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M&A Interactive

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About M&A Interactive

NDA's M&A Interactive is an attempt to analyze, comment and evoke discussion and deliberation on contemporary M&A events both domestic and global which may have an impact on deal making and the wider economy.

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1. Mega M&A Deals: Conspicuous by Their Absence in India!

2015 has already seen a record number of "mega M&A deals"[1] globally including the recent mega takeovers of SABMiller and EMC Corp by AB InBev and Dell respectively.[2] However, by all counts and even by Indian deal market standards mega M&A deals have been absent historically and more particularly this year in India.[3] As per the report published by the Securities Exchange Board of India (SEBI), the largest open offer this year thus far was valued at around INR 132 crores (USD 20 million).[4] While, the level of anti-trust scrutiny is never a conclusive parameter to deduce whether mega deals are present in a given market, nevertheless they provide some indication on the nature of the M&A market. In India since the inception of the merger control framework[5], out of the 264 cases reported to the Competition Commission of India (CCI) only 2 cases have undergone a detailed scrutiny (also referred to as Phase II investigations) which at the very least indicates the absence of large strategic deals in India. In this interactive, we try and explore the possible cause(s) that is plaguing the mega M&A deal market in the context of India.

I. Factors That Facilitate a Mega Deal Market

While it is difficult identify the factors that facilitate mega deals with any degree of certainty, existing literature in the field indicates that (a) a robust macro-economic outlook in the medium to long term, (b) upward stock market movement, (c) level of competition in a market/industry and (d) availability of credit (both on the corporate balance sheet and other external sources of funding) are the some of the key factors that form the bedrock for the creation of a mega deal market.

II. Is a Market For Mega Deals Necessary?

This interactive is not an endeavor to argue that "mega" or "large" M&As are necessarily good for the economy or any of the stakeholders. In fact there is existing literature which suggests that mega M&As destroy value for the acquiring shareholders and that most large M&As fail.[6] Having said that in the larger scheme of things an environment for large M&As may be a "necessary evil"

1. There is no formal definition of what constitutes a 'mega deal'. However, typically a deal for a purchase consideration of USD 1 billion or more is considered as a 'large'/'mega' deal. Having said that, the definition could differ from one jurisdiction to another depending on the market capitalization of the companies in such jurisdictions.
2. James Fontanella-Khan and Arash Massoudi, "Megadeals for 2015 hit record high", New York and London, September 18, 2015, available at http://www.ft.com/cms/s/0/9ef27ce8-5d65-11e5-9846-de406ccb37f2.html#axzz3oXAVQhQW (last visited October 14, 2015). This article evaluates the inbound M&As and not outbound M&As involving Indian companies as outbound M&As are governed are typically governed by the laws of the host/targets jurisdiction and are mostly driven by non-domestic factors.
3. Kanika Datta, "M&As: Waiting for the Bing Bang", New Delhi, October 7, 2015, available at http://www.business-standard.com/article/companies/m-as-waiting-for-the-big-bang-115100701367_1.html (last visited October 14, 2015).
4. Details of Open Offers made under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and SEBI (Substantial Acquisition of Shares and Takeovers), Regulations, 2011, available at http://www.sebi.gov.in/cms/sebi_data/takeover/takeoverapr2015.html (last visited October 14, 2015). Under the Indian takeover laws, the minimum mandatory open offer size has to be a minimum of 26% of the voting capital of the company and the offer price cannot be lower than the negotiated price for the principal transaction that triggers the open offer, therefore the size of the offer is typically a good indicator to deduce the value of the deals.
5. S. 5 and S. 6 of the Competition Act, 2002 which are the principal provisions relating to the notification of M&As was brought into force on March 4, 2011.
6. "Mergers: Why Most Big Deals Don't Pay Off", BusinessWeek, 14 October 2002; "A Brave New World of M&A: How to Create Value from Mergers and Acquisitions", The Boston Consulting Group, July 2007; G. Alexandridis, K.P. Fuller, L.Terhaar and N.G. Travlos, "Deal Size, Acquisition Premia and Shareholder Gains", January, 2011, available at www.efmaefm.org/0EFMAMEETINGS/.../2011-Braga/.../0252.pdf (last visited October 15, 2015).

as such M&As typically reflect the corporate morale and consequently provides some form of anecdotal evidence on the macro-economic outlook. Large M&As can also help create strong and stable companies. For example, during the 2008 global financial crisis the US Government actively brokered deals in the larger interest of the economy and the financial system.[7]

The limited point is that whilst we have no empirical evidence to suggest that mega deals are beneficial for a target country (and the same is outside the scope of this interactive), there should be no reason for the law makers in a free economy to not provide companies various restructuring options including the ability to undertake large strategic M&As, leverage buyouts, take private transactions etc.

III. What is Precluding Mega Deals in India?

The medium to long term macro-economic outlook for India has remained mostly promising and after the general elections last year, the outlook has only improved exponentially. However, the euphoria on the macro-economic front has not resulted in any high value deals especially this year. Intuitively this raises several questions- Is the macro-economic environment as good as it is made out to be? Are Indian companies in a growth phase as opposed to a consolidation phase? Are there other factors that are impeding large deals?

While there is no denying the fact that most Indian companies are in the growth phase as opposed to a consolidation phase, there is no reason to believe that the two cannot co-exist. For e.g. there are several industries were large strategic M&A are desperately required such as telecom. Similarly, there are several public companies that could (and are required to) be restructured, delisted, strengthened and listed again through a typical leverage buyout transaction.

It is extremely difficult to empirically prove the factors that are precluding such large deals in India especially given the presence of large buyout firms. However, it appears that (a) large block of promoter holdings in Indian companies, (b) non-availability of cheap and external credit and (c) other regulatory factors are impeding the growth of a robust M&A market. It is difficult to imagine that large promoter holdings are alone precluding large deals as promoter holdings in Indian companies has been declining over the years and now there are several “blue chip” companies that have dispersed shareholding with no identifiable promoter. Therefore, by deduction it appears that regulatory factors and availability of external credit could be impeding the growth of the M&A market in India.

While, several structures (both onshore and offshore) have been used including asset acquisition for deal financing, it is no secret that external sources of financing for M&A deals (especially acquisition of shares of a public listed companies which are typically the target for large M&As) are extremely difficult if not impossible because of regulatory policies or the sluggish implementation of the existing policies.[8] Indian companies have raised capital from the equity markets through qualified institutional placements (QIPs) or private placements to fund M&As. Globally equity financing is not typically used for funding large M&As as it proves to be expensive. Indian corporates have also tried to tap the global capital markets for meeting their investment needs but because

7. Timothy F. Geithner, “Stress Test: Reflections on the Financial Crisis”, May 12, 2014; Andrew Ross Sorkin, “Too Big To Fail”, October 20, 2009.

8. Narendra Chokshi, “Challenges Faced in Executing Leveraged Buyouts in India”, April 2, 2007, available at https://www.stern.nyu.edu/sites/default/files/assets/.../uat_024317.pdf.

of end-use restrictions on the use of such capital for M&As, this avenue also does not provide the necessary source of currency for funding large M&As. These avenues are likely to freeze further given the imminent tightening of the global credit markets.

The major disappointment, however, has been the availability of debt financing. The bond market especially “junk bonds” which has been a major source of M&A financing globally is at a very nascent stage in India[9] and therefore has not been able to provide the funding support for large M&As. Further, while the bond market has grown over the years, the demand has been more for investment grade bonds as opposed to “junk bonds”. In the absence of a robust bond market one has to rely on bank financing. The prudential norms prescribed by the Reserve Bank of India (RBI) does now permit banks to finance acquisition of shares and therefore this source of financing is also not available in India.

Apart from the credit environment, the foreign investment norms on creation of security in favour of a non-resident or pledge of securities by non-residents makes it extremely difficult for traditional buyout firms to finance a large M&A deal in India. Additionally, the new Companies Act, 2013 does not allow a public company to provide security for the acquisition of its own shares and consequently restricts the ability to undertake a typical leverage buyout.[10]

It is imperative that some of the regulatory barriers are removed to create a robust M&A market and provide both foreign and domestic firms wider ammunition to restructure their businesses and fully realize the inorganic growth potentials. Both the RBI and SEBI realize this and therefore have taken some small steps in this direction. RBI recently permitted leveraged buyout of “stressed companies”.[11] SEBI, on its part has relaxed the norms for delisting of listed companies and consequently created an enabling environment for “take private transactions”.[12] While small steps are being taken to create an enabling environment for M&As and other types of restructuring opportunities, a more concerted effort from the Government and all concerned regulators such as RBI, SEBI, CCI etc. is necessary to achieve a more robust M&A market in India.

– Ankit Mishra & Simone Reis
You can direct your queries or comments to the authors

9. Sunder Raghavan, Ashok Sahoo, Angshuman Hait and Saurabh Ghosh, “A Study of Corporate Bond Market in India: Theoretical and Policy Implications”, March 4, 2014 available at https://rbi.org.in/scripts/PublicationsView.aspx?id=15725.

10. S. 77 (2) of the Companies Act, 2013

11. Since some of the restrictions on implementing a leverage buyout are beyond the regulatory domain of the RBI, the classic leveraged buyout is still a challenge. However, this has to been as a dilution on the prudential restrictions on banks to finance share acquisitions.

12. NDA Hotline, “Going Private Transactions: Set For A Boost”, available at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/going-private-transactions-set-for-a-boost.html?no_cache=1&cHash=a3c3f46d01a1cdcc5ffe9af67697528b

2. Mylan Emerges Victorious!

Of Strategies, Lifesavers and Poison Pills

The heightened M&A deal activity in the pharmaceutical sector globally has the industry in frenzy. A recent study shows that the announced M&As targeting the pharmaceutical sector had already crossed USD 59.3 billion by March, 2015, accounting for 10.5% of the overall M&A activity by value.[1] In the fight to stay relevant, pharma companies that are encountering challenges of limited IP protection, new and rapid developments, prolonged FDA approvals, the need to diversify product portfolios and the like, perhaps have no choice but to seek inorganic growth strategies. Questions are being raised as to whether M&A activity is actually replacing R&D in this sector with economies of scale and reduced R&D costs being the fundamental drivers.[2]

I. The Macro-Economic Landscape

Globally, the aggression in pursuing M&A deals in the pharmaceutical sector is quite apparent. Indian companies have been seen to pursue inorganic growth aggressively - Lupin's proposed acquisition of Gavis Pharmaceutical and Novel Laboratories and Sun Pharma's acquisition of Ranbaxy Laboratories, are cases in point. While mega mergers involving India have been largely docile, the international story isn't quite the same. Last year, various hostile takeover attempts made headlines such as Pfizer's $118 billion bid to acquire AstraZeneca and Valeant Pharmaceuticals' victory in acquiring Salix Pharmaceuticals for $11.1 billion after outbidding its leading rival bidder Endo International. Some deals were also led by activists such as the merger between Forest Laboratories and Actavis Plc. for USD 25 billion and Actavis Plc.'s acquisition of Allergan Inc. after a long drawn hostile battle with activist investor Bill Ackman and Valeant Pharmaceuticals International Inc.

II. Hostility Paves The Way?

One may inquire as to what is driving hostile acquisitions in the pharmaceutical sector? Is it that good assets belong to reluctant sellers who have bets on the economy going forward? Or is it that luring shareholders with premium amounts is a simpler task that convincing a board which may be driven by other factors apart from the price?

III. Teva-Mylan-Perrigo Controversy

This year, of the recent hostile takeover battles, the one that had the market abuzz with its multi-front drama is the Teva-Mylan-Perrigo saga. The three-way takeover war started when Mylan N.V. ("**Mylan**") launched an unsolicited bid to takeover Perrigo Company Plc. ("**Perrigo**") on April 06,

1. See 'Pharmaceutical M&A Activity', Source: Thomas Reuters, V. Flasseur, March 05, 2015, available on http://pdf.reuters.com/pdfnews/pdfnews.asp?i=43059c3bf0e37541&u=2015_03_05_12_45_681be275ac9e4631837c0231e2014223_PRIMARY.jpg, last visited on July 28, 2015
2. See 'M&A in the Pharmaceutical Sector', December 2014, available at http://www.financierworldwide.com/ma-in-the-pharmaceutical-sector/#.Va_a6LPzrIV, last visited on July 28, 2015and 'Are M&A Replacing R&D In Pharma?' By Nicole Fisher and Scott Liebman, April 22, 2015, available at http://www.forbes.com/sites/nicolefisher/2015/04/22/are-ma-replacing-rd-in-pharma/, last visited on July 28, 2015

2015 at a premium of more than 25% for an overall consideration of over USD 29 billion cash-and-stock deal.[3] Not long after, Robert J. Coury, Executive Chairman, Mylan received a 'bear hug'[4] for a compelling USD 43 billion (on a 50:50 cash-stock split basis) from Teva Pharmaceutical Industries ("**Teva**") for a whopping premium of 48.3%.[5] A Bloomberg report suggests Teva's interest in acquiring Mylan stemmed from Teva's attempt to counter-balance the loss of market share to Indian manufacturers such as Sun Pharmaceutical Industries Ltd. and to combat competition from generic manufacturers.[6] Given Mylan's strong focus on prescription generics, the Perrigo acquisition for Mylan should provide an exposure to the over the counter segment of generic drugs or so it has been portrayed. The deal economics aside, what caught the attention of the market are the intricate defense strategies adopted by the Mylan board to fend off the hostile bid by Teva which eventually seemed to have worked in Mylan's favour as Teva finally withdrew its hostile bid[7] and decided to pursue Allergan instead. We evaluate these defenses in this M&A interactive, both in terms of their strategic value and their viability under Indian law.

IV. The Defense Strategy

A. The use of the 'poison pill'

What better way to fend off a hostile takeover than to explore the use of the all-time favourite 'poison pill defense'. Recall Mylan's acquisition of the generics business from Abbott Laboratories in a controversial inversion deal as a part of which Mylan shifted its headquarter from Pittsburgh to the Netherlands. Unbeknownst to all, this shift and the contours of the Dutch law enabled Mylan to use a variation of the poison pill that proved to be onerous for Teva. At the time of the Abbott acquisition, Mylan's shareholders had approved a version of poison pill which was embedded in Mylan's articles of association i.e. the 'Dutch Foundation Defense' on the basis of which Mylan 'stichted' an option agreement with a Dutch foundation, an independent entity established to promote and safeguard the interests of Mylan and its stakeholders including from influences that might adversely affect or threaten Mylan in the future. The option agreement granted the Dutch foundation a revolving option to purchase preference shares up to a maximum number equal to the total number of Mylan ordinary shares for a nominal value and consequently diluting the acquirer's stake. Upon the exercise, the Dutch foundation could hold up to 50% of economic and voting share capital of Mylan for a nominal sum. The intention is for the option to be exercised independently in furtherance of the objective of the Dutch Foundation in situations where the Dutch foundation felt that the interests of Mylan needed to be protected.

3. See Press Release by Mylan dated April 08, 2015, available at http://www.mylan.com/en/news/press releases/item?id=123296
4. Bear hug is generally adopted by the acquirer to pressurize management or shareholders of the Target to consent to the acquisition. It involves informing the management about the intent to acquire through a proposal without any prior warning.
5. Mylan's unaffected share price USD 55.31 per share as on March 10, 2015 i.e. last day of trading prior to the wide-spread speculation of a transaction between Teva and Mylan.
6. See 'Teva Makes $40 Billion Unsolicited Takeover Bid for Mylan', by David Wainer, available at http://www.bloomberg.com/news/articles/2015-04-21/teva-makes-40-1-billion-unsolicited-takeover-offer-for-mylan, last visited on July 28, 2015.
7. See 'Teva Withdraws Proposal to Acquire Mylan' available at http://ir.tevapharm.com/phoenix.zhtml?c=73925&p=irol-newsArticle&ID=2071089, last visited on July 28, 2015.
8. See 'Mylan Issues Statement in Response to Abbott's Support for Perrigo Transaction', June 16, 2015, available at http://apps.shareholder.com/sec/viewerContent.aspx?companyid=ABEA%AD2LQZGT&docid=10763319, last visited on July 28, 2015.

B. Scorched earth defense

While there are stakeholders (including Apollo, a 14.5% shareholder in Mylan who is said to vote in favour of the Perrigo transaction)[8] that believe that the Perrigo acquisition will have commercial benefits for Mylan, it has also been asserted that apart from the poison pill defense, Mylan was pursuing the Perrigo acquisition as a 'scorched-earth defense' to make itself unattractive for Teva. Given that Teva's bid was contingent on the Perrigo acquisition not being pursued the above assertion may have some merit.

C. Regulatory defense

Mylan's cries as regards to the anti-competitive effect of the Mylan-Teva merger were further boosted by a group of consumer activists who had called upon the United States antitrust regulator to 'thoroughly investigate the 'Teva-Mylan merger' and 'to block it' citing various anti-competitive effects that it would have on consumers and on the competition within the industry.[9] Going one step further, the activists were emphatic that the customary curable measure that the antitrust authority would normally resort to in a merger of likes such as divesture of overlapping products would not remedy the loss of competition that would come about as a result of the Teva – Mylan merger. However, given the wide hell or high water clauses that the Teva had offered, it would have been interesting to see how the antitrust authorities would have manoeuvred such an approval.

V. Would The Mylan Defense Strategies Work in India?

Historically, Indian companies had a self-built defense strategy that withstood hostile takeovers i.e. concentrated promoter shareholding. Given the current macro economic climate where (i) there is a more broad based market participation; (ii) consistent decrease in promoter shareholding over the years; (iii) more professionally managed companies; and (iv) more active and informed shareholder participation, the traditional protections may not be available to Indian companies. In 2012, the Economic Times suggested that India Inc. had 480 companies that were vulnerable to hostile takeover risk with promoter shareholding below 25%.[10]

Whilst it appears that some Indian companies may be vulnerable to hostile takeovers, the defenses available may be inadequate. Let's explore the Mylan defenses to see how this would play out in India.

A. The poison pill defense

For the poison pill defense used by Mylan to be effective, the following elements were key: (i) free pricing and timing of issuance; and (ii) disproportionate value to the holder as against the acquirer. Where a listed company is concerned, the board is constrained from issuing shares to a specified shareholder to the exclusion of others without a supermajority consent of the existing shareholders. Other regulatory prescriptions limit the manner, the price and the timelines within which such

9 See 'Coalition presses federal officials to block hostile takeover of Mylan', July 14, 2015, available at http://www.post-gazette.com/business/healthcare-business/2015/07/14/Coalition-urges-Federal-trade-commission-to-block-Teva-s-hostile-takeover-of-Mylan-pittsburgh/stories/201507140177, last visited on July 28, 2015.

10 See '480 cos vulnerable to hostile takeover risk with promoter shareholding below 25%, April 03, 2012', available at http://articles.economictimes.indiatimes.com/2012-04-03/news/31281493_1_hostile-takeover-promoter-holdings-new-takeover, last visited on July 28, 2015.

securities shall be issued. Therefore, the traditional poison pill defense that automatically gets trigged and dilutes the existing shareholder interests and thereby precludes a potential acquirer may not be available in India.

B. Scorched earth defense

When it comes to the scorched earth defenses, while there may not be such strict regulatory prescriptions in pursuing an acquisition to fend off a hostile bid prior to a hostile acquisition being announced, the Takeover Code, if very strictly read could put a dampener in this strategy. Regulation 26 of the Takeover Code does not strictly forbid a target company from pursuing an acquisition but it does preclude the target board from entering into a 'material contract' without super majority shareholder consent during the offer period which may be construed as restriction on acquisitions similar to the one pursued by Mylan. It may be worthwhile to note that Regulation 26 is an 'acquirer friendly' provision which prohibits the board from engaging in scorched earth defenses which involve increasing borrowings or alienating assets without super majority shareholder consent.

C. Regulatory protections

When it comes to seeking the protections to the regulators, in India, the Indian antitrust authority, CCI, has been active in soliciting comments from various stakeholders in mega mergers – for example the approval of the CCI in the Sun Pharmaceuticals Industries Limited – Ranbaxy Laboratories merger was contingent on divesture of several overlapping products. Although, the CCI has not sought to block an acquisition or a merger till date, it is well with its powers to do so if it results in an appreciable adverse effect on the competition in India. In India, at least where the pharma sector is concerned, we have other regulators that could come to the aid of the defense of the Indian company in situations where the acquirer is a non-resident namely, the FIPB since any acquisition of shares in an existing Indian pharmaceutical company requires the approval of the FIPB. This strategy was effectively used by Asian Paints to ward off the takeover that ICI had planned of Asian Paints, albeit at a time when the laws in India in regards to foreign investment were very different.

VII. What Else Can be Done in The Indian Context?

A. White knight

The other defenses that have been successfully deployed in the Indian context is the 'white knight defense' wherein the existing management partners with a friendly investor / strategic player to maintain control of the target company. The 'white knight defense' was employed in 2001, by BAT-controlled VST Industries where ITC entered as a white knight for BAT to thwart the takeover bid made by Mr. R.K. Damani. Similarly in 2010, Reliance Industries played white knight to the promoters of EIH by buying its 14.1% shares in order to thrash ITC group's attempt to make on open offer after it had raised its stake in EIH to 14.8%. Among the more recent deals, Kalindee Rail Nirman employed a seemingly white knight approach when Saroj Poddar's Texmaco Rail invested in the company fending off Jupiter Metal as it explored a hostile bid. Recently, Saroj Poddar also played the white knight to Mangalore Chemicals against hostile acquirer Deepak Fertilizers.

B. Embedded defenses

There other embedded defenses that may be available in India, however, the same has not been successfully tested in Indian courts. These include (i) guaranteeing rights of the promoters in the charter documents of the target company such as their ability to appoint majority of the non-independent directors; or (ii) inserting anti-takeover clauses in material contracts which stipulate that upon a 'change of control' the contract will be terminated.

C. Brand and RPT Pills

Several Indian promoters have housed their brand and other valuable assets used by the principal target company in a separate private company, wholly controlled and owned by the promoters such that, in the event of a hostile takeover, acquisition of the principal target company would result in the acquirer not having access to the whole suite of assets that the target company requires for its business. The SEBI laws only prescribe the manner in which related party transactions need to be carried out but do not, as such, restrict the type of related party transactions that a target company can engage in. Further, the automatic termination of such arrangements may not even be caught within the restrictions imposed by Regulation 26 of the Takeover Code.

Last year, the Financial Times reported that hostile takeovers are making up the greatest proportion of global deal activity in over 14 years.[11] The dynamic and booming M&A landscape in India, shifting legal and regulatory paradigm and rise in shareholder activism over the years creates a fertile ground for hostile takeover activity in India. Therefore, this global trend may soon start percolating down to India and therefore, it is imperative for the Indian corporates to prepare, anticipate and innovate strategies to take on such takeover overtures.

– Tanya Pahwa, Ankit Mishra & Simone Reis
You can direct your queries or comments to the authors

11. See 'Hostile takeovers rise to 14-year high in M&A as confidence grows', By Arash Massoudi in London and Ed Hammond in New York, June 08, 2014, available at http://www.ft.com/intl/cms/s/0/a8a8f608-eee5-11e3-8e8200144feabdc0.html#axzz3h4T3JUJQ, last visited on July 28, 2015.

3. The TV Interview That Cost Zuari Rs 3 Crores!

This article was published on the CNBC- The Firm dated March 23, 2015. The same can be accessed from the link.[1]

The growing anti-trust jurisprudence in India being developed by the Competition Commission of India ("**CCI**") definitely requires deal makers to rethink their strategy in conjuring M&A deals. Hasty reliance on what has become 'good to have customary rights' may attract onerous obligations and will need careful consideration in light of recent anti-trust developments. The notification of sections 5 and 6 of the Competition Act, 2002 ("**Act**") and the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("**Regulations**", the Act and the Regulation are, for the sake of brevity, hereinafter referred to as the "**Merger Control Regime**") was expected to be a game changer for M&As in India and was met with a lot of skepticism.

The central theme in the initial years revolved around the question of the potential delay in deal consummation that would ensue from the implementation of the Merger Control Regime. Amidst the cynicism, the Regulations with the various exemptions they contained provided a breather to the industry especially in relation to non-strategic acquisitions which would have otherwise met with an unwarranted anti-trust scrutiny. However, 4 years since the advent of the Merger Control Regime a different situation arises – having proven its capability in terms of speedy decision making, the CCI has allayed concerns of delays in the approval process but the Regulations and their various exemptions pose an unsolved mystery. In trying to decipher the Merger Control Regime in the early stages a lot was taken for granted under the aegis of how things worked prior to the Merger Control Regime and, naturally references were drawn from how other market regulators like the Securities and Exchange Board of India had acted in similar situations. However the recent orders of the CCI indicates an independent line of thought emerging from the CCI which may very well be different from how other regulators have interpreted the same concepts in the past, adding fresh considerations for deal makers.

The orders of the CCI levying heavy fines on both the architects of the hostile bid of Mangalore Fertilizers and Chemicals Limited ("**MFCL**") is one such example which emphasizes the considerable impact and the conundrum of the Merger Control Regime that deal makers will have to grapple with. The genesis of the MFCL controversy dates back to the vulnerable position of *Vijay Mallya* and the *UB Group* (promoters of MFCL) as a result of the collapse of Kingfisher Airlines which provided an opportunity to *Deepak Fertilizers* (which has always been in the fray to acquire MFCL) to build a significant position in MFCL by purchasing the shares of MFCL through bulk and block deals. The shares of MFCL were easily available in the market at a steep discount because of the liquidity created by the invocation of pledge by the lenders of *UB Group*.

Mindful of the lurking danger, *Vijay Mallya* brought in a white knight in the form of *Saroj Poddar/ Adventz Group* and between April, 2013 and July, 2013 the Adventz Group acquired approximately 16% stake in MFCL through various open market purchases. In July, 2013 Deepak Fertilizer acquired 24.46% in MCFL through a combination of bulk and block deals. Thereafter almost after a year in April, 2014 *Deepak Fertilizers* acquired another 0.8% triggering a mandatory open offer

1. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/the-tv-interview-that-cost-zuari-rs-3-crores-1.html?no_cache=1&cHash=99da4febc1cc061ea73d0c6ce7a502f3

under the takeover code for the acquisition of another 26% of the voting capital MFCL from the public shareholders. In defense of the hostile bid by *Deepak Fertilizers*, the promoters of MFCL (Vijay Mallya and UB Group) entered to an agreement with the *Adventz Group* to jointly launch an open offer to acquire 26% of MFCL from the public shareholders.

While, CCI approved both the offers of *Deepak Fertilizers* and the *UB/Adventz Group* without an adverse finding, it levied a heavy penalty on both the groups for consummating parts of the transaction i.e. the open market purchases without the prior approval of the CCI (internationally in the anti-trust context it also referred to as *gun jumping*). The CCI held that the 16% acquisition made by the *Adventz Group* through open market purchases in four tranches was in violation of the Act since such acquisitions were strategic in nature and with *intent* to acquire control over the MFCL. In arriving at this conclusion, the CCI relied on a televised interview of *Saroj Poddar* where he had said that the open market purchases were made after consulting *Vijay Mallya* and with intent to enter into a joint venture with the UB Group at a future date.

The CCI further held that the acquisition of 24.46% and 0.8% shares of MFCL by *Deepak Fertilizers* through open market purchases was in violation of Act and was an act of gun jumping. The CCI relied on the filings made by *Deepak Fertilizers* with the stock exchanges wherein it had said that the acquisition was made because MFCL was a *"very strategic and good fit with company (Deepak Fertilizers)"*.

In both the cases CCI discarded the contention of the *Adventz Group* and *Deepak Fertilizers* that the respective acquisitions were exempt under the Regulations. The Regulations exempts a combination (which meets the financial asset and turnover thresholds prescribed under the Act) involving an acquisition of shares from the prior approval of CCI if (a) solely made as an investment or (b) is in the ordinary course of business and (i) does not result in an acquisition of more than 25% of the shares or voting rights of the target company and (ii) does not give the acquirer control over the target company ("**Exemption**"). In this case, CCI found based on the evidences discussed above that the open market purchases of 16% and 24% (and subsequent 0.8%) by the *Adventz Group* and *Deepak Fertilizers* respectively were strategic in nature and were not acquisitions *solely as investment*.

The Exemption is commonly availed by private equity players and other acquirers acquiring minority positions. While the CCI has in its decisions analysed one of the limbs of the Exemption i.e. control, in this instance for the first time CCI has examined the scope of the word *'solely made as an investment'* in the Exemption. The CCI has observed that the phrase *'solely made as an investment'* indicates *'passive investment'* and any investment in a target enterprise which is done with a strategic intent cannot be treated as 'solely made as an investment'. Since an investment that is not made *'solely an investment'* or in the *'ordinary course of business'* does not qualify for the Exemption even if no control or less than 25% of the shares or voting rights are being acquired, interpreting these terms is critical for examining when the acquirers can rely on the Exemption. Given that the Exemption permits for acquisition of shares up to 25% of the shares or voting rights of the target company, it is questionable whether such a large threshold can ever be acquired without a plausible 'strategic intent'. However it appears that the conduct of the acquirer will play a decisive role in the determination of the nature of investment with the CCI even possibly relying on TV interviews as evidence.

While the finding of the CCI may seem draconian in the Indian context, in fact it appears to be in line with the global position on the issue. For e.g. the US anti-trust law has a similar exemption for acquisition of shares that are made *'solely for investment purposes'*. In the US context the exemption has been interpreted very narrowly and the intention of the parties are looked at in order to ascertain whether the acquisition of shares was *'solely made as an investment'* or a strategic one. Typically, any acquisition which gives the acquirer the right to (a) nominate a director on the board or (b) propose any corporate action which requires shareholder approval is considered *prima facie* strategic under the US anti-trust law. Even if the acquisition is made with intent to solicit proxies or appoint directors of the board, such acquisitions are considered strategic. In fact, at times acquisition of a miniscule stake in a competitor could be deemed a strategic acquisition under US anti-trust laws.

Clearly, the recent rulings will change the M&A game plan in India. For instance, several companies acquire miniscule shares in some of their competitors (sometimes less than 5% since public disclosure is required of a shareholder who acquires more than 5% in a listed entity). Henceforth such acquisitions will have to be carefully examined from an anti-trust perspective. Further, the strategy in the case of hostile bids has to be carefully examined since building positions with the intent to acquire control at a future date may not be possible without a CCI approval. However the two constituencies on whom the recent orders is likely to have a significant impact are activist shareholders/hedge funds and private equity investors. Hedge funds who intend to acquire shares and solicit proxies may be viewed as 'activist shareholders' not being able to avail the Exemption prescribed unless they are registered as FPIs. Similarly private equity investors who typically have exhaustive rights in the target company may not be able to avail the Exemption.

While the CCI's action against *Deepak Fertilizers* and the *Adventz Group* may have legal justifications, there are a number of fundamental questions that CCI will have to provide greater clarity on such as (1) what if the intent is *solely for investment* when the acquisition is made and thereafter the intent changes, will the initial investment be deemed strategic?, (2) how will open market purchases for strategic reasons be made without disclosing the same to the market prior to the purchase given that will almost always be the case if all such open market purchases require prior CCI approval? Perhaps, the day is not far when CCI will come out with the much awaited merger control guidelines and provide guidance on some of these questions.

– Ankit Mishra & Simone Reis
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4. The Curious Case of Spice Jet: Why is SEBI Quiet?

On February 23, 2015, Ajay Singh (“**AS**”) acquired a controlling stake of 58.46% in the ailing budget airline, Spice Jet, from Mr. Kalanithi Maran and Kal Airways (“**Existing Promoters**”). While the deal is a temporary savior for both the aviation industry in general and Spice Jet in particular, it has triggered an interesting debate on some intricate aspects of the Indian takeover code specifically general exemption from an open offer in the case of a scheme of reconstruction.

I. The Deals

On January 15, 2015, Spice Jet informed the Bombay Stock Exchange (“**BSE**”) that the Spice Jet board had recorded the transfer of a controlling stake by the Existing Promoters to AS pursuant to a Scheme of Reconstruction and Revival for the takeover of ownership, management and control of Spice Jet (“**Scheme**”) to be filed before the Competent Authority, the Ministry of Civil Aviation, Government of India (“**MCA**”). Thereafter on January 22, 2015, Spice Jet informed the BSE that Spice Jet had received the approval of the MCA for the Scheme. On January 29, 2015 AS executed a share purchase agreement with the Existing Promoters of Spice Jet for the acquisition of 58.46% stake in Spice Jet. However, interestingly public announcement of an open offer was not made by AS.

While the details of the Scheme have not been made public, it appears from the board resolutions made available in the public domain and the media reports that the Scheme is (a) to transfer the management, ownership and control from the Existing Promoters to AS, (b) recapitalize the company and (c) improve operational efficiency by reorganizing the routes in which the airline operates.

II. The Controversy

Unless exempted under the takeover code or by the Indian securities regulator (“**SEBI**”), (i) an acquisition of 25% stake or more or (ii) the acquisition of control requires the acquirer to make a mandatory offer to the public shareholders for atleast another 26% stake of the target company. Therefore, *prima facie* AS’s acquisition should have triggered the mandatory open offer under the takeover code. The takeover code envisages two broad categories of exemption, one which is expressly provided for under the takeover code and others where SEBI specifically exempts the acquirer(s) from making an open offer. In this case, it appears that AS has not approached SEBI for a specific exemption. On the contrary, AS has contended that the acquisition is pursuant to the Scheme approved by a competent authority (in this case the MCA) under law and therefore is expressly exempt under the Indian takeover code.

Regulation 10(1)(d)(ii) of the Indian takeover code exempts an acquisition pursuant to a *scheme of arrangement involving the target company as a transferor or a transferee company or a reconstruction of the target company including amalgamation, merger, demerger pursuant to an order of the court or a competent authority under any Indian or foreign law (emphasis supplied)* (“**Exemption**”). Therefore, to qualify for an exemption under this Exemption two tests must have to be met-(i) the acquisition of shares or control is pursuant to a scheme of reconstruction and (ii) it is approved by a court or a competent authority under any law.

The controversy in this case is (a) whether the Scheme qualifies as a scheme of reconstruction and (b) whether the MCA is a competent authority under law to approve the Scheme.

III. The Analysis

Is the Scheme a scheme of reconstruction? It has been argued that the scheme of reconstruction that is exempt under the Exemption code is limited to schemes undertaken under s. 391-394 of the Companies Act, 1956 ("**Cos Act**") and since the Scheme in the case of Spice Jet is not a scheme undertaken under s. 391-394 of Cos Act it does not squarely fall within the Exemption. This argument may have some merit based on the following propositions-:

A. General principle of exemptions

The Indian takeover code envisages limited instances wherein a general exemption from an open offer is provided and such instances can be conceptually categorized to acquisition(s) (a) wherein no real change of control takes place (for e.g. inter-se transfer between promoters) (b) undertaken in the ordinary course of business (for e.g. acquisition by underwriters and stock brokers) or (c) which requires the prior approval of the shareholders and a special mechanism is provided under law for the same (for e.g. acquisition pursuant to SICA, CDR, delisting offer). Therefore, the scheme of arrangements or reconstruction also must necessarily fall under one of these buckets and since it does not fall under (a) or (b), it must conceptually fall under (c) in line with the spirit of the Indian takeover code and broader principles of governing general exemption from an open offer.

B. Historical construction

Similar exemption was available under the old takeover code ("**1997 Takeover Code**") and based on the discussions of 2002 Bhagwati Committee Report ("**2002 Report**") it is abundantly clear that the Exemption is limited to schemes of reconstruction undertaken under s. 391-394 of the Cos Act as such schemes are statutorily contemplated and require the approval of the shareholders and courts thus conferring adequate protection to the shareholders (this is perhaps the reason why originally preferential issue of shares was exempt under the 1997 Takeover Code).

While the argument seems attractive, legally sustain it may not be entirely straightforward. Firstly on a plain reading of the exemption there is nothing to suggest that the scheme of reconstruction contemplated under the Exemption is limited to schemes undertaken under s. 391-394 of the Cos Act. In fact the phrase "including" and "any law" in language of the Exemption envisages schemes of reconstruction which may not be in the form of mergers, amalgamations or demergers under s. 391-394 of the Cos Act. Secondly, the historical construction of the Exemption in (b) above can be controverted on the ground that neither 1997 Bhagwati Committee Report nor the 2002 Report expressly states that acquisition pursuant to scheme of arrangement or reconstruction for which an exemption from an open offer is granted is limited to schemes undertaken under s. 391-394 of the Cos Act. In fact it can be potentially argued that the 2010 Report of the Takeover Regulation and Advisory Committee contemplates an exemption for any scheme of reconstruction which transforms the target company and does not allude to only schemes of reconstructions undertaken under s. 391-394 of the Cos Act.

Therefor AS and Spice Jet may very well argue that the Scheme involves a change in control of the company, recapitalization and operational changes and therefore may by itself qualify as a reconstruction and should be exempt under the Exemption so long as it is approved by a competent authority under any law.

IV. Is MCA a competent authority under law?

In order to satisfy the Exemption it is not sufficient to demonstrate that the acquisition is made pursuant to a scheme of reconstruction of the target company, the acquirer will also have to demonstrate that such reconstruction is contemplated under some law or regulation and is approved by a competent authority. The exemption is not available in cases where the parties undertake a voluntary reconstruction of the target company and approach the regulatory authorities for necessary approvals. It may well be argued that no law or regulation expressly mandates or empowers MCA to initiate or approve the reconstruction of a scheduled air transport company such as Spice Jet and therefore MCA is not a competent authority for the purposes of the Exemption.

It is correct that the Aircrafts Act, 1934 ("**AA**") or the Aircraft Rules, 1937 ("**AR**") does not expressly contemplate a scheme of reconstruction or revival. However, on a closer analysis of the scheme of the AA and AR, the argument that MCA is a competent authority to approve a reconstruction for the purposes of the Exemption may have some force. Under the AA, the MCA has the power to monitor and regulate the operation of all air transport services and specifically regulate tariffs. Further, introduction of new routes or alteration in existing routes or change in ownership or control of a scheduled air transport passenger airline also requires an approval of the MCA (through Directorate General of Civil Aviation). The MCA has the power to temporarily suspend an airline carrier's licence/permit if the MCA is of the view that the airline does have the financial resources to undertake regular operations and this power has been recently exercised in the case of Kingfisher Airlines. The suspension may be lifted if the airline carrier is able to submit a revival plan to the MCA.

On the basis of the above, AS and Spice Jet may well argue that Spice Jet was financially distressed and could have lost its license and therefore had to undertake the Scheme which was mandatorily required to be approved by the MCA and therefore such the Scheme is undertaken under a specific law (AA read with AR) and approved by a competent authority (MCA) for the purposes of the Exemption.

V. Is the Controversy Puerile?

It may well be argued that the entire discussion is puerile as none of the shareholders of Spice Jet seem to be agitated. However, such an argument may not be accurate as the takeover code does not contemplate a whitewash provision (shareholders agreeing to waive an open offer in certain circumstances) and therefore the duty is upon the SEBI to enforce the provisions of the takeover code in case there is a violation. In this case, tacitly SEBI seems to have taken the view that AS is exempt from making an open offer. However, given the controversy and possible a potential misuse of the Exemption given its wide ambit, some guideline/clarification from the regulator should certainly help.

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– Ankit Mishra & Simone Reis

You can direct your queries or comments to the authors

1. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/the-curious-case-of-spice-jet-why-is-sebi-quiet.html?no_cache=1&cHash=3a09ee67b7061416b012dd8e7d290d99

5. Where The Rubber Meets The Road – Labour Strikes M&A !

Based on the new central government and vibrant capital markets, M&A activity in India is expected to witness a significant upsurge in 2015. Typically, M&A strategies and structuring in India have revolved around two pivotal considerations – tax optimization and regulatory hurdles (including foreign investment regulations). However, with the changing climate of labour mobilisation, the labour-force has emerged as an important stakeholder in the M&A landscape. The largest example of this was seen last year, when the $2.5 Billion Apollo-Cooper deal was aborted primarily because of labour agitations in the US and China.

Under Indian company and securities law, the consent of shareholders and creditors is required for a transaction when a business is being sold or significantly restructured. Employment law in India requires that workmen, whose employment is impacted by the merger or acquisition, are either paid all statutory severance dues or afforded equal or more beneficial terms of employment with the transferee employer. Additionally, judicial precedent has introduced a new dimension in the form of requiring employee consent *for a transfer of their employment* (if the employing entity changes). While this position has been heavily litigated with judgments on either side, the Apex Court in its most recent judgment on the matter seems to have held in favour of requiring such consent.

Employee consent for a transaction, though not a legal requirement has practically emerged as highly relevant to the consummation of a deal. Often, the value of an organization being acquired is itself heavily dependent on the employees in it. Leveraging this and the fact that strategic labour-force disruptions can potentially bring any deal to a stand-still, employees have given themselves a space at the deal negotiating table. Instances of this may be seen in the recent reports relating to Coal India and ING Vysya, where employee action was targeted at blocking deals which posed a threat to their position in the company. The reports of unionization of TCS-employees further highlight a transcendence in the character of unionization in India which is becoming sector agnostic. Trade unions are also usually influenced by external bodies, political or otherwise, which could pose different challenges, and introduce additional players to a deal.

In order to keep pace with the labour environment, the outlook towards deal strategy must correspondingly change. First, it is paramount to recognize the labour force as an important participant in a merger or acquisition, and consult with them at a timely juncture. Often this timing is key to successfully closing a deal and must be strategically planned. An acquirer may also consider entering in to collective bargaining agreements with existing unions and proactively seek their co-operation to ensure certainty with respect to the acquisition.

Secondly, due diligence requirements take on a new avatar, in that gauging the labour culture of a target company becomes an integral part of the information gaining process before any investment. More often than not, this determination will not be something that emerges from documents, and may require some form of dialogue with current or past employees/unions. A thorough analysis of the costs of employee benefits as a part of diligence is also a recommended must.

Thirdly, parties to a deal could choose to insulate themselves by ensuring that the purchase price or deal consideration includes any severance dues that may be payable and that valuations can be adjusted to take into consideration any related losses.

Lastly, entities looking to expand by way of M&A at a future stage must also be cognizant of the fact that labour issues might pose a threat to such growth and hence identify and resolve labour issues on a continuous basis, and maintain good relationships with employees and unions.

The growing impact of labour on the M&A process coupled with the fact that the Companies Act 2013 places a responsibility on the directors to also act in the best interest of its employees has brought about a shift in the M&A ethos, bringing in new aspects to investment assessment and risk management. How this shift will interact with the rising market is yet to be seen in 2015.

– Ashish Alexander, Shreyas Bhushan, Veena Gopalakrishnan & Simone Reis
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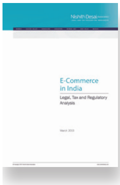

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