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Steps in the Right Direction: A Look at the Draft Regulations Framed by the CCI Regarding M&A Controls

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In January this year, the yet to be fully-constituted Competition Commission of India ("CCI") brought out its Draft Regulations relating to (a) its meetings; (b) the procedure in case of investigations pertaining to anticompetitive agreements and abuse of dominance; (c) determination of cost of production in predatory pricing investigations; (d) calling on and the engagement of experts; (e) leniency regulations in case of cartels; and finally, the most eagerly awaited (f) Combinations Regulations relating to mergers and acquisitions.[1]

The reason the Combination Regulations were most eagerly awaited was a result of an amendment brought into the Competition Act in September 2007. Although the provisions in the Act relating to combinations remained largely the same, certain small but crucial amendments were made. The most important of these amendments was the introduction of a mandatory notification and suspension regime. This resulted in the Indian trade and industry, which had largely been dormant thus far, creating a furore on

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[1] All revised draft regulations available at Competition Commission of India's website, *at* http://www.cci.gov.in.

the grounds that the amendments would hamper the growth of companies and weaken them against their competitors on the global stage.

The requirement to necessarily notify any acquisitions to the CCI and await its approval quite rightly raised some alarm. Particularly, since the provisions as they are framed require transactions with minimal or no nexus to India at all to be notified, as does it require notification regardless of the size of the acquisition. Further, the period for which a combination would have to be kept in suspended animation could extend to 210 days, if not more. These concerns were brought to the attention of the CCI by business houses, professionals, and members of the U.S. Federal Trade Commission ("FTC") and U.S. Department of Justice ("DOJ") as well.

I. THE DRAFT REGULATIONS

To its considerable credit, the CCI took it upon itself to address these concerns. After numerous rounds of discussions, the CCI incorporated in its draft Combination Regulations two very important provisions. First, it introduced a provision which practically exempts parties from filing a notification[2] if certain de minimis thresholds are not met. Second, it imposes upon itself a 30-to-60-day deadline for the purposes of reaching an opinion on whether or not to make a detailed investigation into the combination.[3]

Section 5 of the Act as it stands would require, for example, an acquirer to notify its proposed acquisition even if, standing alone, it breached the thresholds. An acquisition

[2] However, this is not explicitly stated.

[3] This would depend on which Form is filed. Regulation 6(1), read with Regulation 26(2), states that if Form I (Long Form) is filed, the waiting period would be 30 days, whereas if Form II (Short Form) is filed, the waiting period would be 60 days.

by a company based in London of a company based in Colombo would be reportable if either of the companies standing alone had, for the purposes of S. 5(a)(1), for example, assets of over Rs. 1000 crores or a turnover of Rs. 3000 crores in India. The draft Regulations therefore elaborates on the thresholds contained in S. 5 of the Act. The Regulations now provide that “each of at least two of the parties to the combination” must have assets of the value of Rs. 200 crores of a turnover of Rs. 600 crores in India. Thus, it would no longer be sufficient for the London-based or Colombo-based company to satisfy the thresholds based on their own individual figures, but *each* would need to have assets of the value of Rs. 200 crores of a turnover of Rs. 600 crores in India in order to breach the thresholds.

II. COMMENTS RECEIVED

After posting the Draft Regulations on its website and inviting comments (a first for a regulator), the CCI received approximately nine representations, again divided among chambers of commerce, professionals and a joint comment of the FTC and DOJ. While commending the efforts of the CCI, the comments contain certain recurring concerns over the draft. In summary, the major concerns were:

(a) whether the CCI has the power to carve out “exemptions” from the notification requirements;

(b) that clarity was required on whether a notification would still be required for transactions listed in Regulation 5(2) which, it is stated, are “not likely to cause appreciable adverse effect on competition in India”;

(c) that clarity was required with regard to the terms “in the ordinary course of business” and “solely as an investment”;

(d) that the waiting period of 210 days is too long in comparison to other jurisdictions;

(e) that the Regulations should exempt intra-group transactions and reorganizations;

(f) that the Regulations would need to be synchronized with the Securities and Exchange Board of India ("SEBI") Takeover Regulations 1997 ("Takeover Code"); and

(g) that a three-stage fee levy may incentivize the CCI to prolong investigations.

Certain comments also suggested that the thresholds in S. 5 of the Act should be based on the size of the transaction and market shares rather than the size of the parties in terms of assets or turnover. However, the asset or turnover test was prevalent in the Act since 2002, and follows the European Community, which uses a turnover test alone. Moreover, in so far as comparable asset or turnover test figures are concerned, India's thresholds (ranging from USD 500 million in worldwide assets and USD 1.5 billion in worldwide turnover to USD 2 billion in worldwide assets and USD 6 billion in worldwide turnover)[4] are significantly higher than those in the United States (USD 138.8

[4] This is somewhat of an oversimplification. The thresholds vary depending on whether one considers the assets or turnover of the parties to the transaction alone or considers that of the entire group to which the acquirer belongs and that of the target enterprise. It further varies depending on whether the worldwide assets or turnover is considered as opposed to only India assets or turnover. The figures above refer to the worldwide assets or turnover of the parties to the acquisition alone (USD 500 million) and to worldwide assets or turnover of the entire group to which the acquirer belongs and that of the target enterprise (USD 1.5 billion).

million in worldwide assets or turnover)[5] and comparable to those in the European Community (ranging from USD 3.7 billion to USD 7.4 billion in worldwide turnover).[6]

Strangely enough, the business houses that initially clamored over the absence of minimal thresholds are the ones that raised the objection that the CCI may not have the requisite power to exempt transactions based on the thresholds requested. The exemptions, they argued, should be provided for in the Act itself, or a specific power enabling the CCI to do so should be introduced in the Act.

On the other hand, the Commission has clearly stated (as is the stated objective of the Act) that its mandate is to regulate combinations that "are likely to cause an appreciable adverse effect on competition in India." Moreover, Section 64 of the Act empowers the CCI to make regulations to carry out the purposes of the Act. Read in conjunction with the CCI's stated duties in Section 18, then in interpreting and elaborating on the said phrase contained in S. 6(1) (which contains the prohibition), the Commission cannot be said to be overstepping the boundaries of the Act.[7]

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[5] According to US law, of the USD 138.8 million threshold one of the parties must have assets or turnover of at least USD 126.2 million and the other party assets or turnover of at least USD 12.6 million. *See* U.S. Federal Trade Commission, Pre-Merger Introductory Guides, *at* http://www.ftc.gov/bc/hsr/introguides/introguides.shtm (last visited Aug. 25, 2008); and U.S. Federal Trade Commission, Revised Jurisdictional Thresholds for Section 7A of the Clayton Act, Billing Code 6750-01P (2008), *available at* http://www.ftc.gov/os/2008/01/P859910sec7a.pdf.

[6] The figures refer to the aggregate worldwide turnovers of all the undertaking concerned. European Commission, Council Regulation (EC) No. 139/2004 of 20 January 2004 on the Control of Concentrations between Undertakings ["The EC Merger Regulation"], 2004 O.J. (L 24) 1. The exchange rate taken is USD 1 = EUR 0.67.

[7] India's securities market regulator, the Securities Exchange Board of India (SEBI), a similarly placed authority, has framed several substantive regulations relying on its regulation making power contained in S. 30 of the SEBI Act 1992. That provision is virtually identical to S. 64 of the Competition Act empowering the CCI to make regulations. Based on S. 30, SEBI has issued regulations relating to takeovers, insider trading, fraudulent and unfair trade practices, stock brokers, mutual funds, venture capital funds, foreign venture capital investors, and so on. These regulations govern most of the everyday activities of the securities markets. None of these are specifically provided for in S. 30 of the SEBI Act. If, therefore, the above argument is accepted, all SEBI regulations could be questioned for want of regulation making

Should the Regulations be challenged, one can only hope that they would be upheld.

III. THE REVISED DRAFT

Of the remaining concerns, while some have been addressed, others remain. The modified regulations have attempted to synchronize the timing and effect of the Draft Regulations with the Takeover Code. While the original draft required a notification only if an enterprise acquired more than 25 percent shareholding in the target company (thereby obtaining negative control), the revised regulation required the notification to be made at 15 percent. This is for the reason that according to the Takeover Code, it is mandatory that any person who crosses a threshold of 15 percent voting rights in a company make an open offer to the shareholders to acquire a minimum additional 20 percent of the voting capital in that company. Also in line with the Takeover Code, the revised Regulations allows the acquisition of voting rights of up to 5 percent per financial year where the acquirer already held between 15 and 55 percent in the target company. The revised Regulations also exempt intra-group transactions and as opposed to the three-stage fee levy initially contemplated, the CCI has now settled on a one-time levy at the time of filing the notification.

As mentioned earlier, the CCI has sought to address the concern regarding the 210-day waiting period by imposing on itself an initial 30-to-60-day waiting period (depending on the Form filed). The CCI has also stated that failing to reach a decision one way or the other within this period would result in automatic approval. The waiting

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power. However, to the knowledge of the authors, no SEBI Regulation has been challenged on the grounds of being ultra vires the SEBI Act.

period of 30 days is comparable to the sister provisions in the United States (30 days)[8] and the European Community (25 working days).[9] The maximum period in the EC (for a Phase II proceeding) is, however, briefer (90 to 125 working days, which, given a five-day work week, would be approximately 114 to 157 days). In the United States, the issuance of a Second Request extends the statutory waiting period for a further period of 30 days. However, in practical terms, effective compliance to a Second Request commonly takes parties anywhere between four to six months, only after which the extended 30-day period would begin.[10]

The Regulations are still unclear on whether a notification would be required in cases of transactions listed in Regulation 5 as it only states that those particular transactions are not likely to cause an appreciable adverse effect on competition in India, and not that those transactions are not reportable. Moreover, the terms "in the ordinary course of business" and "solely as an investment" remain undefined.

IV. TWEAKING REQUIRED

Despite addressing most concerns the provisions could do with some modifications. For example, although the revised Draft Regulations have been brought in line with the Takeover Code, two possibilities are not provided for. First, an unsuccessful open offer may leave the acquirer with a shareholding of above 15 percent but below 26 percent. Although the Commission would have examined this issue at the stage of initial

[8] *See supra* note 5. The period is 15 days for reportable acquisitions by means of a cash tender offer, as well as acquisitions subject to federal bankruptcy provisions.

[9] *See supra* note 6.

[10] *See* Joe Sims, New FTC Second Request Procedures, Jones Day Antitrust Commentaries (Mar. 2006), *available at* http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=3219.

notification when the acquirer made the open offer, market conditions could have changed substantially by the time the acquirer crosses 25 percent, in which case a fresh look may be necessary. Second, crossing the 50 percent threshold should warrant a notification, regardless of whether it is done incrementally or otherwise. An acquisition of more than 5 percent in a financial year in any case mandates an open offer under the SEBI Takeover Code.

The exemption relating to the 15 percent threshold is also subject to the qualification that it should be solely for the purpose of investment or be made in the ordinary course of business. Ideally, however, any acquisition of up to 15 percent shareholding without any change in control should be exempt regardless of whether it is being made solely as an investment or being made in the ordinary course of business.

The Regulations also leave some basic issues unaddressed. For example, the regulations do not clarify who the “acquirer” in an acquisition would be, whether it is the acquiring entity alone or the parent or controlling entity of the enterprise engaged in the actual acquisition. If the assets or turnover of the acquiring entity alone is taken into account, then nothing would prevent an enterprise (which would have satisfied the thresholds in S. 5(a)(i) had it made the acquisition itself) from circumventing the notification requirements by setting up a wholly owned subsidiary for the purpose of having negligible assets or turnover figures (if at all), given that the threshold limits in 5(a)(ii) (for a ‘Group’) are much higher than in (i). Taking the parent or controlling entity into account rather than just the entity making the actual acquisition would also follow the rationale that for the purposes of a competition law analysis a parent and its subsidiary company are looked at as a single economic entity (or unit). This would follow the approach in the United States and European Community.

On the other hand, unlike the U.S. and E.C. approaches, Section 5 of the Indian Competition Act provides a staggered threshold limit. S. 5(a)(i) begins with the words "the parties to the acquisition, being the acquirer and the (target)" whereas S. 5(a)(ii) begins with the words "the group, to which the (target) would belong." The term "Group" is defined as "two or more enterprises which are in a position to exercise twenty-six per cent or more of the voting rights in the other enterprise." The threshold limits in 5(a)(ii) are much higher than in (i). It is arguable therefore that the assets or turnover of the parent company of the entity making the acquisition would be taken into account only for the purposes of (ii) and not (i).

Similarly, the Regulations do not clarify how the turnover would be calculated in the case of a public sector undertaking ("PSU") (i.e., two government-owned companies). Presumably, the PSUs would not be treated as a "group" (and the transaction be exempt as being intra-group as provided in Draft Regulation 5) nor would the turnover of all PSUs be added up for the purposes of thresholds. It is also not clear whether turnover would be calculated net of taxes and rebates, as is the case in the European Community. Joint ventures and their treatment is another crucial area of concern that the CCI would do well to throw some light on.

Such clarifications are essential and should be specifically provided for, if not in the Regulations themselves, by way of guidance notes or the like,[11] or face being swamped with a myriad array of notifications interpreting the provisions their own separate ways. Hopefully, the Commission will adopt a practice of allowing pre-merger notification contact with the merging parties. This would help in obtaining relevant information, streamlining the process and facilitating quick clearances.

The combination regulation is bound to affect both local and foreign businesses alike. As with most legislation, no matter how laudable, much depends on the CCI's approach in implementation. So far the CCI has shown that it is willing to listen and address the concerns of the stakeholders while adopting a transparent and fair approach, all of which are steps in the right direction.

[11] Valuable cues could be taken from the European Commission Notice on the concept of concentration under Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings (98/C66/02); the Commission Notice on the concept of undertakings concerned under Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings (98/C66/03); and the Commission Notice on calculation of turnover under Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings (98/C66/04). *Also see* U.S. Federal Trade Commission, Pre-Merger Introductory Guides, *at* http://www.ftc.gov/bc/hsr/introguides/introguides.shtm (last visited Aug. 25, 2008).