitatively. The measurement of control is determined by acquiring a substantial acquisition of 25% of the voting rights of a target company. The purpose of the mandatory bid is to provide fair and equal treatment to all shareholders and the minority shareholders should be protected from the coercion of the majority. Nonetheless, changes in the shares of the target company often left minority shareholders in the lurch.

This paper aims at highlighting the issues of control under the Takeover Code and what kinds of loopholes are there in Mandatory Bid rules. It further reflects the negligence of regulatory authorities in defining the contour of direct and indirect control. Consequently, I have taken the help of various case laws wherein the concept of direct and indirect control was unsatisfactorily explained by the regulatory authority. The author has also outlined the purpose of the TRAC recommendations for a 25% Mandatory open offer which eventually seems to have failed in achieving the objectives. The author also has given the suggestions as to how regulatory authority shall the clash of control into account while determining and rethinking upon the 25% criteria. Most importantly, the regulatory authority shall rethink the scope of control and the MTB in the light of leading jurisdictions. One of the questions this paper seeks to address is whether the TRAC’s

¹ F.H. Easterbrook & D.R. Fischel, ‘The Proper Role of a Target’s Management in Responding to a Tender Offer’ (1981) 94 Harvard Law Review 161-204

² Menaka Doshi, ‘Column: 50 Shades of Control’ (*The Financial Express*, 24 May 2013) <<https://www.financialexpress.com/archive/column-50-shades-of-control/1119849/>> accessed on 19 July 2021

³ *Ibid*

recommendations in the form of a 25% numerical threshold are correct for adding the degree of objectivity and consistency for determining the concept of control?

2. Concept of Control in India: The Evolution

Securities and Exchange Board of India⁴ (“SEBI” *hereinafter*) in 1992 consolidated the very provision of the mandatory open offer. Since liberalization and privatization had a profound impact on the Indian economy, the necessity of effective regulation for the purpose of control was largely felt. Given the development, growth, and new challenges of the financial market, the formation of the Justice Bhagwati Committee was seen as a blessing in disguise. Taking into consideration recommendations of Justice Bhagwati Committee, the Substantial Acquisition of Shares and Takeover Regulations (“Takeover Regulations” *hereinafter*) was passed in 1997.⁵ The Committee noted that the acquisition of control could take place not only through acquiring a particular percentage of shares or voting rights but the projection of control could also take the shape in terms of exercising control over the Board of Directors. It could easily be referred to as *de facto* and *de jure* control.⁶

The numerical threshold was increased in this particular recommendation from ten percent to fifteen percent.⁷ The further staggering development of Takeover Regulations 1997 had taken place with the appointment of the Takeover Regulations Appointment Committee (“TRAC” *hereinafter*) in the year 2009.⁸ The purpose of setting up such committee was to look into the market volatilities, to remove inconsistencies and to bring fair and equitable market treatment for all shareholders.⁹ As a consequence of this, the TRAC suggested that the obligation of making a mandatory open offer should be indispensable in case of both direct and indirect control.

In addition to this, the committee further opined that the acquisition of twenty-five percent shares or voting rights would be tantamount to the fact that the acquirer is entitled to take *de facto* control over the company

⁴ Shubhang Swaroop, ‘Provisions of Takeover Code and Recent Changes’ (*Tax Guru*, 20 Jun 2020) <<https://taxguru.in/company-law/provisions-takeover-code.html>> accessed on 24 July 2021

⁵ Report: *The Reconvened Committee on Substantial Acquisitions of Shares and Takeovers under the Chairmanship of Justice P. N. Bhagwati* (May 2002), <<https://www.sebi.gov.in/takeover/takeoverreport.pdf>> accessed on 27 July 2021

⁶ Vinita Nair, *SEBI aborts brightening the fine lines of control*, <<http://vinodkothari.com/2017/09/sebi-aborts-brightening-of-fine-lines-of-control/>> accessed on 05 August 2021

⁷ SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, reg. 10.

⁸ *Ibid*, at reg. 12.

⁹ Morbis Philipose, ‘Which Track did SEBI Follow’ (*Live Mint*, 01 August 2011) <<https://www.livemint.com/Opinion/NvxGNIRmAuNJz7RypXKs3I/Which-Trac-did-Sebi-follow.html>> accessed on 08 August 2021

thereby making the obligatory requirement of the mandatory open offer.¹⁰ The Substantial Acquisition of Shares and Takeover Regulations, 2011 (“Takeover Regulation 2011” *hereinafter*) is the by-product of recommendations of abovementioned TRAC committee. In this regard, Regulations 3, 4, and 12 are pretty relevant for issuing a mandatory open offer in terms of voting rights and *de facto* control respectively, if it meets the criteria of 25% of the acquisition.¹¹

The fundamental object behind the enactment of Mandatory Bids under the Takeover Regulation 2011 was to prevent the catastrophic effect of a ‘change without permission’ in control. It was also aimed to prevent the bidder from taking advantage of the power of the single person to whipsaw the others.¹² Thus, maintaining the principle of equality among shareholders is one of the primary concerns of the insertion of MTB.¹³ Astonishingly enough, there is no uniform pattern for the definition of acquisition of control across different jurisdictions. Control can take place in the form of voting rights or the majority of members of the Board of the Company. It was *one* of the main reasons SEBI thought of the Brightline Test for decoding the conception of control.¹⁴

3. Role of Judiciary in Defining the Concept of Control

It is important to mention that investors demand veto rights to protect their interests at the time of purchasing the shares in a particular company which contains in the shareholder’s agreement.¹⁵ The question before the judicial authority arises is whether the negative control conferred under the same rights will constitute control under the ambit of Regulation 2(1)(c) of the Takeover Regulations 2011.¹⁶ To substantiate this issue, the author shall hereby refer the relevant case in this regard. In *Subhkam Ventures Pvt Ltd v. SEBI*¹⁷ while defining the concept of control under the Takeover Regulation, the SEBI held that specific affirmative voting rights or veto rights acquired by the acquirer by shareholders agreement would amount to control over the target company.

¹⁰ Report: *Takeover Regulations Advisory Committee under the Chairmanship of Mr. C. Achutban* (SEBI, 19 July 2010) <https://www.sebi.gov.in/sebi_data/attachdocs/1287826537018.pdf> accessed on 13 August 2021

¹¹ Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011, reg. 8 & 10

¹² Victor Brudney, ‘Equal Treatment of Shareholders in Corporate Distributions and Reorganizations’ (1983) 71 *California Law Review*

¹³ William D. Andrews, ‘The Stockholder’s Right to Equal Opportunity in the Sale of Shares’ (1965) 78(3) *Harvard Law Review*

¹⁴ Discussion Paper: *Brightline Tests for Acquisition of ‘Control’ under SEBI Takeover Regulations*, <https://www.sebi.gov.in/sebi_data/attachdocs/1457945258522.pdf> accessed on 15 August 2021

¹⁵ Rudresh Mandal & Hardik Subedi, ‘Demystifying the Concept of Control in the Takeover Regime: Of Harmonisation and Whitewash Provisions’ (2018) 5(1) *NLUJ Law Review* 27, 34

¹⁶ *Ibid*

¹⁷ *Subhkam Ventures Private Limited v SEBI* (2010) SCC Online SAT 35

On the other hand, the Securities Appellate Tribunal (“SAT” *hereinafter*) discarded the contour of control by saying that the positive control amounts to control whereas the negative control in terms of veto rights could not be classified as control. Although in the case of *Rhodia SA v. SEBI*¹⁸ the SAT held that the veto rights on structural and strategic changes enabled the acquirer to acquire control over the target company. The SAT further delineated that it is not essential to have control over the day-to-day functioning of the target company to exercise veto rights.

On a contrary note, the *Jet-Etihad*¹⁹ case is quite different wherein the SEBI opined that the imposition of open offer obligation is not essential having accessed the cooperative commercial arrangements and seeking some required changes in the terms.²⁰ Furthermore, it was elucidated that the agreement in concern has no role to play for Etihad for the sake of acquiring control over the management and affairs or policy decisions of Jet.²¹ In other words, to establish control, the right to appoint two directors out of twelve is not sufficient in so far as all major policy decisions would be required to be taken by both the Jet Airways and Etihad.

*Arcelor-Mittal India Private Limited v. Satish Kumar Gupta & Ors.*²² The Apex Court explained the definition of control as per the Companies Act which agrees with the definition of control under the Takeover Code and further categorized the same into two parts namely *de facto* and *de jure* control.²³ The *de jure* control implies the fact that it is a right for appointment of the majority of directors whereas the *de facto* control enables a person positively, directly, or indirectly to influence the management or policy decision of a company.²⁴

Interestingly, the Supreme Court agreed upon the reasoning of the SAT in the *Subbkam Ventures*²⁵ case and opined that control fundamentally means positive control.²⁶ However, the power to block special resolution cannot be termed as control.²⁷ Given the crux of the abovementioned judgments, it is important to understand

¹⁸ *Rhodia SA v SEBI* SCC OnLine SAT 30 (2001)

¹⁹ *Jet Airways (India) Limited by Etihad v SEBI* SCC OnLine SEBI 283 (2014)

²⁰ *Ibid*

²¹ *Ibid*

²² *Arcelor-Mittal India Private Limited v Satish Kumar Gupta & Ors* Civil Appeal No. 95820 (2018)

²³ Tanushree Bhuvalka & Srikanth Mantravadi, ‘What the Top Court’s ruling in Arcelor Mittal Case means for PE firms in ‘Control’ Deals’ (*VC Circle*, 15 May 2019) <<https://www.vccircle.com/what-the-top-court-s-ruling-in-arcelormittal-case-means-for-pe-firms-in-control-deals/>> accessed on 22 August 2021

²⁴ *Ibid*

²⁵ *Subbkam Ventures Private Limited* (n 17)

²⁶ Tanushree Bhuvalka (n 23)

²⁷ *Ibid*

that the judicial authorities have to be careful and vigilant while adjudicating the issues of any change in control that the ability to adversely affect the business in any way.²⁸

4. Control under the Takeover Regulation 2011: The Conundrum

Since, the author has earlier dealt with the evolution of the conception of control in the light of various committee reports and recommendations, and have also outlined the role of the judicial authorities as to how they performed their role of interpretation while determining the contour of control. Furthermore, the author has encapsulated how the particular authority shall adjudicate the disputes in concern. Now, the author shall extensively elaborate on the implications of control that were hardly touched upon by the regulatory authority. What kinds of ambiguities and inconsistencies are there in terms of numerical thresholds along with control face to face with significant influences?

The expression ‘control’ essentially enables a person to exercise the right for the appointment of the majority of directors to have control individually or in concert over management or policy decisions either directly or indirectly which undisputedly includes shareholding and management rights or shareholders agreements and voting agreements.²⁹ One should understand the principle that there is no application if the director or the officer of the target company has control just because of his position.³⁰

Indian companies have been playing a bigger role in cross-border takeover markets.³¹ In fact, Indian companies are playing a pivotal role so far as acquiring targets and assets overseas through outbound deals are concerned.³² Moreover, lots of takeover activities are taking place in the Indian market, takeover regulations have strictly or constantly been tested and regulated.³³

The MTB which contains the proposition of equal treatment of all shareholders acting like an elixir for the protection of minority shareholders, does contain the numerical threshold of 25% along with the subjective

²⁸ Bhavya Nahar, ‘Reviewing the Ambit Of ‘Control’ Apropos to be Objective of ‘Mandatory Bids’: An Analysis under the Takeover Regulations’ (2018) 11 NUJS Law. Review

²⁹ Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011, reg. 2(1)(e)

³⁰ Yogesh Gupta, ‘SEBI Takeover Code - Detailed Analysis (Tax Guru, 28 November 2018) <<https://taxguru.in/sebi/sebi-takeover-code.html>> accessed on 27 August 2021

³¹ Umakanth Varottil, ‘The Impact of Globalization and Cross-Border Mergers & Acquisitions on the Legal Profession in India’ in Wilkins DB, Khanna VS, Trubek DM (eds.) *The Indian Legal Profession in the Age of Globalization: The Rise of the Corporate Legal Sector and its Impact on Lawyers and Society* (Cambridge University Press 2017) 170-216

³² *Ibid*

³³ Menaka Doshi (n 2)

definition of control.³⁴ Additionally, if the above two conditions are satisfied, the acquirer would initiate the MTB.³⁵ Ironically, the root cause of deviation of the Takeover Code from rest of the jurisdictions is that it contains low numerical threshold and broader subjective definition of control.³⁶

5. Mandatory Bid Rule: The Ambiguities

It is pertinent to mention that the purpose of the MTB was to provide protection to minority investors and to grant fair and equitable benefits to them. On the contrary, it contains some ambiguities as well. One of the disadvantages of MTB is that it not only prevents the occurrence of value-increasing takeover but it also makes the takeover an expensive venture. Once an acquirer exceeds the 25% threshold, the mandatory bid rule comes into play.³⁷ Consequently, there is an increase in the costs of such acquisition which ultimately results in high expenditure.³⁸ Another form of ambiguities is that sometimes the creeping acquisition works as a gateway for the acquirer in terms of getting benefits thereby to strengthen control over the company.³⁹ Surprisingly enough, if the Regulation 3(2) of the Takeover Code 2011 comes into play, it may work as a deprivation of equal treatment of shareholders which eventually could act as a setback over the very objective of the Takeover Code. Hence, a possible solution lies upon the act that creeping acquisition threshold must be decreased thereby preventing the promoters from taking undue advantages.⁴⁰ One of the loopholes of the Takeover Code 2011 is that it does not reflect the actual meaning of the term control since the term “control the management and policies”⁴¹ is a subjective proposition whereas the “right to appoint directors” is an objective proposition.

6. Conclusion

It goes beyond any reasonable doubt that when it comes to the issue of takeover regulation and the MTB, conception of control has been quite complicated particularly in India. The blend of the qualitative and

³⁴ Umakanth Varottil, ‘Comparative Takeover Regulation and the Concept of Control’, (2015) Singapore Journal of Legal Studies 208–231

³⁵ *Ibid*

³⁶ *Ibid*

³⁷ Anirudh Laskar & Vyas Mohan, ‘India raises the threshold for a Mandatory Takeover Offer’ (*Live Mint*, 29 July 2011), <<https://www.livemint.com/Politics/JpNtBUVruCRadEdslrPVAO/India-raises-threshold-for-mandatory-takeover-offer.html>> accessed on 04 September 2021

³⁸ SEBI (*Substantial Acquisition of Shares and Takeovers*) Regulations 2011, reg. 4

³⁹ Devasheesh Pathak, ‘Mandatory Bid Rule under the Takeover regulation in India’ (*iPleaders*, 28 September 2018) <<https://blog.iPLEaders.in/mandatory-bid-rule-takeover-regulation-india/>> accessed on 07 September 2021

⁴⁰ *Ibid*

quantitative concept of control has been a herculean task to be resolved. It is, therefore, essential for regulators to exercise larger freedom while examining and introspecting the perspective of control taking into consideration the facts and circumstances of cases. A crystal clear and concise definition of a conception of control shall be provided while ensuring the protection of minority investors and providing minority shareholders fair and equitable benefits. Hence, a more balanced approach would be desirable given the encouragement of the acquisition of equity stakes. Moreover, in determining the control, special attention shall be paid towards the ability of acquirers as to whether such thing could essentially influence the company's Board of Directors. Moreover, the regulatory authority shall rethink the concept of control and increase the numerical threshold in the pattern of certain leading jurisdictions like that of the UK Takeover Code. Further, it is imperative to resolve the intricacies imbibed in Mandatory Bids considering the inclusive growth and development of our country.