

M&A Hotline

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INTERPRETATION OF 'CONTROL': AN UNCONTROLLED INCREASE IN AMBIGUITY?

- SEBI issues self-contradictory order in relation to 'control' under the takeover regulations
- *Obiter dictum* suggests that obtaining affirmative rights are not to be viewed as acquisition of 'control'
- Whole-time member shies away from directly deciding on aspect of 'control' on grounds of irrelevance, while simultaneously indirectly ratifying that there was an acquisition of 'control'.

The interpretation of 'control' under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Code 2011") and the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("Takeover Code 1997") has thus far stood on watery ground; in particular, 'affirmative voting rights' and 'control' have shared a tempestuous relationship, with no clear stance having been taken by the apex court till date, even though debates have done the rounds among various stakeholders for over two decades. Though the determination came up before the Supreme Court in *Subhkam Ventures*¹, the Supreme Court did not conclusively decide the interpretation of 'control', due to subsequent developments in the matter. Consequently, the question of whether having affirmative rights in a company amounts to an acquisition of 'control' in the company or not remained open.

With speculation abound in the investor community, the Securities and Exchange Board of India ("SEBI"), in 2015, issued a discussion paper on the 'Brightline Tests for Acquisition of 'Control' under the SEBI Takeover Regulations' for public comments; however, the same is still pending finalization.

On March 31, 2017, 'control' received a fresh chance, having come up before the Whole Time Member ("WTM") of SEBI for adjudication, in the matter of Kamat Hotels (India) Limited². In this matter, the WTM had to decide, *inter alia*, whether there had been an acquisition of control by the Noticees (*defined below*) by the signing of an agreement under which they obtained certain rights (as described below), which would mandate the making of an open offer under the Takeover Code 1997. The WTM ruled that the determination of 'control' due to the presence of affirmative voting rights, in light of the facts of the case, was irrelevant. However, there are certain parts of the order of the WTM which are contradictory leading to an unclear conclusion.

BACKGROUND AND FACTS

In 2007, Clearwater Capital Partners (Cyprus) Limited, along with Clearwater Capital Partners Singapore Fund III Private Limited (together the "Noticees") subscribed to foreign currency convertible bonds ("FCCB") issued by Kamat Hotels (India) Limited ("KHIL"), and subsequently entered into an agreement with certain shareholders of KHIL in 2010 ("Agreement"). In 2012, the Noticees were obligated to make a mandatory open offer under the Takeover Code 2011, pursuant to the conversion of the FCCBs into equity shares resulting in the acquisition of voting rights in KHIL in excess of the limits set out in Regulation 3(1) of the Takeover Code 2011³. Upon filing the draft letter of offer with SEBI, the latter observed, vide letter dated November 30, 2012 ("Observations") that the Noticees should have, in fact, made an open offer under Regulation 12 of the Takeover Code 1997⁴, even prior to the conversion, due to rights obtained by them under the Agreement which were in the nature of 'control'. These rights included the right to nominate a director on the board of KHIL, restrictions on KHIL and its promoters from acting against the interest of the Noticees, and affirmative voting rights granted to the Noticees. Since this open offer had not been made in 2010, SEBI observed that the Takeover Code 1997 had been violated. The Observations consequently required the Noticees to do the following: (i) recalculate and revise the offer price to factor in for the price calculated on account of triggering the open offer requirement by entering into the Agreement in 2010, which included the 10% interest per annum for the delay in making the open offer (the delay period began from 2010 till 2012) ("2010 Price"); (ii) make the open offer pursuant to Regulation 12 of the Takeover Code 1997⁵ since the rights acquired by the Noticees were in the nature of 'control'; and (iii) disclose that SEBI may initiate appropriate penal action against the Noticees for the alleged violations mentioned in (i) and (ii) herein above in terms of the provisions of the Takeover Code 1997 and the SEBI Act, 1992. The Noticees consequently amended the letter of offer and included for the revised calculation of the offer price. The Noticees however did not follow SEBI's Observations that the open offer was to be made pursuant to Regulation 12 of the Takeover Code 1997 as they intended to appeal against the same before the Securities Appellate Tribunal ("SAT").

This non-compliance with the directions of the Observations prompted SEBI to issue a show-cause notice to them. The order of the WTM was passed after hearing the Noticees pursuant to the above show-cause notice. In their averments before the WTM, the Noticees expressed their apprehension in being classified as 'promoters' should they accept, in the final letter of offer, that they acquired 'control' in KHIL as per the terms of the Agreement. Being classified as promoters would subject them to various onerous promoter-related obligations, and adversely impact their operations as financial investors.

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ISSUES DISCUSSED BEFORE THE WTM

The WTM was required to determine three questions in this case:

■ **Whether the Noticees failed to disclose that the open offer was to be made pursuant to Regulation 12 of the Takeover Code 1997?**

As discussed above, the Noticees failed to make the open offer under Regulation 12 of the Takeover Code 1997, and made the offer only under Regulation 3(1) of the Takeover Code 2011. However, the Noticees clearly set out details of the Observations in the final letter of offer, specifically stating that (i) SEBI had required the offer to be made under the Takeover Code 1997, (ii) that SEBI may initiate penal action against the Noticees for alleged violations of the Takeover Code 1997, and (iii) that they intended to appeal against the Observations. Consequently, the WTM observed that the Noticees had made adequate disclosures about the Observations in their letter of offer which enabled the shareholders to make an informed decision, and hence decided the first question in the negative.

■ **Whether the Noticees acquired 'control' in KHIL under the Agreement?**

While examining the second question, the WTM, with regard to the rights available to the Noticees under the Agreement (mentioned above), made an *obiter dictum* in its order: "*It is apparent that the scope of the covenants in general is to enable the Noticees to exercise certain checks and controls on the existing management for the purpose of protecting their interest as investors rather than formulating policies to run the Target Company*".

However, the WTM observed that the Agreement got extinguished in July 31, 2014, and the clauses that purportedly conferred 'control' on the Noticees under the Agreement were no longer binding on the promoters of KHIL; consequently the WTM decided that the determination of 'control' was no longer relevant.

Although the *obiter dictum* seems to suggest that the WTM is of the view that affirmative voting rights and customary investor protection rights should not amount to acquisition of 'control' in a company, the conclusion drawn by the WTM that the determination of control was no longer relevant leaves the reader a little confused on the actual intent and purpose of the *obiter dictum*. The matter in question was whether at the time that these rights were in force, the Noticees acquired control. Therefore one could argue that since the matter related back to a time in 2010, whether or not the Agreement was in force in 2014 was not relevant to the matter.

■ **Whether the offer price would be different if it was calculated taking into consideration the 2010 Price along with 10% interest per annum since 2010?**

The above decision by the WTM on control is also in conflict with his determination of the third question in the negative; the WTM observes that the price of the open offer has correctly been arrived at after considering the 2010 Price which includes the 10% interest per annum calculated since entering into the Agreement in 2010. In other words, the same has been calculated as if there had been an acquisition of 'control' under the Agreement, leading to a non-compliance of the Takeover Code 1997 and consequent penalty being levied since 2010. While this may have been a result of the Noticees erring on the side of caution and complying with the Observations, the WTM's acknowledgement of the correctness of such calculation implies that there had, in fact, been an acquisition of 'control' under the Agreement in 2010, which necessitated that the 2010 Price including the interest of 10% to be factored in.

Although the WTM issued an order favourable to the Noticees in the present case, the matter of what really constitutes control continues to be ambiguous. Perhaps the decision read along with the WTM's *obiter dictum* as a whole suggests that the authorities are in fact warming up to the fact that 'negative control' and protective rights in the Indian context is not control as envisaged under the Takeover Code. If only the WTM had taken a different stand on the computation of the 2010 Price, there would have been a meaningful conclusion to this confusion. In light of this mayhem, one's only ray of hope may be the finalization by SEBI of the Brightline Tests for Acquisition of 'Control' to attain some sense of clarity.

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You can direct your queries or comments to the authors

¹ Civil Appeal No. 3371 of 2010.

² In the matter of Kamat Hotels (India) Limited, Order number WTM/GM/EFD/DRAIII/20/MAR/2017 dated March 31, 2017.

³ Regulation 3(1), Takeover Code 2011, states that a public announcement of an open offer shall be made by every acquirer that acquires shares or voting rights in a target company which taken together with shares or voting rights, if any held by him and by persons acting in concert with him in such target company, entitles them to exercise 25% or more of the voting rights in such target company.

⁴ Regulation 12, Takeover Code 1997 states: Irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the regulations.

⁵ *Ibid.*

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