CPI Antitrust Chronicle
April 2011 (1)

The New Indian Merger Control Regulations: How Does the Balance Tilt?

Vijaya Sampath & Ankita Goel De Mallik
Bharti Enterprises Ltd.

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2011© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

The New Indian Merger Control Regulations[1]: How Does the Balance Tilt?

Vijaya Sampath & Ankita Goel De Mallik [2]

I. INTRODUCTION

The Utilitarianism concept of the "greater public good" is the underlying basis of many laws in a developing country like India. This "greater good of many" is seen as one side of a fine balance, with profit motive, liberalization, and economic growth as the other side of the coin. The recently notified Indian merger control regulations titled "The Competition Commission of India (Procedure in regard to the transaction of business relating to combination)" ("Draft Regulations") seems to be an attempt to balance these sometimes conflicting principles.

The "greater good" is clearly visible in the very fact that scrutiny of "combinations" (which term is quite widely defined under section 5 of the Competition Act, 2002 ("Act"), and includes mergers, amalgamations, acquisitions, control etc. by the Commission is designed to ensure that there is no "appreciable adverse effect on competition" ("AAEC"). And the proposal of increased application fees ranging from INR 1 million to 4 million required to be submitted with the form for a notice of proposed combination will bring in more revenues to the public exchequer. At the same time, industry's interests seem to be the reason behind the higher thresholds (but with disregard to transaction size), the proposal of pre-merger consultations, and the prescribed period of 210 days within which the Commission is required to give a decision on a case, after which it is deemed approved.

However, an overview of the merger regulations indicates that certain important factors, such as the milestones which Indian industries have lately been achieving through global acquisitions (like Tata's acquisition of Corus or Bharti Airtel's acquisition of Zain's Africa business), were over-looked while drafting the framework within which these merger regulations will work, as the merger regulations seem to be divorced from the practices and precedents within which global transactions (acquisitions or mergers) take place. Without complete details

[1] The term 'new merger control regulations' is loosely used to define what are actually four official gazette notifications and a draft regulation (titled "The Competition Commission of India (Procedure in regard to the transaction of business relating to combination) Regulations"), issued on March 4, 2011. By the gazette notifications the Indian central government has: (1) notified the sections 5, 6, 20, 29, 30 and 31 of the Competition Act, 2002 (which sections shall come into force from 1 June, 2011 and relate to regulation of "combinations" and provide powers and procedures for the Competition Commission to inquire into combinations); (2) specified the thresholds for a transaction to qualify as a "combination" under section 5 (what is significant here, is that the earlier thresholds specified under section 5 have been increased by 50 percent); (3) provided for exemption for target enterprises with assets less than Indian Rupees 2.5 billion or turnover less than Indian Rupees 7.5 billion from section 5 of the Act for a period of five years; and (4) exempted a "Group" exercising less than 50 percent of voting rights in other enterprises, from the purview of section 5 of the Act, for a period of five years.

[2] Vijaya Sampath is Group General Counsel and Company Secretary, Bharti Enterprises, Ltd. Ankita Goel De Mallik is Legal Counsel

and specifics, below are just a few arguments in support of this proposition that the perspective of Indian industries endeavoring to make global acquisitions needs to be better taken into account.

II. VITAL OUTSTANDING ISSUES

A. Thresholds

The foremost facet leading to serious concerns are thresholds. While the thresholds from the earlier specified levels in the Act have been increased by 50 percent, these thresholds are the asset size or the turnover of the target and not the value of the stake being acquired. Even acquisition of a minor stake (in theory, even a single share) will attract these provisions, requiring a notice, an approval with a waiting period of up to 210 days, and payment of a substantial application fee (INR 4 million for mergers, amalgamations, or acquiring of control over an enterprise and between INR 1 million to maximum of 4 million for acquisition of shares, voting rights, or assets of an enterprise, based on the value of acquisition).

B. Foreign Acquisitions

Since the objective of the Act itself is to ensure healthy and vibrant competition in Indian markets, the Draft Regulations should have brought in the test of territorial nexus of transactions with reference to regulation of combination in the context of a group (section 5(a) (ii) of the Act, in particular). Acquisition of a foreign target by a foreign subsidiary of an Indian company is unlikely to have an impact on competition in India though there may be few exceptions if the target is a main supplier to the Indian market.

C. Options

The Draft Regulations indicate that put- and call options are within the scope of these regulations and will be considered as combinations or proposed combinations. The question that then arises is: When does an acquirer have to notify the Commission—prior to execution of these documents or after execution of these documents or before these options are actually exercised? It is also pertinent to link the reality of circumstances (primarily relating to health of an enterprise) when these options are exercised. The fact is that the price at which these options are exercised is linked to the value of the enterprise, and the review period of 210 days under the Act and the Draft Regulations—which means there could be a substantial decline in value of shares between the date of exercise of such an option and the date when this could be effected after an approval from the commission.

D. Timing

Compounding the above problem is the provision in the Draft Regulations which states that these regulations will not apply to a combination, if the combination has "taken effect" prior to the date when the central governments gives effect to sections 5, 6, 20, 29, 30, and 31 of the Act (regulation 28 of the Draft Regulations). The term "taken effect" has not been elaborated and is open to interpretation as to when an acquisition transaction takes effect. Is it when the complete purchase consideration is paid to the seller? So would it mean that the transaction has not taken effect if a tranche of a consideration remains to be paid, even though control over the target has passed to the acquirer? Or, is it when the acquirer takes control of the target? But then would these regulations apply to combinations, where the acquirer does not have control over the target or may have picked up a small stake? The trigger event may also apply at the execution of the definitive documents or may be applicable on closing, which itself may be in

transaction. These are definitely questions of concern to enterprises that have concluded such transactions recently.

E. Filing

Another glaring issue for the merger regulations is that the acquirer is required to file the notices and provide information to the Commission, for review of the proposed combination, on whether or not it has an AAEC in India. In certain circumstances, acquirers may be under immense pressure from the seller or target not to reveal certain information, which then basically makes what to file a value judgment for the acquirer. Second, section 20(4) of the Act prescribes "factors" on the basis of which the Commission will reach a conclusion of whether a combination will have an AAEC.

While the questions in Form I and Form II for the Commission to reach a conclusion are factual, the factors listed on section 20(4) themselves are subjective and open to judgments and interpretation. For instance, there can be no empirical and conjecture-free answers to factors like "likelihood that the combination would result in the removal of a rigorous and effective competitor or competitors in the market," "possibility of a failing business," "relative advantage, by way of the contribution to the economic development, by any combination baring or likely to have appreciable adverse effect on competition," and "whether the benefit of the combination outweighs the adverse impact of the combination, if any." Therefore, the merger regulations contain a high risk of subjectivity and discretion for each transaction, with the acquirers having no basis to pre-judge whether a proposed combination will pass the test. A pre-merger consultation process has been provided for in the Draft Regulations, but it should be noted that this is informal, verbal, and not even binding on the Commission.

On the issue of subjectivity, it would not be amiss to digress a bit and recall the proposed acquisition of the Chinese Huiyuan Juice Group Ltd. by Coca Cola, which was blocked by the Chinese Ministry of Commerce (MOFCOM) by enforcing China's Anti-Monopoly Law. An important outcome of this blocked acquisition, which is quite evident in most available discussions of this acquisition, was highlighting the concern that implementation of antimonopoly laws can lead to not very discernible reasons for regulator's decisions, producing insecurities in the industry of the stance that a regulator may take.

III. PERIPHERAL ISSUES

Moving on to seemingly more peripheral issues, any acquisition, especially a global acquisition, relies on three important factors: confidentiality, a stringent timeline, and the ability to juggle regulatory requirements of different jurisdictions at the same time.

A. Confidentiality

The Draft Regulations considerably impact the confidentiality aspect. A request for confidentiality made under the Draft Regulations, first, is only applicable "as far as its disclosure to public is concerned." Therefore, even before a deal dynamics is worked out, various governmental agencies and regulatory bodies may start their own investigations of the deal or seek more information.

Further, as the Commission is entitled to ask the parties to publish details of a combination which it considers to likely to have an AAEC in newspapers, and may even host such information on its own website, the element of exclusivity which confidentiality imparts to a deal will be completely lost. A competitor of the acquirer will not only have the opportunity to

directly or indirectly thwart or delay the deal with frivolous complaints, but will also have the opportunity to present overwhelming competing offers (which may absolutely change a deal's dynamics) to a seller or target. Bargaining positions may, thus, be compromised. Finally, an assurance of confidentiality is aimed at inspiring trust from the seller and/or target who will then, it is hoped, be willing to share more information in a due diligence process. The Draft Regulations may just make the diligence process more difficult for acquirers.

B. Stringent Timelines & Juggling Jurisdictional Requirements

The Draft Regulations also provide that the filing with the commission has to be made within 30 days of an approval by the Board or execution of an agreement or any document. This means that even a preliminary non-binding expression of interest triggers a notification and can cause a huge volatility in the stock price, wreck a half-baked deal, or, worse, kill it altogether by making it public.

The earlier draft regulation (2009) had identified certain transactions as unlikely to cause an AAEC; but now these transactions are required to be filed along with a high fee and will cause delays and burden the CCI with unproductive workloads.

The review period of 210 days that is provided in the Competition Act, 2002 and reinforced by the Draft Regulations, contains an even more ambitious term for the Commission to endeavor to dispose of the matter within 180 days from the filing of the notice; but this is still a long period. Global acquisitions happen within a span of months in the interests of (i) thwarting competing offers; (ii) keeping sellers and/or target's interests in the deal alive; (iii) completing the deal within the small window for exclusivity which is negotiated; and (iv) complying with the different timelines for the regulatory requirements (such as open offers, regulatory consents, etc.) in different jurisdictions. Scheduling all these tasks with the wait period under the merger regulations is definitely going to be as daunting a challenge as structuring the transaction!

IV. CONCLUSION

The arguments for and against the merger regulations can go on and on. For a more comprehensive detailing, an interested reader should definitely peruse the comments put forth by Federation of Indian Chambers of Commerce and Industry ("FICCI") and CUTS International. Based, however, on an extremely simplistic reading, because of the ambiguity, the required structuring, and the massive paperwork, the merger regulations seem a lawyer's paradise and the industry's migraine! Perhaps there is a need to shift the underlying paradigm or basis of these regulations and to stop viewing these requirements as requiring a balancing act. Indian realties are different—profit motive of entrepreneurs cannot be completely segregated from the public interest in global acquisitions, particularly in terms of economic growth employment opportunities, resources, capacity, and capability building.