

M&A Hotline

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SEBI CLARIFICATION ON CREEPING ACQUISITIONS BEYOND 55%

We had earlier written an article titled "[SEBI goes the distance in easing takeover regulations](#)" where we discussed amendments made by the Securities and Exchange Board of India ("**SEBI**") to Regulation 11 (2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the "**Takeover Code**") extending creeping acquisitions of up to 5% beyond 55% ("**Amendments**"). The article discussed the Amendments and ambiguities therein at length.

In order to allay all ambiguities relating to the Amendments, SEBI on August 6, 2009 issued an interpretative circular ("**Circular**") under Regulation 5 of the Takeover Code read with section 11 of the Securities and Exchange Board of India Act, 1992, for removal of difficulties in the interpretation of the Regulation 11(2) as amended on October 30, 2008.

This Hotline seeks to analyze the provisions of the Circular, its background and its implications.

WHAT WERE THE AMENDMENTS?

In terms of the Amendments, Regulation 11(2) of the Takeover Code was amended to do away with public announcement requirements for consolidation of shareholding through creeping acquisition (including passive acquisition by way of buyback) up to 5% by persons holding 55% and above, but below 75% shares of the target company ("**Target**"), provided the acquisition is by way of open-market purchases in the normal segment, and not by way of bulk/ block/ negotiated deals, or through preferential allotments and the post-acquisition shareholding of the acquirer does not increase beyond 75%.

Prior to the Amendments, an acquirer had to make a public announcement for even an acquisition of one share, if his shareholding in the Target was 55% or more.

WHAT WERE THE AMBIGUITIES?

Although the extension on the creeping acquisition limit was welcomed, the Amendments were riddled with ambiguities, some of which were as follows:

(a) 5% threshold: The most critical ambiguity in the Amendments perhaps was not to clarify the time frame within which the 5% creeping acquisition limit stipulated in Regulation 11(2) could be exercised. It was unclear if the acquirer was permitted to acquire up to 5% shares only once in the entire lifetime of the Target or whether the 5% limit was to be reckoned on a per financial year basis (as in the case of Regulation 11(1)). In fact, on account of the above ambiguity, though a little farfetched, it was also possible to interpret the Amendments in a way that would allow a person holding more than 55% shares to go on acquiring shares of the target by open market purchases in less than 5% tranches multiple times in a year.

(b) 75% Limit: The Amendments by restricting the shareholding consolidation to a maximum of 75% left a room for interpretation on whether the 75% threshold will stand modified to 90% in case of companies which are required to have a minimum public shareholding of only 10%. In fact, had the Amendments not stipulated the 75% limit, it would have been only natural to read the 75% threshold in conjunction with the earlier proviso to Regulation 11(2), which provides that the 75% threshold will stand modified to 90% in cases where the listing agreement permit minimum public shareholding of 10%.

WHAT ARE THE CLARIFICATIONS?

Having received representations from market participants / listed companies with respect to the interpretation of the Amendments, SEBI has clarified the ambiguities mentioned above in terms of the Circular. The clarifications are discussed herein below.

(a) 5% threshold: SEBI has clarified that the 5% creeping acquisition limit is available *only once in the lifetime of the Target* and is not renewed each financial year as in the case of Regulation 11(1).

Whilst the industry perception seemed to be that SEBI intended to apply such 5% limit each financial year in light of the spirit of the Takeover Code and more particularly Regulation 11(1), we had in our article mentioned that the creeping acquisitions beyond 55% were probably intended only once in the lifetime of the Target. We anticipated this earlier in our article, where we had mentioned "... *SEBI probably wants to permit such creeping acquisitions beyond 55% only once in the lifetime of the Target, and any further acquisitions whether in the same year or in the subsequent years should mandate a public announcement. This view is not entirely without foundation as the amendments were introduced as an aggressive measure to bolster the bearish stock market, and it appears likely that SEBI would like to retrogress to a more cautious position as and when the markets gain momentum.*"

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(b) Net of Sales: The Circular introduces an interesting mechanism for calculation of the threshold mentioning that the 5% threshold shall be calculated by aggregating all purchases, without netting the sales.

This comes as bit of a surprise because earlier, in the absence of any specific provision to this effect, it was assumed that the 5% acquisition limit was to be computed netting the sales made by the acquirer. Prior to the Circular, if an acquirer holding 55% shares acquires 5% shares to hold 60% shares and then sells 1% shares in the same year, it was assumed that he had the headroom to acquire such 1% shares in light of the shares sold by him. With the issuance of the Circular, however, now the headroom to acquire such 1% shares will not be permitted, unless by way of making a public announcement.

(c) 75% limit: SEBI has clarified that the limit of 75% shall be absolute, and will not stand modified to 90% in case of companies which are required to have a minimum public shareholding of only 10%. Accordingly, any consolidation beyond 75% under Regulation 11(2) can now not be done without a public announcement.

The reason to limit the creeping acquisitions to a maximum of 75% even in cases where the public spread of the Target is 10% appears to be to ensure public participation in matters requiring special majority (requiring 75% majority).

CONCLUSION

The Circular, which significantly limits the scope for consolidation beyond 55%, does seem to indicate that SEBI is probably now not as encouraging towards shareholding consolidation as it was about a year ago in a bearish market.

On an attendant aspect, the Circular leaves it to interpretation if the mechanism to calculate the 5% threshold (without netting of sales) will also be applicable in case of computing the 5% threshold in Regulation 11(1) as the Circular is an interpretation and not an amendment to 11(2). It remains to be seen whether this particular interpretation was intended to be extended to Regulation 11 (1) as well by the market regulator.

References:

- Interpretative circular under Regulation 5 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 1997 - Applicability of provisions of Regulation 11 (2) thereof, as amended on October 30, 2008. - <http://www.sebi.gov.in/circulars/2009/cfdcir012009.pdf>
- **SEBI goes the distance in easing takeover regulations**, The Economic Times, Ruchir Sinha & Nishchal Joshipura, November 11, 2008

- **Akshay Bhargav, Ruchir Sinha & Nishchal Joshipura**

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