IVCA
INDIAN PRIVATE EQUITY
& VENTURE CAPITAL ASSOCIATION

C-7, Pashchimi Marg, Vasant Vihar, New Delhi - 110057

21st June, 2013

Mr. Ashok Chawla,
Chairperson,
Competition Commission of India,
New Delhi. 110001

Sub: Issues relating to interpretation of "control" under the Competition Act

Dear Sir,

The Indian Private Equity and Venture Capital Association (***IVCA***) was established in 1993 and is based in Delhi. IVCA's mission is to promote the development of the venture capital and private equity industry in India and to support entrepreneurial activity and innovation. IVCA pursues this mission by promoting sound public policy on issues related to tax, regulation and securities through representations to the Securities and Exchange Board of India, Ministry of Finance, Reserve Bank of India and other Government departments and statutory authorities. IVCA also provides a forum for the professional development of its members and those interested in the venture capital and private equity industry through educational and training events.

As you are aware, Sections 5 and 6 of the Competition Act, 2002 (***Competition Act***) require the mandatory pre-notification of all acquisitions, mergers and amalgamations which cross specified asset or turnover thresholds (defined as "combinations" under the Competition Act) to the Competition Commission of India (***CCI***) (commonly known as "merger control"). Over two years have passed since the provisions of the Competition Act relating to combinations were brought into force on 1 June 2011. During this period, the CCI has examined over 120 combinations.

While the speed at which the CCI has handled merger clearances is commendable, a recurring issue faced by parties to a transaction is determining what constitutes "control" for the purposes of notifications under Sections 5 and 6 of the Competition Act. It should be noted that in a

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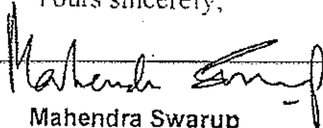
number of jurisdictions, merger notification requirements are triggered solely by a change in "control" over the target. However, in India, an acquisition of shares or assets may constitute a combination even if there is no acquisition of control. Nonetheless, the question of "control" is often important in determining whether an acquisition of shares or assets constitutes a combination. It is therefore critical for parties to a combination to understand the meaning of control under the Competition Act and its manner of application by the CCI.

At present, there is limited guidance on this issue and the CCI has observed that a case by case approach should be taken in determining what constitutes "control". Therefore, parties are often in the dark while assessing their transactions and are unable to determine what rights would constitute "*mere investor protection rights*" and what rights would confer "*control*". In this climate of uncertainty, parties are facing increased legal and compliance costs and losing valuable time in ascertaining whether their transactions will require notification to the CCI. Given the CCI's objective of establishing a "soft-touch" merger control regime, it is critical that the CCI provides clarity on the concept of "control". Clarity in the concept of "control" would go a long way in promoting sound public policy and reducing uncertainties for businesses in India. This would also reduce the costs of doing business and promote a conducive investment climate by smoothening out the regulatory process.

Accordingly, in order to discuss the issues faced by the venture capital industry, IVCA humbly requests for a meeting with you and members of your merger control division at the CCI at a time to your convenience. In advance of a meeting, please find enclosed a brief note setting out an overview of the concept of "control" under the Competition Act, the decisional practice of the CCI to date, the challenges faced by parties to transactions, and some suggestions to the CCI to ensure greater certainty for parties on this issue.

We look forward to hearing from you.

Yours sincerely,



Mahendra Swarup

President

The Private Equity and Venture Capital Association

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CONCEPT OF "CONTROL"-CHALLENGES FACED AND SUGGESTIONS FOR THE CCI

A. INTRODUCTION

1. Sections 5 and 6 of the Competition Act, 2002 (***Competition Act***) require the mandatory pre-notification of all acquisitions, mergers and amalgamations which cross specified asset or turnover thresholds (defined under the Competition Act as "combinations") to the Competition Commission of India (***CCI***) (commonly known as merger control). On 4 March 2011, the Government of India issued a notification, bringing into effect, Sections 5 and 6 of the Competition Act from 1 June 2011. Additionally, on 11 May 2011, the CCI issued the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (the ***Regulations***). The Regulations were amended on 23 February 2012 and more recently on 4 April 2013.

2. Under the Competition Act and the Regulations, parties are required to notify the combination to the CCI within 30 days of entering into binding documents (in the case of acquisitions) or passing of board resolutions approving the combination (in the case of mergers and amalgamations) and, importantly, transactions cannot be completed until clearance of the CCI has been obtained, or a review period of 210 calendar days has passed, whichever is earlier. A proposed combination will be void where the CCI finds that it causes or is likely to cause an "appreciable adverse effect on competition" (***AAEC***) in the relevant market in India. The Regulations require the CCI to form a *prima facie* opinion about whether a combination is likely to cause an AAEC within 30 days of receiving the notification.[1]

3. If the parties to a transaction fail to notify a combination, the CCI has the power to impose a penalty which may extend upto 1% of the total turnover or the assets of the combination, whichever is higher.[2] The CCI also has the power to investigate a non-notified combination on its own motion, for upto one year from the date such combination has taken effect.

4. In over two years of enforcement of the provisions of the Competition Act relating to combinations, the CCI has examined and unconditionally approved 117 combinations and has approved 2 combinations after accepting modifications and commitments from the parties.[3]

5. While the speed at which the CCI has handled merger clearances is commendable, a recurring issue faced by parties to a transaction is determining what constitutes "control" for the purposes of notification under Sections 5 and 6 of the Competition Act. It should be noted that in a number of

[1] Any time taken by the parties in furnishing additional information or offering modifications and the time taken by the CCI in evaluating the modifications offered of upto 15 days is excluded while calculating this 30 day time period.

[2] The CCI took a lenient view and did not impose penalties for late notifications in the year 2012 as it was the first year of enforcement of the provisions of the Competition Act relating to combinations. However, the CCI has imposed penalties for belated notification of a combination in *DHFL/First Blue/DHPL* (C-2012/11/92) and *Titan/Wheels India* (C-2013/02/109) in January 2013 and April 2013 respectively.

[3] These figures are up to date as of 10 June 2013. Please note that these figures do not include 4 notifications where the CCI has found that the notice was invalid and one notification where the CCI found that the transaction did not constitute a combination.

jurisdictions, merger notification requirements are triggered solely by a change in "control" over the target. However, in India, an acquisition of shares or assets may constitute a combination even if there is no acquisition of control. Nonetheless, the question of "control" is often important in determining whether an acquisition of shares or assets constitutes a combination. It is therefore critical for parties to understand the meaning of control under the Competition Act and its manner of application by the CCI.

6. At present, there is limited guidance on this issue and the CCI has observed that a case by case approach should be taken in determining what constitutes "control". Therefore, parties are often in the dark while assessing their transactions and are unable to determine what rights would constitute "*mere investor protection rights*" and what rights would confer "*control*".

7. Set out below is a brief overview of the concept of "acquisition of control" under the Competition Act, the decisional practice of the CCI to date, the challenges faced by parties to transactions, and some suggestions to the CCI to ensure greater clarity and certainty for parties on this issue.

B. CONCEPT OF "CONTROL"

8. As a starting point "control" is defined (rather circuitously) under the Competition Act to include "*controlling the affairs or management by- (i) one or more enterprises, either jointly or singly, over another enterprise or group; (ii) one or more groups, either jointly or singly, over another group or enterprise*".[4]

9. The CCI, in its decisional practice has interpreted control to mean, "*the ability to exercise decisive influence over the management or affairs and strategic commercial decisions*"[5] of a target enterprise, whether such decisive influence is being exercised by way of a majority shareholding, veto rights (attached to a minority shareholding) or contractual covenants. Having negative control, or the ability to veto (or cause a deadlock in respect of) strategic commercial decisions (such as, the annual business plan, budget, recruitment & remuneration of senior management, and opening of new lines of businesses) could be considered as sufficient to confer at least joint control.[6] The acquisition of joint control or moving from joint to sole control would also require notification to the CCI. Thus, it may appear that the CCI has adopted an expansive interpretation of control. At the same time, however, the CCI has appropriately observed that the question of control must be considered on a case by case basis "*to differentiate mere investor protection rights from those rights which result in a situation of [·] control.*"[7]

10. It is important to note that the CCI's approach to control is a departure from the meaning of "control" spelt out by the Securities Appellate Tribunal (***SAT***) in *Subkham Ventures India Private Limited v. SEBI*.[8] The SAT has held that veto rights acquired by a financial investor in a target company cannot be construed as a controlling stake for the purposes of the Takeover Code merely because: (i) the

[4] Explanation (a) to Section 5 of the Competition Act.
[5] *Independent Media Trust/Network 18* (C-2012/03/47) at paragraph 15.
[6] *SPE Holdings/MSM/Grandway and Atlas* (C-2012/06/63) and *Century Tokyo Leasing Corporation/Tata Capital Financial Services Limited* (C-2012/06/63).
[7] *SPE Holdings/MSM/Grandway and Atlas* (C-2012/06/63) at paragraph 10 (a).
[8] *Subkham Ventures India Private Limited v. SEBI* (2003) 3 CompLJ 301 SAT.

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investor has the right to appoint a nominee director on the board of a target company and require the nominee director's presence for purposes of constituting a valid quorum; (ii) the investor has certain affirmative voting rights, such as approval or revision of the annual business plan, amendment of the constitutional documents of the company, etc., under a shareholders' agreement; or (iii) if there are conventional "standstill" provisions for ensuring that there are no material changes to the target between signing of the agreement and the actual investment of funds. While this SAT order may not be a precedent from a question of law perspective, it is important to note that the SAT observed that control under the Takeover Code is a proactive and not a reactive power.

C. DECISIONAL PRACTICE OF THE CCI

a) Acquisition of "control"

11. The CCI found that the acquisition of zero coupon optionally convertible debentures (*ZOCDs*) which would entitle the acquirers to hold more than 99.9% of the fully diluted equity share capital of each of the target companies upon conversion was an acquisition of control over the target companies since the ZOCDs could be converted at the acquirer's option at any time.[9]

12. In another case, certain decisions relating to strategic affairs of the target enterprise could not be taken unless they were approved by at least one supervisory committee member nominated by each of the parties. The CCI found that the grant of such veto rights in respect of the strategic affairs of the target enterprise amounted to the acquisition of (joint) control over it.[10]

13. Acquisition of control is limited not only to direct control but also appears to cover indirect control, such as, acquiring control of a subsidiary through the acquisition of control over the parent and exercising veto rights through existing shareholders pursuant to a voting arrangement entered into by them. The CCI has found that a contractual obligation on existing shareholders to vote their shares in accordance with the acquirer's instruction is one of the factors contributing to acquisition of control.[11]

b) Safe harbours

14. The Regulations establish certain safe harbours and transactions falling within these safe harbours "*are ordinarily not likely to cause an appreciable adverse effect on competition in India*" and therefore, "*need not normally be*" notified to the CCI. The CCI's interpretation of "control" affects the scope of these safe harbours as most of these safe harbours are inapplicable when there is an acquisition or change in control.

15. For instance, an acquisition of shares/voting rights, solely as an investment or in the ordinary course of business, which does not entitle the acquirer to hold 25% or more of the shares or voting rights of the target enterprise and does not lead to an acquisition of control need not normally be notified to the CCI. It should be noted that the shareholding trigger of this safe harbour is aligned with the open offer trigger under the Takeover Code (i.e., 25%). However, it can often be the case that an acquisition

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[9] *Independent Media Trust/Network 18* (C-2012/03/47).

[10] *Century Tokyo Leasing Corporation/Tata Capital Financial Services Limited* (C-2012/06/63).

[11] *USL/Diageo* (C-2012/12/97) at paragraph 8 (It must be noted that the acquirer in this case also had an absolute right to appoint a majority of the directors and all senior executives of the target enterprise).

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which does not trigger an open offer under the Takeover Code may still require the CCI's prior approval if it results in an acquisition of "control" or is not made "*solely as an investment or in the ordinary course of business*."[12]

16. The CCI has found that the acquisition of 3.3% shareholding in a target enterprise which was in the nature of a strategic technology partnership whereby the parties would jointly bid for business projects and the acquirer was granted certain affirmative rights (including the right to nominate one director to protect its investments and intellectual property rights) to be a notifiable transaction as it cannot be considered to be an acquisition "*solely as an investment or in the ordinary course of business*".[13] The CCI's approach has far reaching consequences and parties to a transaction can no longer assume that an acquisition which results in the acquirer holding less than 25% in the target enterprise is not required to be notified as a combination.

17. The CCI has, in its recent amendments to the Regulations in April 2013, also introduced an additional safe harbour for creeping acquisitions of upto 5% additional shares or voting rights in a financial year on a gross basis, where the acquirer or its group holds between 25% to 50% of the shares or voting rights of the target enterprise both prior to and after such acquisition, provided that such acquisition does not result in acquisition of sole or joint control. This change goes some way in addressing the gap in the merger control regime where acquisitions between 25% and 50% were notifiable as a matter of course if the jurisdictional thresholds were met. However, this safe harbour is not applicable in a situation where there is an acquisition of "control".

18. Another safe harbour available under the Regulations is for an acquisition of shares or voting rights where the acquirer already holds 50% or more shares or voting rights, except in cases where the transaction results in a transfer from joint control to sole control. The CCI has observed that the exit of one joint venture (*JV*) partner in a 50:50 JV by way of acquisition of all its shares by the other JV partner amounts to a transfer from joint control to sole control.[14] In another case, the CCI found that the acquisition of 32.39% shares in the target enterprise (by an acquirer who already held 62%) from two entities holding 20.28% and 12.11% shares would amount to a transfer from joint control to sole control because the two entities acted collectively as a block and exercised negative control by way of veto rights over certain strategic commercial decisions like opening of new offices and hiring key managerial personnel and special resolutions under the Companies Act, 1956.[15]

19. A safe harbour is also available for acquisitions of shares or voting rights in enterprises within the same group. However, the recent amendments to the Regulations in April 2013 restrict the applicability of this safe harbour to enterprises "controlled" by a single group, thereby effectively limiting the application of this safe harbour for joint ventures.

D. CHALLENGES FACED BY PARTIES

[12] Further, the mere acquisition of shares/voting rights which entitles the acquirer to hold less than 25% shares/voting rights without veto rights over strategic commercial matters does not automatically mean that the transaction is exempt. If a sub-25% acquisition is not made in the ordinary course of business or for investment purposes, it will not be exempt even if there is no acquisition of "control". See *SAAB/Pipavav* (C-2012/11/95).
[13] *SAAB/Pipavav* (C-2012/11/95) paragraph 5.
[14] *Larsen and Toubro/Komatsu* (C-2013/03/113).
[15] *SPE Holdings/MSM/Grandway and Atlas* (C-2012/06/63).

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20. The biggest challenge for parties to transactions in relation to the interpretation of control continues to be the question of how to "*differentiate mere investor protection rights from those rights which result in a situation of [ ] control*". The CCI's general observation that a case by case approach is to be taken on this issue is of limited assistance in the absence of detailed guidance on what rights constitute control. In this climate of uncertainty, parties are required to take a "call" on whether their acquisition will or will not be viewed by the CCI as an acquisition of control. Thus, there is a need for formal guidance on this issue from the CCI.

21. It should be noted that the Regulations provide for a mechanism of pre-notification consultations with the CCI. However, such consultations are oral, non-binding and limited purely to the procedural aspects of filing a notification with the CCI. The CCI has so far, not given any guidance on substantive issues during pre-notification consultations. In the absence of detailed guidelines on what constitutes "control", the CCI, at the very least, ought to provide guidance on this issue on a case-by-case basis during pre-consultation notifications.

22. Another challenge that is faced results from the impact of an expansive interpretation of control on the definition of a "group" under the Competition Act and the scope of the safe harbour available for intra-group acquisitions under the Regulations. The definition of a "group" under the Competition Act includes the case of "*two or more enterprises which, directly or indirectly, are in a position to ... control the management or affairs of the other enterprise.*" The CCI has, so far, only obliquely considered this issue in a few cases and has found that where the parties to the combination had common promoters/shareholders and a majority of the directors were common to them, such parties were under common control and management.[16] It must be noted that in the EU, the concept of "control" is given a much narrower interpretation for the purposes of defining a "group" for calculating group turnover than for determining whether a transaction constitutes an "acquisition of control" requiring notification. In the EU, control for the purposes of a "group" arises only when an enterprise has majority control or manages the affairs of another enterprise and negative control will not suffice. If the CCI were to interpret "control" in an expansive manner for the purposes of defining a "group" to calculate group turnover, this would create significant uncertainties in assessing which entities form part of a "group" and would artificially increase the number of transactions requiring notification under Sections 5 and 6 of the Competition Act.

23. The application of the concept of control also has implications in determining whether persons acting in concert (*PAC*) for the acquisition of shares, voting rights or control (a concept under the Takeover Code) can constitute a group for the purposes of the Competition Act. Further, where such PACs act together in exercising their rights over the company on an ongoing basis, they could be seen as jointly exercising control over such company, and therefore be treated as a group.

24. Finally, the question of control is also an important consideration where, as is common in the Indian context, promoter groups play a significant role. Since there may sometimes be a lack of structural (shareholding) linkages between all persons and legal entities declared to be a part of the promoter group, the concept of control can play a big role in filling the gaps by showing that enterprises (including natural persons) that are part of the "promoter group" act together to control the management and affairs of the company concerned.

[16] *Alok Industries Limited/Grabal Alok Impex Limited* (C-2012/01/28) and Kalyan Jewellers Salem Private Limited/Kalyan Jewellers India Private Limited (C-2012/04/49).

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25. There is presently little clarity on how the CCI will approach the issues highlighted above and consequently, a lot of uncertainty for parties.

E. SUGGESTIONS FOR THE CCI

26. Based on the challenges identified above, set out below are certain suggestions for the CCI to ensure greater clarity and certainty for parties on the concept of "control":

    a) The CCI should suitably amend the Regulations to expand upon the definition of "control" under the Competition Act through detailed guidelines and, provide an indicative list of what rights would constitute "control".

    b) The CCI should, as part of its detailed guidelines provide guidance on:

    - the circumstances under which an acquisition of less than 25% shares/voting rights is likely to be considered as not being an acquisition "*solely as an investment or in the ordinary course of business*"; and
    - how the concept of control would apply to PACs and promoter groups.

    c) The CCI should, (on an informal and non-binding basis) provide guidance on whether certain rights are likely to be construed as conferring "control" during pre-notification consultations.

    d) The CCI should, through suitable amendments to the Regulations, clarify that the definition of "control" for the purposes of defining a group for calculating group turnover to only rights conferring majority control or the power of management of the affairs of another enterprise and should not include negative control.

27. In the current climate of uncertainty, parties are facing increased legal and compliance costs and losing valuable time in ascertaining whether their transactions will require notification to the CCI. Given the CCI's objective of establishing a "soft-touch" merger control regime, it is critical that the CCI provides clarity on the concept of "control". Clarity in the concept of "control" would go a long way in reducing uncertainties for businesses and would reduce the costs of doing business in India. This would also promote a conducive investment climate by smoothening out the regulatory process