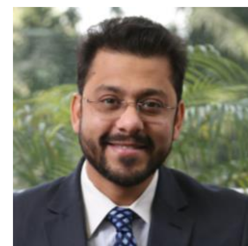
EXEMPTIONS UNDER THE TAKEOVER CODE

Manish Kumar Sharma
Partner
E: manish@singhania.in



Sudhanshu Gupta
Associate
E: sudhanshu@singhania.in

The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Regulations**") govern the transaction relating to acquisition of shares of a target company (listed company in India), where undertaken by an existing shareholder of the company or any other independent acquirer company. The purpose of the Regulations is to regulate the acquisition of shares or voting rights (directly or indirectly) or takeover of the '*control*' of the target company and ensure that the said acquisition is done in a fair and transparent manner. For instance, Regulations 3 and 4 of the Regulations ensures that a public announcement of an open offer is made, prior an acquisition of the shares of a target company beyond a certain threshold. This open offer is made to the existing shareholders of the target company, so that they may have a fair exit opportunity in case of a substantial change of control or shareholding in the company.

However, Regulations 10 and 11 of the Regulations provides for general exemptions from making such announcement/open offer. In fact, under the erstwhile Takeover Code of 1994, certain exemptions were granted to the acquirer and persons acting in concert ("**PAC**") by Securities and Exchange Board of India (SEBI), in terms of the authority given to it under Regulation 4 on a case-to-case basis. However, under the aforesaid code of 1994, since there existed no clarity and transparency as to what kind of acquisitions may be exempted, amendments were enforced to negate the same.

Thereafter, on the TRAC (Takeover Regulatory Advisory Committee) Report's recommendations; exemptions had certainly been streamlined and classified on basis of the specific charging provision from which exemptions would be available, with conditions for eligibility for such exemptions. Accordingly, this article would deliberate and shed light upon such exemptions under the Regulations i.e. within Regulations 10 (1) (2) (3) (4) and 11.

Basically, there are three types of acquisitions regulated under the Regulations. *First*, initial trigger acquisitions; where an acquirer acquires 25% or more of the shares or voting rights in the target company. *Second*, creeping acquisitions; where an acquirer (who already holds 25% of the shares or voting rights in the target

company) acquires another percentage of shares in excess of 5% of the total shares during the financial year. *Third*, acquisition of control; where an acquirer acquires (directly or indirectly) the control of the target company. For such acquisitions, the Regulations mandate the acquirer to make a public announcement of an open offer to the existing shareholders of the target company. However, the Regulations regulate the same through particular exemptions.

CATEGORIZATION OF EXEMPTIONS:

Type of Acquisition	Initial Trigger Acquisitions (Regulation 3(1))	Creeping Acquisitions (Regulation 3(2))	Acquisitions of Control (Regulation 4)
Exemptions	(i) Reg. 10(1) (ii) Reg.10(3) (iii) Reg. 11	(i) Reg. 10(1) (ii) Reg. 10(4) (iii) Reg. 11	(i) Reg. 10(1) (ii) Reg. 10(2) (iii) Reg. 11

I - EXEMPTIONS APPLICABLE TO INITIAL TRIGGER ACQUISITIONS (REG. 3(1))

1. **Inter Se Transfer of Shares:**

Acquisitions arising out of inter-se transfer of shares among "*qualifying parties*" as specified under this Regulation would be exempted from making an open offer. The nature and type of such qualifying parties have been determined upon the underlying principle that, such transfers do not represent a typical acquisition carrying an economic value. The following parties, namely, are:

i. Immediate Relatives - Where inter se transfers takes place between relatives as defined under Regulation 2(1)(l) which includes *"any spouse of a person, and parents, sister, brother or child of such person or of the Spouse"*.

ii. Promoters; where Inter se transfers takes place between the persons named as promoters in the shareholding pattern of the target company as filed by them with the stock exchanges for a period not less than 3 years prior to the proposed acquisition. The above acquisition of shares or voting rights of the target company by the acquirer along with the PAC from the promoters of the target company is exempted from giving public announcement. The exemption can be explained through the following cases:

- *Commercial Engineering and Body Builders Company Limited (CEBBCO)*:- A promoter of the CEBBCO (listed on NSE and BSE) intended to sell shares to another promoter. Both the promoters had sought exemption under Regulation 10 (1). However, SEBI rejected the application and clarified that in order to avail the exemption under Regulation 10 (1) (a) (ii), all the compulsory conditions should be duly fulfilled. One of the prescribed condition that the transferor and the transferee should have been identified as promoters of the target company in the shareholding pattern filed under the listing agreement or the Regulations for three years prior to the acquisition. This was not fulfilled. Hence, the exemption could not be availed.
- *Weizmann Forex Ltd. (WFL)* –WFL is an Indian company listed on NSE and BSE. A composite scheme of arrangement was sanctioned by the jurisdictional High Court. Thereafter, the shares of the resulting companies were also listed on the BSE and NSE. Promoter and few other promoters group companies intended to transfer their

Singhania & Partners LLP
Solicitors & Advocates

shares to other promoter group companies. All the Transferor Companies held shares in the WFL for more than three years.

SEBI had opined that since the transferees collectively held shares for a period of three years, and other conditions for availing the exemption were fulfilled, the proposed Inter-se Transfer could be exempted under Regulation 10 (1) (a) (ii).

iii. Company and its subsidiaries - Where inter se transfers take place between company, its subsidiaries, its holding company, other subsidiaries of such holding company, or persons who hold 50 % or more of the equity shares of such company. Under the 2018 recently amended regulations, the said company could be an Indian or foreign company.

iv. Shareholders of the Target Company -Where inter se transfer takes place between the shareholders of the target company(who have been 'PAC' for a period of not less than 3 years prior to the proposed acquisitions), and any company which is owned by such shareholders in the same proportion as their holdings under the Target Company.

2. **Acquisitions done by persons, within the course of their business.**

The second class of acquisitions exempted from the requirements of giving a mandatory open offer under Regulations 3 and 4 of the Regulations, are those done by certain persons within their "ordinary course" of business. Such categorized persons include underwriters, stock brokers, merchant bankers, stabilizing agents, market makers, Scheduled Commercial Banks '*acting as a escrow agents'*, Scheduled Commercial Banks or Public Financial Institutions '*acting as pledgees while invoking a pledge'*, and nominated investors '*in the process of market making or subscription to the unsubscribed portion'.*

3. **Acquisitions at subsequent stages.**

This exemption covers those subsequent stages of the acquisition (*acquisitions in pursuance of an agreement of disinvestment*), where at a prior stage, an open offer is already made. However, it must be ensured that both the acquirer and seller are the same at all stages of the acquisition and full disclosures of the subsequent stages have been made in the open offer (during the prior stage).

4. **Acquisitions pursuant to various schemes.**

There may exist acquisitions which are undertaken in pursuance of certain legislations and schemes of arrangement. Regulation 10(1)(d) enlists exemptions for such acquisitions, namely;

a) an acquisition in pursuance of a scheme, under Section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985. It is pertinent to note that the aforesaid act was repealed by the Repeal Act of 2003, and accordingly the Insolvency and Bankruptcy Code (IBC), 2016 is now applicable *vis a vis* Sick Industrial Companies. Therefore, such schemes if made under the IBC 2016 would be exempted under Regulation 10.

b) an acquisition in pursuance of a scheme of arrangement wherein the target company goes through reconstruction, directly, like amalgamations, mergers or demergers, (due to any order of Court, tribunal or competent authority), would also be exempted.

c) an acquisition in pursuance of a scheme of arrangement where the target company does not directly go through reconstruction like amalgamations, mergers, or demergers, (*due to any order of Court, tribunal or competent authority*) exemption may be given if certain pre-conditions are satisfied which includes the situation where the amount of cash equivalents

paid is less than 25% of the total consideration under the scheme of arrangement, where the persons who held the entire voting rights before implementation of the scheme of arrangement, must at least hold 33% of the new combined entity. It is important to note that both the aforementioned conditions must be satisfied in order to obtain the exemption to make the public announcement.

5. **Acquisitions in relation to provisions of certain legislations or rules:**

In addition, Regulation 10 (1) exempts certain acquisitions made in pursuance or in relation to specific provisions of legislations/regulations, like the following:

i) **SARFAESI Act, 2002:** As per the SARFAESI Act, a change in control of the borrower target company occurs through the takeover of its management, by the secured creditor. Hence, any acquisition under the SARFAESI Act would be deemed as an 'acquisition of control' under Regulation 4. Nonetheless, Regulation 3 may also apply in case of a notice issued in regard under Section 4(5) (c) (ii) of the SARFAESI Act i.e. in cases where the borrower is directed to transfer shares in favour of the secured creditors.

   The reasoning behind why an exemption is created for a lending company under the SARFAESI Act, while acquiring control of the borrower company, is that after recovering their dues, the former company is duty bound to return the control of the company. Hence, such acquisitions of control can be exempted under Regulation 10 (1) from making the public announcement.

ii) **SEBI (Delisting of Equity Shares) Regulations, 2009:** Within voluntary or compulsory delisting, a company will acquire shares through either a buy back arrangement or preferential allotment. Further, the public shareholders holding equity shares which are sought to be delisted must be given an exit opportunity in accordance with the aforesaid delisting regulations. If such an exit opportunity is complied with under the delisting regulations, then an exemption under Regulation 10 (1) would be given to the acquirer(s).

iii) **The Companies Act, 1956**: Regulation 10(1)(h) earlier purported (the 2017 amended Regulations) to exempt acquisitions of voting rights or preference shares carrying voting rights, arising out of the operation of Section 87(2) of Companies Act, 1956. According to the TRAC Report, the voting rights that accrue on preference shares in proportion to the paid up preference share capital, when dividend remains unpaid beyond the periods set out in Section 87(2), would not attract an obligation to make an open offer. Such voting rights are temporary in nature and upon dividend being paid, cease to exist. It is however, pertinent to note that Section 87(2) of the Companies Act 1956 is now not applicable, and is replaced by its mirroring provision of Section 47(2) of the Companies Act, 2013. Hence, such a change has also been reflected under the amended regulations 2018.

iv) **The Companies Act, 2013**: In accordance with Section 106 (1), no member of a company can exercise voting rights over called-on shares that are unpaid by him. Regulation 10(1)(j) exempts acquirers from making an open offer, where such called-on unpaid shares are acquired.

v) **The Insolvency and Bankruptcy Code, 2016 ('IBC'):** A newly found exemption is also created under the 2017 amended Regulations, where an acquisition is done in compliance of a resolution plan under Section 31 of the IBC. Under section 31 of the IBC, a resolution plan is approved by the Insolvency and Bankruptcy Board of India, to help the target company recover. Such a plan may permit any acquisition in relation to the shares of the target

company. Accordingly, the exemption applies to any acquisition done in pursuance of the resolution plan.

vi) **Strategic Debt Restructuring Scheme:** The Reserve Bank of India has notified the Strategic Debt Restructuring Scheme to enable banks to recover their monies provided to the listed companies by taking control of the same. In order to recover these loans or debts, the debt is extinguished by an allotment of equity shares of the target company, to the lender/acquirer company. Thus, where equity shares are allotted to/or acquired by the secured lenders in pursuance of Strategic Debt Restructuring Scheme 2016, an exemption is carved out under Regulation 10 (1) (i) and (ia).

6. Acquisition by way of transmission, succession or inheritance: Where shares of the target company are acquired by the virtue of transmission (transfer by operation of law), succession (succession to a business), or inheritance (through Will or succession certificate), such acquisitions by the acquirer company would be exempted from making an open offer under Regulation 10(1).

Acquisitions where there exist an increase in voting rights due to buy back of shares under Regulation 10(3)*:* Regulation 3(1) provides that if the acquirer company acquires 25% or more of the voting rights in the target company (initial trigger limit), then the former is mandated to make an open offer. However, there may exist a situation in which an acquirer (who already has voting rights in the target company) may have a passive increase in voting rights due to buy-back of shares by the target company, and thereby cross the threshold limit of 25%. Regulation 10(3) purports to exempt such acquirer/shareholder for this increase of voting rights if such shareholders reduce his shareholding below the above threshold within 90 days from the date of increase.
Similarly, Regulation 10(4)(c) purports to exempt situations in which an acquirer (who already has 25% or more voting rights in the target company) may have a passive increase in voting rights due to buy-back of shares by the target company, and thereby cross the creeping acquisition limit of 5%. However, the said Regulation also provides for certain pre conditions to be satisfied for the application of an exemption, such as, the increase in voting rights should not result in acquisition of control of the target company, etc.

Exemption by SEBI under Regulation 11: Regulation 11 empowers the Board ("SEBI") to provide exemption to the acquirer/target Company, for reasons recorded in writing, from open offer obligations and/or any procedural requirement or compliance, if it deems fit. This is very similar to the powers vested in the Board under Regulation 3 (1) (l) of the Takeover Code 1997. The company seeking such exemptions shall have to file an application supported by an affidavit [Regulation 11 (3)] and a non-refundable fee of Rs. 5 lacs [Regulation 11 (4)], post which, the Board may refer the case to a panel of experts constituted and on appropriate recommendations shall pass and host the exemption order on its website [Regulation 11 (6)].
For instance, in the example of ***Diamond Power Infrastructure Limited (Target Company)***; SEBI vide order dated March 23, 2016 exempted the Target Company from open offer on receipt of application on behalf of the promoters under Regulation 11 of Takeover Regulations. SEBI had noted that the Takeover Regulation specifically provided for a general exemption from the requirements of making open offer in acquisition of shares pursuant to the CDR Scheme. Hence, an exemption was granted in this case.

II - EXEMPTIONS APPLICABLE TO CREEPING ACQUISITIONS - REG. 3(2)

It is pertinent to note that the aforementioned schemes of exemptions under Regulation 10(1) and 11 are also applicable to creeping acquisitions. Nonetheless, there exists another set of exemptions specifically applicable to creeping acquisitions, i.e. under **Regulation 10(4)**.

Regulation 10(4)(a) provides exemptions where acquisitions are undertaken by the shareholders of the target company, in pursuance of a rights issue. Section 81(1)(a) of the Companies Act, 1956 deals with issue of shares on a rights basis to existing shareholders of a company. When there is a proposed increase in capital, this provision offers a right to the existing shareholder to acquire additional shares in the company, in proportion to his existing shareholding. Hence, if the existing shareholder acquires these additional shares within his entitlement, he would be exempted from making an open offer under Regulation 10(4)(a).

The general rule is that if he acquired more shares than his entitlement, he would be mandated under Regulation 3 to make an open offer. However, if more shares are acquired than the entitlement, another exemption can be availed under Regulation 10(4)(b). This exemption is subject to two conditions being fulfilled, i.e. (1) the acquirer should not have renounced any of his entitlements in such rights issue, and (2) the price of the shares at rights issue must not be greater than the ex-rights price of the target company as determined under sub-clauses [A] and [B] of the same regulation.

Regulation 10(4)(d) tends to exempt acquisitions in a target company *in exchange* for shares in another target company, pursuant to an open offer. Since such types of acquisitions were deemed as 'passive acquisitions' by the Review Committee, an exemption for the same could be afforded.

Regulation 10(4)(e) tends to exempt acquisitions made in a State level financial institution or their subsidiaries or companies promoted by them, by its promoters, pursuant to *an agreement* between the two.

Similarly, Regulation 10(4)(f) tends to exempt acquisitions made in a venture capital fund, alternative investment fund (category I) or foreign venture capital investor (that are registered by the SEBI Board), by its promoters, pursuant to *an agreement* between the two.

III - EXEMPTIONS APPLICABLE TO ACQUISITIONS OF CONTROL (REG. 4)

In reiteration, the aforementioned schemes of exemptions under Regulations 10(1) and 11 are also applicable to acquisitions of control. In addition, another exemption is afforded to these acquisitions under **Regulation 10(2)**. This exemption is in relation to the Corporate Debt Restructuring ('CDR') Scheme, wherein acquisitions do not change the control of the target company. The introduction of the CDR Scheme was for the revival of corporate companies as well as for the safety of the money lent by the banks and financial institutions. Such a scheme shall be approved by the shareholders, by passing a special resolution by way of postal ballot. Any acquisition of shares done in pursuance of the aforementioned scheme, which does not involve a change of control in the borrower company, would be exempted from making the open offer.

Conclusion

It is must be reiterated that the Regulations were introduced to ensure that acquisitions were undertaken in a fair and transparent manner. For example, Regulations 3 and 4 of the Code provides a strict obligation to make an open offer, when a certain percentage of acquisition in the target company is made. However, if such Regulations were to apply to all acquirer companies in all circumstances, then there would have been both, restriction in the overall business of companies,

and an overlap of obligations within other laws. As seen, the above Regulations have either provided for general exemptions (*i.e. Regulations 10(1) and 11 which apply to all acquisitions*) or exemptions within specific situations (*i.e. Regulations 10(3), 10(4) and 10(2) which apply to initial trigger acquisitions, creeping acquisitions, and acquisitions of control, respectively*). Hence, we may certainly conclude that the ultimate objective of the TRAC has been well met under the Regulations, i.e. to categorize, streamline, and specify unambiguous exemptions.

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Backdrop	**Settlement**	**No Reference/ No Bar to Arbitration**
Claim referred to conciliation/ Pre -litigation Lok Adalat	Terms of Settlement drawn and signed by both parties and attested by Conciliator/Members of Lok Adalat	No reference to Arbitration
Negotiations are held for settlement of disputed claims resulting in an agreement settling all the pending claims/disputes	Settlement made, amount agreed is paid and contractor issues a discharge voucher/ no claim certificate/ full and final receipt	No reference to Arbitration
Employer admits part of the claimed amount and expresses that it shall be released only once it is accepted by the contractor as the full and final payment	Subsequently the contractor who is hard pressed on funds signs the dotted line in order to get the amount released. Such a discharge is under economic duress on account of coercion employed by employer and does not amount to discharge of the contract by accord and satisfaction	No bar to Arbitration
An Insured makes a claim for loss suffered. Claim is neither admitted nor rejected. It is informed to the insured that unless the claimant gives a full and final voucher for a specified amount (less than the claimed amount), the entire claim would be rejected.	The Claimant agrees and issues an undated discharge voucher in full and final settlement. Thereafter only the admitted amount is paid. The accord and satisfaction is not voluntary and is in duress, compulsion and coercion.	No bar to Arbitration
Claimant makes a claim which is disputed by the Respondent,. The claimant who is keen to have a settlement and avoid litigation, reduces the claim and requests for settlement.	Respondent agrees, settles claim and obtains a full and final discharge voucher. Here even if the claimant might have agreed for settlement due to financial compulsions, commercial pressure or economic duress, the decision was his free choice	No reference to Arbitration

- Mere allegation that the discharge voucher/no claim certificate has been obtained by fraud/coercion/undue influence by the other party is not sufficient for appointment of the arbitrator unless the party alleging the same is able to produce prima facie evidence to substantiate the allegation. The Court has the power to find out if prima facie the dispute is genuine and requires invocation of Sec. 11(6) of the Act.

In the instant case, the Apex Court reversed the decision of the High Court and held that prima facie no dispute subsisted after the discharge voucher was signed by the Respondent without any demur or protest. The Appellant after 11 weeks of the settlement of claim sent a letter on 27th July, 2016 for the first time raising a voice in the form of protest that the discharge voucher was signed under undue influence and coercion with no supportive prima facie evidence being placed on record. In absence thereof, the Apex Court

opined, it must follow that the claim had been settled with accord and satisfaction leaving no arbitral dispute subsisting under the agreement to be referred to the Arbitrator for adjudication.