

M&A Hotline

October 31, 2008

CREEP UP TO 75% - TAKEOVER CODE RELAXED

INTRODUCTION

Extraordinary times call for extraordinary measures: With the stock market plummeting and stocks of even fundamentally strong blue chip companies sinking, the Securities and Exchange Board of India ("SEBI") recently relaxed the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the "Takeover Code") to extend the creeping acquisition limit from 55% to 75% in listed companies to facilitate promoter consolidation and boost investor confidence in such companies.

BACKGROUND – WHAT IS CREEPING ACQUISITION?

Creeping acquisition governed by Regulation 11 of the Takeover Code refers to the process through which the acquirer together with persons acting in concert ("Acquirer") increase their stake in the target company ("Target") by buying up to 5% of the voting capital of the company in one financial year. Regulation 11 deals with consolidation of holdings in the Target, and is targeted at the following two situations.

Situation 1: Regulation 11(1) of the Takeover Code stipulates a condition where an Acquirer holds shares between 15% and 55% and wishes to acquire further shares in the Target. In such a situation, for an acquisition of more than 5% of the shares or voting rights of the Target, public announcement will be required. Accordingly, for example, if an Acquirer holds 50% of the shares and proposes to acquire another 4%, Regulation 11 (1) will not be attracted.

Situation 2: Regulation 11(2) of the Takeover Code stipulates a condition where an Acquirer already holds 55% or more but less than 75% of the Target's shares or voting rights, and still intends to increase its shareholding further. In such a scenario, the Acquirer is forbidden to acquire any additional shares in the Target without making a prior public announcement as stipulated in the Takeover Code.

In the aforesaid situations, SEBI mandates public announcements to be made by the Acquirer which requires the Acquirer to make a public offer to the shareholders to acquire at least additional 20% of the voting capital of the Target. Such a requirement ensures that the shareholders of the Target are provided an opportunity to exit in case of a takeover or substantial acquisition of shares.

PROPOSED AMENDMENTS – PROMOTING OPEN MARKET PURCHASES

In a move which may be seen as aggressive, SEBI has in its press release No. 239/2008 dated October 27, 2008 proposed to make the following two significant amendments to the Takeover Code.

(1) Consolidation through creeping acquisition up to 5% to persons holding 55% and above but below 75% shares of the Target will now be permitted, subject to the condition that such acquisition can only be via open market purchases in the normal segment, and for the purpose, no consolidation via bulk/ block/ negotiated deal or through preferential allotment would be permitted.

(2) Earlier, any increase in the shareholding of the promoters pursuant to buy back required prior exemption under the Takeover Code. Now, any such increase in the promoter shareholding shall be automatically exempt if such increase/ consolidation is up to 5% per annum and as a result of buy back by the Target.

NDA VIEW – THE IMPLICATIONS

It appears likely that the proposed amendments will be received favorably by the promoters and seen as an opportunity to consolidate / increase their shareholding in the Target without triggering the complex and cost inefficient public announcement requirements. Amendments will also provide a strong impetus to open market purchases which will be far more lucrative in times like these, when the share prices are at an all time low. Nishchal Joshipura, Head of M&A Practice at Nishith Desai Associates, observes that "Increase/consolidation of promoter's shareholding upto 5% per annum may not be exempt if such increase/consolidation results in a change in control thereby triggering the requirements of making a public announcement under Regulation 12 of Takeover Code".

Whilst SEBI intends to promote consolidation of promoter shareholding, it has tried to ensure that the retail investor gets to participate in such consolidation by subjecting the creeping acquisition (under the automatic route) to only open market purchases and in the normal market segment and excluding consolidation via bulk/ block/ negotiated deal or through preferential allotment.

With such relaxations in the place, it is only natural for the SEBI to expect that the move will help sustain the stock prices against irrational movements and exhibit promoters' faith and confidence in the battered stocks of their companies. In the current scheme of things, where the market is more driven by symbolic and psychological reasons than fundamentals, any further consolidation by promoters will help the sliding market and companies shore up investor's confidence and sentiment.

On the flipside, there may be an apprehension that the amendments may vest the promoters with unrestricted leverage to gain special majority (75% shareholding) over the Target by acquiring less than 5% shares of the Target

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each financial year without providing an exit opportunity through open offer to all the shareholders.

Whilst, given the lack of liquidity in the market, it remains to be seen whether the SEBI is able to garner requisite investor interest from the investors or the promoters, SEBI must be complemented at its balanced approach to stimulate open market purchases which are much needed in times like these. As the Finance Minister recently said, “there is a time for imposing restrictions, and there is a time for relaxing them”.

- **M&A Practice Team**

<http://www.sebi.gov.in/press/2008/2392008.html>

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