

Legal Update

“Passive acquisition would not attract Regulation 11(1) of the Takeover code” – an overview of the recent SAT decision

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The Securities Appellate Tribunal (hereinafter “SAT”) in an appeal¹ before it by the promoters of OCL India Limited against the order of Securities and Exchange Board of India (hereinafter “SEBI”) has held vide order dated 21st November 2011, that passive acquisition would not attract the provisions of Regulation 11(1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations (hereinafter “SAST”) 1997. By virtue of the said SAT order, ambiguities surrounding requirement of open offer pursuant to passive increase in voting rights of a shareholder due to buyback by company would no doubt be addressed with respect to the SAST 1997 Regulations. Though the newly enacted SAST 2011 Regulations strives to address the issue of passive acquisition pursuant to buy back to certain extent by exempting increase in voting rights in a target company of any shareholder pursuant to buy back from the requirement of open offer subject to satisfaction of conditions specified therein, nevertheless the said SAT decision would continue to act as guide in respect of matters involving passive acquisition. The ensuing paragraphs seek to unveil the circumstances leading to the SAT decision along with the rationale behind the same and also highlight the actual position with respect to the newly enacted SAST Regulations 2011.

Facts in brief:

OCL India Limited, incorporated under the Companies Act 1956 with its registered office located in Orissa, declared a scheme to buy back 16.59% of its issued and paid up capital on February 24, 2003. According to the scheme, the promoters were not entitled to participate in the buy back. Consequent to the said buyback, the percentage shareholding of the promoters increased from 62.56% to 75% of the total paid up capital. However, such increase did not result in change in control of the Company. The Securities and Exchange Board of India (hereinafter “the Board”) did not receive any complaint against the buyback or increase in the percentage of shareholding of promoters. The Board also did not raise any objection on its own while processing the buy back offer document of the company.

¹ Appeal No.134 of 2011, date of decision: 21.11.2011

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Writ petition filed against the Company:

Subsequently, a writ petition was filed in Delhi High Court against the Company on October 9, 2006 by Jindal Securities Private Limited alleging violations of Regulations 11(1) of the SAST 1997 Regulations on the part of the promoters. The petitioner stated in the writ petition that as a consequence of increase in the percentage shareholding of the promoters from 62.56% to 75% pursuant to buyback, the promoters had attracted Regulations 11(1) and 11(2) of the SAST 1997 wherein they were required to make a public announcement to acquire shares which the promoters incidentally did not.

Disposal of writ petition by the High Court:

The High Court disposed the said writ petition on February 7, 2007 and directed the Board to treat the same as “a representation on behalf of the petitioner and deal with it in accordance with law.”

Issuance of Show Cause notice by SEBI:

Thereafter, a show cause notice dated July 17, 2007 was issued by the Board to the promoters wherein the Board alleged violation of Regulation 11(1) of the SAST 1997 by the promoters and sought explanation from the promoters as to why they should not be instructed to make an offer for acquiring shares to the shareholders as per SAST.

In reply, the appellants i.e. the promoters/members of the promoter group denied violating Regulation 11(1) of the SAST 1997 and contended that they had not acquired any additional share or voting right in the Company that might entail compliance of the said Regulation.

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Adjudication proceedings initiated by SEBI:

The Board did not consider fit to direct the promoters to make a public offer to the shareholders of the target Company as intended in the said show cause notice. The Board opined that issuing such direction would not benefit the shareholders by applying the pricing formula as laid down in SAST 1997 since the market price of the scrip of the Company as on January 25, 2010 was around Rs.134.90 compared to the price range of Rs.40 (in September 2002) to Rs.77 (in March 2003). Hence vide order dated January 28, 2010, the Board held violation of the provisions of Regulation 11(1) of the SAST 1997 and initiated adjudication proceedings against the promoters for violating the said provisions.

Appeal against SEBI order before SAT:

Aggrieved by the aforesaid order of the Board the promoters filed an appeal before the Securities Appellate Tribunal (hereinafter “SAT”) to which SAT suggested the promoters to make an application to the Board seeking exemption from the provisions of the SAST 1997 under Regulation 3(1)(1). SAT did not examine the issue as to whether Regulation 11(1) of the SAST 1997 was attracted and disposed the appeal with an instruction to the Board to consider the application seeking exemption. The Board, however vide order dated July 19, 2011 rejected the application on the ground that the Board has no power to grant exemption from the provisions of SAST 1997 after acquisition. Subsequently the promoters/members of the promoter group of the company filed an appeal against the said order of the Board before the SAT.

Decision of SAT:

Upholding the appeal of the promoters/members of the promoter group, SAT held that the Regulation 11(1) of the SAST is not attracted in the instant case and hence the promoters are not required to make a public announcement. Therefore, vide order dated November 21, 2011, SAT set aside the order of the Board dated January

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28, 2010 and allowed the prayers of the appellants thereby making the order of the Board dated July 19, 2011 ineffective.

Rationale behind order of SAT:

- In deciding the instant case, SAT held that the Regulation 11(1) of SAST is applicable to an acquirer who acquires additional shares or voting rights in a company by himself or through or persons acting in concert with him. Citing the definition of the word “acquire” as laid down by Black’s Law Dictionary as well as the SAST Regulation, the tribunal observed that the word “acquire” implies “acquisition of voting rights through a positive act of the acquirer with a view to gain control over the voting rights” which was absent in the instant case since the percentage increase in the voting rights of the promoters was due to any act of theirs but “incidental to the buy back of shares of other shareholders by the company” and hence such “passive increase” of voting rights of the promoters would in no way attract Regulation 11(1) of SAST 1997.
- The tribunal further added that passive acquisition cannot be regarded as indirect acquisition as intended in the definition of ‘acquirer’ since the words ‘directly’ and ‘indirectly’ in the definition of ‘acquirer’ should be used with respect to a person who acquires voting rights vide his “positive act” and if such acquisition falls within the limits set by Regulation 11(1) of SAST 1997 it is only in that particular case the Regulation 11(1) of SAST would get attracted.
- The tribunal also observed that since the provisions of SAST applies both to promoters and non promoters, an increase in percentage shareholding of a non promoter pursuant to a buy back scheme or other scheme like forfeiture of shares of other shareholders would lead to a situation wherein non promoters would find difficult to comply with the provisions of the SAST. Moreover, a situation might arise wherein a non promoter might find his shareholding percentage increasing without even participating in the buyback scheme. In such an eventuality the non promoter would find himself unnecessarily

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burdened with the responsibility of making public announcement which as per tribunal's view, could not be the “intent” of the legislature.

- In conclusion, the tribunal held that “.....In this view of the matter, we are of the firm opinion that passive acquisition does not attract the provisions of Regulations 11(1) of the takeover code. In view of our finding that Regulation 11(1) was not attracted to the facts of the present case, it is not necessary for us to go into the question whether the Board has the power to grant exemption to an acquirer from the provisions of the takeover code post acquisition. In the result, the appeal is allowed, order dated January 28, 2010 set aside and prayers (i), (iii) and (iv) in para 6 of the memorandum of appeal granted. Consequently the order dated July 19, 2011 has become infructuous.”

Position with respect to Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:

It has been specifically laid down in Regulation 10 (4) (c) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, that increase in voting rights in a target company of any shareholder pursuant to buyback of shares shall be exempted from open offer provided certain conditions specified therein are satisfied which includes:-

- The shareholder has abstained from voting in favour of resolution authorizing buy back of securities under section 77A of the Companies Act 1956.
- In case of shareholder resolution, voting is carried out vide postal ballot.
- Such shareholder in his capacity as a director or any other interested director has abstained from voting in favour of the resolution of the board of directors of the target company authorizing buy back of securities under section 77A of the Companies Act 1956.

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- The said increase in voting rights does not result in an acquisition of control by such shareholder over the target company.

If the shareholder fails to comply with the conditions mentioned hereinabove, the shareholder would be required to make a public announcement not later than the 90th day from the date of such increase in the voting rights beyond the relevant threshold mentioned in Regulation 3. Where the said conditions are not met, the shareholder would not be required to make an open offer if the shareholder reduces his shareholding such that his voting rights fall below the level triggering open offer under Regulation 3(2), within 90 days from the date on which the voting rights so increase.