Indirect Acquisitions under the Takeover Code: The Fairness-Efficiency Spectrum and Lessons for Regulation

Gautham Srinivas, Pranav Agarwal and Sai Saket Rachakonda[*]

The Indian regime of takeover regulation is characterised by a strong emphasis on the protection of minority shareholders, which has the potential to deter merger and acquisition activity. This is particularly true of 'indirect acquisitions', or acquisitions of entities upstream that result in a change in the person(s) ultimately controlling a downstream entity. Indian law mandates that a takeover bid be made for all such indirect acquisitions, regardless of whether such acquisition was of any consequence to the primary transaction that resulted in it. This article presents a critical view of this position in view of the limitations it places within the Indian securities market, as well as the impact it has on foreign merger and acquisition transactions. It examines Indian law in light of the approaches taken by various overseas jurisdictions, relying on the conceptual framework of a 'fairness-efficiency spectrum' to classify the relative weightage a jurisdiction gives to the concerns of minority shareholder protection (fairness) and the promotion of merger and acquisition activity (efficiency). Drawing on these practices, it offers suggestions on recalibrating India's approach to indirect acquisitions, in order to achieve greater balance between the concerns at play.

[*] The views of the author(s) in this article are personal and do not constitute legal/professional advice of Khaitan & Co. For any further queries or follow up please contact us at ergo@khaitanco.com.

Introduction

Early 2017 saw two global industrial gas behemoths, Linde AG ("**Linde**") and Praxair, Inc. ("**Praxair**") announce the signing of a definitive business combination agreement to merge their businesses.[1] This would result in their consolidation under a common holding company, creating the world's single largest supplier of industrial gases.[2] While the merger was going through regulatory scrutiny in the jurisdictions where it left a footprint, a unique challenge cropped up in India. The Securities and Exchange Board of India ("**SEBI**"), India's securities market regulator, determined that pursuant to the consolidation, a change of control in the listed Indian entity, Linde India Limited ("**Linde India**") (held by Linde through several layers of intermediary entities) had occurred, requiring that an offer be made to Linde India's shareholders to acquire its outstanding shares.[3] The merging entities sought to demonstrate how the requirement of making such an 'open offer' was not applicable to them, but this reading was rejected on a technicality.[4] The BOC Group Limited (a subsidiary of Linde), Praxair, and other 'persons acting in concert'[5] would eventually have to cross the regulatory hurdle of making

1 Praxair, Inc, 'Praxair News Release' (SEC, 1 June 2017) <http://www.sec.gov/Archives/edgar/data/884905/000119312517191218/d506854dex991.htm> accessed 13 April 2020.

2 Oliver Sachgau and David Mclaughlin, 'Linde, Praxair Win US Antitrust Nod to Create Gas Giant'Bloomberg (22 October 2018) <www.bloomberg.com/news/articles/2018-10-22/linde-praxair-win-u-s-antitrust-nod-to-create-gas-giant> accessed 11 April 2020.

3 Linde AG, 'Informal Guidance SEBI/CFD/DCR/OW/P/2017/15182/1' (SEBI, 3 July 2017) <www.sebi.gov.in/sebi_data/commondocs/oct-2017/Lindeinformal_p.pdf> accessed 9 April 2020.

4 *Ibid*. SEBI denied granting the exemption available to acquisitions that result from schemes of arrangement on the technicality that it was not sanctioned by a court or competent authority, even though there was no such requirement in the United States or Germany, jurisdictions where the primary transaction took place. Further, refer to Tarunya Krishnan, Tanushree Bhuwalka and Aman Dwivedi, 'Foreign Mergers: Exemption from Open Offer Under the Takeover Code' (*MONDAQ*, 14 November 2017) <www.mondaq.com/india/CorporateCommercial-Law/646098/Foreign-Mergers-Exemption-From-Open-Offer-Under-The-Takeover-Code> accessed 30 March 2020.

5 'Persons acting in concert' are those that co-operate to acquire shares, voting rights or control over a company, pursuant to a common objective to do so. In examining whether a takeover bid has been triggered, the voting rights or control held by such persons are considered alongside those of the principal acquirer. Further, refer to the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011, reg 2(1)(q).

a takeover bid, for a seemingly insignificant entity in a merger of global proportions.[6]

This was only one of the many instances where large corporations undergoing merger and acquisition activity were forced to make offers for the outstanding shares of relatively inconsequential downstream Indian entities. Much like Linde dwarfed Linde India in size, Indian companies held by foreign entities tend to represent a small portion of these upstream entities. This has, therefore, given rise to the question of whether or not offers of such nature for seemingly inconsequential entities are even warranted. This proposition was considered by the Takeover Regulations Advisory Committee ("**Achuthan Committee**"), which gave shape to the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**"). A survey of listed Indian companies with foreign parent companies carried out by the Achuthan Committee showed that the mean of the market capitalisation, net worth and net sales of Indian companies in the survey, in comparison to their foreign parents, were a paltry 5.4%, 1.8% and 2.1%, respectively. Of the 35 companies that the Achuthan Committee studied, only three companies had a market capitalisation that exceeded 20% of their foreign parents; none exceeded even 15% of their parents' net worth or net sales.[7] This presents a curious difficulty for Indian securities market regulation – the ultimate owners of Indian listed companies often change in transactions where acquiring control over such a company was, at best, a minor consideration. In response, as we shall explore over the course of this article, the relative importance of suchan Indian leg to global transactions, or the intent underlying them, comes to assume minimal importance in Indian takeover regulation. A decade since this approach was adopted, some practical questions remain.

Takeovers, simply put, are transactions where one or more persons attempt to acquire control over a company, ordinarily through the purchase of its shares.[8] Statutes concerned with takeover regulation, performed in India through the Takeover Code, regulate such takeovers - as we shall explore in Part I of this article, at least in theory, they ensure the orderly conduct of

---

6 Linde India Limited, 'Post-Offer Advertisement in accordance with regulation 18(12) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as amended, for the attention of the shareholders of Linde India Limited', (*SEBI*, 14 October 2019) <www.sebi.gov.in/filings/takeovers/oct-2018/linde-india-limited_40818.html> accessed 13 April 2020.

7 C Achuthan Committee, *Report of the Takeover Regulations Advisory Committee under the Chairmanship of Mr C Achuthan* (SEBI 2010), annexure 7. Admittedly, the study is a decade old, and it shall be interesting to *see* if circumstances have changed since.

8 Paul Davies, 'The Transaction Scope of Takeover Law in Comparative Perspective' (2016) ECGI Working Paper Series in Law 313/2016 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2749266> accessed 1 April 2020.

takeovers while protecting minority shareholders through such a change in control. Central to Indian takeover regulation is the 'mandatory takeover bid' – a requirement that any person that comes to control a company must make a general offer to acquire its outstanding shares, at the best possible price – one which is equal to or higher than the price paid for the shares that gave the person such control.[9]

It is not necessary that control over a 'target' is acquired directly through the purchase of shares or other rights therein. One may also do so by acquiring an intermediary (what this article calls the 'primary acquisition') which already holds control over one's target, allowing one to control the target through the intermediary (the 'indirect acquisition'). Consider a company, A, which holds a 60% stake and a controlling interest in company B. Were you to acquire A, you would also be able to exercise the rights that company holds through its 60% stake in B, thereby effectively holding control over B. Such 'indirect' acquisitions also come under the purview of the Takeover Code, even though there is no change to the listed company's own shareholding. Under the provisions of the Takeover Code, *all* such acquisitions trigger mandatory takeover bid requirements, regardless of the intention underlying the primary acquisition.[10] While indirect acquisitions have served as potential triggers for mandatory takeover bids since 1997,[11] the Takeover Code is noted by some as having cemented the law on the matter, laying a detailed and transparent framework for how such acquisitions are treated.[12] With this change in the law, many mandatory takeover bids now occur pursuant to indirect acquisitions – in the three previous fiscal years, 8.33% of all public announcements for such mandatory takeover bids have been pursuant to indirect acquisitions.[13] Despite this, however, there is little academic litera-

---

9 *Ibid* 9.

10 Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011, reg 5 read with regs 3 and 4.

11 The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 1997 ("**Takeover Code 1997**") make several references to indirect acquisitions. Prominent among these is the explanation to regulation 12 of the Takeover Code 1997, which cover acquisitions of control over a company. As the explanation stated, "… acquisition shall include direct or indirect acquisition of control of target company by virtue of acquisition of companies, whether listed or unlisted and whether in India or abroad".

12 Cyril S Shroff, 'New Takeover Regime Provides Clarity for Indirect Acquisitions in India and Overhauls Old Regime' (*International Institute for the Study of Cross-border Investment and M&A*, 18 October 2011) <xbma.org/indian-update-new-takeover-regime-provides-clarity-for-indirect-acquisitions-in-india-and-overhauls-old-regime/#ftn4> accessed 23 March 2020.

13 This data has been obtained from documents we studied that were publicly available on the website of SEBI, for each public announcement made for a takeover bid in the period. There were a total of 180 such announcements in this period, of which 15 involved indirect acquisitions.

ture analysing India's approach to takeover regulation, despite their potential to greatly hinder merger and acquisition activity.

This article takes a critical view of the regulation of indirect acquisitions in India, attempting to suggest alternative models for how the same may be achieved. Part I of this article sets forth the main rationales offered for takeover regulation, which it terms 'efficiency' and 'fairness' considerations, arguing that moving too far in the favour of fairness can potentially have a negative impact on efficiency. Carrying on from this understanding, Part II of this article reviews approaches that jurisdictions across the globe have taken to indirect acquisitions along a rudimentary 'fairness-efficiency' spectrum and highlights how the approaches they opt for, promote, or derogate, against either consideration. Part III describes India's approach to indirect acquisitions in some detail, drawing out its trajectory along the fairness-efficiency spectrum over time. Acknowledging that Indian law today lies at one far extreme of this spectrum, Part IV presents a case for reform based on the principle of comity, along with our suggestions on the way forward.

I. The Objectives of Takeover Regulation

Two rationales are often given for takeover regulation, which we term 'efficiency' justifications and 'fairness' justifications. The former argues that takeovers, as an integral aspect of the 'market for corporate control', promote efficiency in markets by pushing managements to ensure the highest price for a company's shares, lest they be taken over by another entity. The latter suggests that takeover regulations serve as a means of ensuring that minority shareholders are treated fairly, allowing them the option to exit from the company in the case of a change in its management, at terms that are comparable to those shareholders that transferred control to the new management.

As we shall see, however, particularly with mandatory takeover bid requirements, these considerations potentially work against one another. While such requirements do give minority shareholders greater rights where there is a change in control, these rights come at the expense of efficiency, by increasing the cost of a change in control. Designing takeover legislation, therefore, is a balancing act – one of ensuring that shareholders are given the maximum possible protection, while the impact of regulation on merger and acquisition activity is kept at a minimum.

A. Efficiency

Markets are famously believed to have a disciplining effect on producers, as customers flock towards attractive products, while avoiding unattractive ones. Likewise, many believe that securities markets discipline managements, as investors buy into companies that are managed well, keeping their share prices high, while staying away from badly managed companies. This, as Henry Manne first argued in 1965, creates a 'market for corporate control',[14] pushing company managements to compete with one another to ensure that the company's share prices are high.

Takeovers are an important tool for the functioning of these markets for corporate control. Takeover bidders often seek targets that have low share prices due to mismanagement. The fear of being taken over creates an incentive for managements to work as efficiently as possible so that the company's share price is too high for a takeover to be profitable. Should existing managements fail in this endeavour, takeovers allow a path for new managements to replace them and potentially improve the company's performance.[15] Takeover regulations can play a crucial role in this regard, by ensuring the orderly conduct of takeovers, without undue interference from entrenched managements.[16] It is thus that the G20 and OECD recommend ensuring the efficient functioning of markets for corporate control to enhance corporate governance, for which they consider essential the existence of clearly articulated rules and procedures governing takeovers.[17]

The model of takeover regulation opted for by India,[18] however, is best suited for jurisdictions where share ownership is highly dispersed, making

[14] Henry G Manne, 'Mergers and the Market for Corporate Control' (1965) 73 The Journal of Political Economy 110.

[15] *Ibid*. Further, refer to Jonathan R Macey, 'Market for Corporate Control' (*The Library of Economics and Liberty*) <https://www.econlib.org/library/Enc/MarketforCorporateControl.html> accessed 27 March 2020.

[16] Francis Okanigbuan, 'Corporate Takeovers and Shareholder Protection: UK Takeover Regulation in Perspective' (2013) 2 Manchester Student Law Review 267, 273–274.

[17] Organisation for Economic Co-operation and Development, 'G20/OECD Principles of Corporate Governance' (*OECD Publishing*, 2005) <https://www.oecd-ilibrary.org/docserver/9789264236882-en.pdf?expires=1585308830&id=id&accname=guest&checksum=F607D3BAC54560F55F4644E286534C65> accessed 27 March 2020.

[18] Explored in greater detail, particularly in the context of indirect acquisitions, in Chapter III of this article. While sixteen countries' takeover laws were studied for its formulation, India's takeover laws are widely understood to be modelled, at least in part, on the United Kingdom's City Code on Takeovers and Mergers. Further, refer to John Amour, Jack B Jacobs and Curtis J Milhaupt, 'The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework' (2011) 52 Harvard International Law Journal 219, 277.

it relatively easy for an outsider to take over a company.[19] For a variety of historical, structural, and cultural reasons,[20] India has a notably stagnant market for corporate control, with a large majority of its companies being controlled by family business groups.[21] This presents a problem for the governance of listed Indian companies. With shareholdings largely concentrated in the hands of founders and their families, managements have little accountability to public shareholders.[22]

In such a setting, takeover regulations have had little impact on spurring a market for corporate control. Despite mandatory takeover bid requirements forming part of Indian law since 1990,[23] hostile takeover attempts have been few and far between.[24] Even though the report of the Justice P.N. Bhagwati Committee ("**Bhagwati Committee**"), which led to the promulgation of the Takeover Code 1997 (which preceded the Takeover Code), saw them as a

---

19 This is often termed the 'Anglo-American' model, due to highly dispersed shareholdings being typical in the companies of the United Kingdom and the United States. In such jurisdictions, holding ~30% of the shares of most companies is believed sufficient to gain control over them.

20 For an examination of some of these factors, refer to Abhinav Chandrachud, 'The Emerging Market for Corporate Control in India: Assessing (and Devising) Shark Repellents for India's Regulatory Environment' (2011) 10 Washington University Global Studies Law Review 187.

21 For an analysis of corporate ownership trends in Indian companies between the years 2001-2011, for instance, refer to N Balasubramanian and RV Anand, 'Ownership Trends in Corporate India 2001-2011: Evidence and Implications' (2013) Indian Institute of Management Bangalore 419/2013 <https://www.iimb.ac.in/sites/default/files/2018-07/WP_No._419_0.pdf> accessed 26 March 2020.

22 As the preface to the report of the Kotak Committee notes, many Indian companies are run by promoters (an Indian legal concept, referring to persons who control a company, and in most cases are its founders) as personal fiefdoms: "In the '*Raja*' (monarch) model, promoter interest i.e., self-interest precedes interests of '*Praja*' (subject) i.e., other stakeholders. Given the sizeable number of promoter-led companies that are present in the Indian market, the challenges India Inc. faces are inherently unique. There are instances of promoters carrying out actions that are favourable to them but detrimental to the interests of minority shareholders" (translations inserted). Refer to Kotak Committee, *Report of the Committee on Corporate Governance* (SEBI 2017) <https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html> accessed 27 March 2020.

23 At the time, clause 40 of the erstwhile listing agreement that companies would enter with stock exchanges governed takeovers, mandating that a takeover offer be made to shareholders of a listed company where a person acquired more than 25% of the voting rights of the company.

24 Only three such attempts, it appears, have been successful: the takeover of Mindtree Limited by Larsen and Toubro Limited in 2019, the takeover of Zandu Pharmaceutical Works Limited by Emami Limited in 2008 and the takeover of Raasi Cements Limited by India Cements Limited in 1998. Some commentators, however, have opined that this is simply a result of India's favourable economic conditions. Should its economic climate deteriorate (as is possibly the case at the time of writing), the number of hostile takeovers shall increase. Refer to Shaun J Mathew, 'Hostile Takeovers in India: New Prospects, Challenges and Regulatory Opportunities' (2007) Columbia Business Law Review 800.

means to spur the market for takeovers,[25] this appears to have made little impact. In fact, almost half of the takeover bids recorded between the years 1997-1998 and 2014-2015, inclusive, were by incumbent owners looking to consolidate their holdings.[26]

The failure of India's takeover laws to create takeover activity of any note has led some commentators to argue that they strengthen the position of incumbent owners.[27] The need to make a takeover bid imposes an added cost on bidders, lowering the likelihood that they shall attempt to take control over companies regulated by the Takeover Code. It forces the acquirer to secure the finances to purchase many more shares than they originally envisaged, in addition to the costs that accompany the takeover bid process itself. When such additional costs come to undermine the economic feasibility of a takeover, these requirements, far from facilitating a market for corporate control, become inadvertent takeover defences.[28] Many jurisdictions where corporate shareholding is highly concentrated have experienced similar problems.[29]

B. Fairness

The core rationale underlying Indian takeover law, recognised by the various committees that have contributed to its development, is the need to ensure fairness and the equality of opportunity to all shareholders.[30] This principle was central to the United Kingdom's City Code on Takeovers and Mergers ("**City Code**"),[31] from where the concept of the mandatory takeover bid originated.[32] Shareholders selling a 'controlling block' of shares are often given a 'control premium' – a better price for selling their shares since such shares collectively give an acquirer control over the company. Takeover bids negate this advantage by giving all shareholders an equal opportunity to sell their

---

25 Justice PN Bhagwati Committee, Report on Takeovers (SEBI 1997) para 1.1.

26 Umakanth Varottil, 'The Nature of the Market for Corporate Control in India' (2015) NUS Law Working Paper No 2015/011, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2698474> accessed 27 March 2020.

27 *Ibid.*

28 Umakanth Varottil, 'Comparative Takeover Regulation and the Concept of Control' (2015) Singapore Journal of Legal Studies 208, 213.

29 For a similar argument from Europe, for instance, refer to Marco Ventoruzzo, 'Takeover Regulation as a Wolf in Sheep's Clothing: Taking UK Rules to Continental Europe' (2008) 11 University of Pennsylvania Journal of Business Law 135.

30 Justice PN Bhagwati Committee (n 25); C Achuthan Committee (n 7) para 9.

31 City Code, general principle 1 ("All holders of the securities of an offeree company of the same class must be afforded equivalent treatment; moreover, if a person acquires control of a company, the other holders of securities must be protected").

32 While the City Code was itself enacted in 1968, mandatory takeover bid requirements were introduced to it in 1972, in response to a defensive acquisition of shares intended to thwart bids for a corporation. Refer to Ventoruzzo (n 29) 145.

shares, on conditions which accompanied the sale of the controlling block.[33] Mandating such a bid ensures that the control premium is dispersed among shareholders, ensuring that no individual share of the company is more valuable than others, merely by being part of a controlling block.[34]

Additionally, mandatory takeover bid requirements offer an exit opportunity to shareholders in the case of a change in the control of a company's management. Such an exit opportunity is necessary since a change in control potentially implies a change in the company's policies, and it may be difficult for a shareholder to exit later on similar terms, should changes to the company's policies be detrimental to the shareholder's interests.[35] A takeover bid presents minority shareholders with a decision: in their estimation, will the management provided by an acquirer take the company's shares to a price thatis higher than the premium being offered by the acquirer? Unless the answer to such a question is in the affirmative, exiting the company becomes a rational choice for the shareholder.[36] Shareholders are, therefore, likely to stay in the case of value-enhancing takeovers, while exiting in the case of value-reducing takeovers.

C. Striking a balance

For the reasons enumerated above, far from being a universal positive, takeover regulation in economies like India must perform a delicate balancing act between maintaining a healthy market for corporate control and ensuring that shareholders' rights are protected.[37] While mandatory bid requirements have rightfully been hailed as a net benefit for shareholders,[38] the obstacles

---

[33] Takeover statutes are designed in a manner that require the acquirer to pay the best possible price for shares purchased in a mandatory takeover bid. For Indian law in this regard, refer to regulation 8 of the Takeover Code, which requires the acquirer to pay the best possible price, obtained on comparison of the prices of the triggering acquisition and other recent acquisitions, the market value of the shares and that obtained on valuation of the shares, among others.

[34] For a discussion of this concept, refer to Ruth Luttman, 'Changes of Corporate Control and Mandatory Bids' (1992) 12 International Review of Law and Economics 497, 498-499.

[35] Varottil (n 28) 213.

[36] Hubert de la Bruslerie, 'Equal Opportunity Rule vs. Market Rule in Transfer of Control: How Can Private Benefits Help to Provide an Answer?' (2013) 23 Journal of Corporate Finance 88.

[37] C Achuthan Committee (n 7) 9. The Achuthan Committee makes several allusions to the need for such a balance. In fact, one of the fundamental objectives of takeover regulation, in the view of the committee, is "[t]o balance the various, and at times, conflicting objectives and interests of various stakeholders in the context of substantial acquisition of shares in, and takeovers of, listed companies".

[38] Varottil (n 35). As Professor Varottil writes, upon comparing the positives and negatives of mandatory bid requirements, "Despite some critique of the [mandatory bid requirement], its rationale as founded on the basis of the equal opportunity principle is unassailable...".

they imply for a change in a company's ownership demand careful consideration. The high concentration of shareholding in the Indian market allows for little room for error in striking this balance.

Maintaining such balance is particularly important when the acquisition is indirect. Such acquisitions are not triggered by a bid for control over the target company, but over a separate entity upstream. This impacts how one must view both, considerations of efficiency and fairness. Mandatory bid requirements, in such cases, place a regulatory cost on changes in control that have a weaker nexus to the company triggering the bid, thereby creating additional obstacles for the market of corporate control. Shareholders, too, are less likely to be impacted by a takeover upstream. This is particularly so when an indirect acquisition is merely incidental to the primary acquisition since an acquirer that did not intend to take control of a company in the first place is less likely to make significant changes to its functioning.

For these reasons, while there is considerable uniformity in how direct acquisitions are treated internationally,[39] such convergence is absent in the case of indirect takeovers. Different jurisdictions have evolved different models for the treatment of indirect acquisitions, demonstrating a lack of international consensus on how such cases are to be treated. We shall explore such models in the coming chapter.

II. Approaches to Indirect Acquisitions

Across the world, in regulating indirect acquisitions, jurisdictions have attempted to balance two competing considerations. On the one hand, minority shareholders must not be left stranded, should indirect acquisitions become an artifice through which a company is acquired downstream (echoing the fairness argument). On the other hand, over-regulation must be avoided, lest it choke merger and acquisition activity altogether (echoing arguments of efficiency). As we shall see later, jurisdictions such as New Zealand have also paid heed to the third principle of international 'comity'; according respect to the policies of other jurisdictions by ensuring that their laws do not place an undue burden on international transactions.

With these considerations in mind, approaches of different jurisdictions to indirect acquisitions may be plotted along a rudimentary 'fairness-efficiency'

[39] Of the ten jurisdictions the authors of this article have studied, only one, the United States, does not mandate takeover bids for direct acquisitions. While the remaining jurisdictions differ in the triggers they prescribe, the need for a mandatory takeover bid appears universal.

spectrum. For ease of understanding, we broadly categorise the approaches we study into 'efficiency-heavy', 'balanced', and 'fairness-heavy' models.

A. Efficiency-heavy models

Weighing towards the efficiency-end of this spectrum are countries that exempt indirect acquisitions from mandatory takeover bid requirements. Some outliers, like the United States of America, provide for no mandatory takeover bid provisions whatsoever, regardless of the type of acquisition.[40] Even within more conventional legal frameworks, however, various jurisdictions offer exemptions to indirect acquisitions in certain circumstances, to ensure that mandatory takeover bid requirements do not become too onerous.

For instance, while the laws of Australia ordinarily mandate a mandatory takeover bid where a person comes to control more than 20% of a company's voting, whether directly or indirectly,[41] they accord certain protections to ensure that these requirements do not become overly cumbersome. Where an acquirer makes a secondary acquisition of a company pursuant to the acquisition of a listed company,[42] such takeover bid requirements do not apply.[43] As a result, even though the existence of intermediary entities does not ordinarily insulate an acquirer from a mandatory takeover bid, attempts at a merger or acquisition are not bogged down by a multiplicity of takeover bid requirements. In order to ensure that such exemptions are not misused, the Australian Takeovers Panel is empowered to declare the circumstances of specific transactions 'unacceptable', denying them the benefit of such exemption.[44]

Structuring mandatory bid requirements in this manner ordinarily ensures that any merger or acquisition transaction triggers a maximum of

[40] Federal securities laws of the United States eschew prescribing mandatory bids, instead only placing information requirements on potential acquirers. An underlying theory, explaining the American approach, is offered in Geoffrey P Miller, 'A Simple Theory of Takeover Regulation in the United States and Europe' (2009) 42 Cornell International Law Journal 301. Much of the United States' federal law on takeovers comes from amendments made by the Williams Act of 1968 to the Securities Exchange Act of 1934. While these allow potential acquirers to make 'tender offers' to a company's shareholders to acquire control therein, the same is not mandatory. Individual states may, however, place additional requirements, the analysis of which is outside the scope of this article.

[41] Corporations Act 2001, s 606 (1)(c) read with s 611, item 1.

[42] This includes companies listed in Australia, as well as a select group of foreign stock exchanges recognised as 'approved foreign markets' by the Australian Securities and Investments Commission.

[43] Corporations Act 2001, s 611, item 14.

[44] *Ibid* s 657A.

one takeover bid. This potentially leads to situations where minority shareholders do not necessarily have an exit option, signalling that fairness concerns do not always warrant the imposition of too significant a regulatory burden. To avoid shareholder harm, however, the Australian model creates a safeguard in the form of the oversight of the Takeover Panel, which may mandate a takeover bid in case greater protection is warranted.

B. Balanced models

Between the two extremes is an approach that many jurisdictions dub the 'chain principle'.[45] Chain principle provisions, which feature in the takeover statutes of the United Kingdom,[46] Hong Kong,[47] and Singapore,[48] highlight the manner in which a person that acquires control over a company may, by the virtue of such control, indirectly acquire control over a second company. Each of these provisions specifies that such situations shall only trigger mandatory takeover bid requirements where one of two requirements are met: *first*, such second company is 'significant' in relation to the company directly acquired by such person,[49] or *second*,where a significant motivation for the upstream transaction was such acquisition of control over the second country.

In clearly setting out both – the need for takeover bids, as well as exemptions for incidental indirect acquisitions – without giving primacy to either, this approach balances the rights of shareholders to an exit option and the need to keep merger and acquisition activity from becoming unduly difficult. Unlike the Australian approach, which requires the regulator to pro-actively

---

[45] There appears to be some confusion on what the 'chain principle' actually entails, possibly because most jurisdictions which incorporate the chain principle set out both - the manner in an indirect acquisition may occur, as well as exemptions where the company acquired indirectly forms a small part of the primary transaction. This has led to commentators using the term to imply vastly divergent ideas. While some understand the exemptions to be at the heart of the principle, i.e., that indirect acquisitions may trigger takeover bids only if they form substantial part of the primary transaction, others use it to refer to the fact that the acquisition of a company implies the acquisition of all downstream entities. For the former reading, refer to Shroff (n 12). For the latter, refer to Abhijit Joshi, 'Takeover Law in India' (2011) 24 International Law Practicum 74. While this article uses the term in the former sense, as a convenient short-hand to indicate a middle-of-the-road approach, the authors claim ignorance as to its correct usage.

[46] City Code, r 9.1, note 8.

[47] The Codes on Takeovers and Mergers and Share Buy-backs, r 26.1, note 8.

[48] Singapore Code on Takeovers and Mergers 2019, reg 14.1, note 7.

[49] Different jurisdictions take different approaches in attributing such significance. Jurisdictions variously use factors such as assets, market values, sales and profits as markers for significance. While the United Kingdom and Hong Kong specify numerical thresholds to measure such significance (at 50% and 60% of the company acquired in the primary acquisition respectively), Singapore leaves such question to the discretion of its Securities Industry Council.

restrict transactions where shareholders may be left stranded, this specifies a mandatory takeover bid as being the norm. By encoding the exemption to transactions where an indirect acquisition is only incidental, on the other hand, it ensures that such transactions cannot be targeted nonetheless by a regulator.

C. Fairness-heavy models

Several jurisdictions prefer to impose a takeover bid for indirect acquisitions of a company, regardless of whether the same formed a significant part of the primary acquisition. The European Union ("**EU**"), for instance, directs its member states to place mandatory takeover bid requirements on persons that acquire control over listed companies, whether directly or indirectly.[50] It suggests no exemptions or relaxations for indirect acquisitions. While EU member states are granted discretion in determining how the directive applies to their own jurisdiction,[51] most major jurisdictions, including France,[52] Germany,[53] Italy,[54] and Netherlands[55] have incorporated such provisions in their own domestic laws governing takeovers, without offering any explicit exemptions for indirect acquisitions. As we shall see in the coming chapter, India follows a similar approach.

Interestingly, however, some such jurisdictions allow domestic regulators the discretion to grant exemptions in the case of an indirect acquisition. For instance, the *Autorité Des Marchés Financiers*, France's financial markets regulator, may waive the requirement for a mandatory takeover bid where it believes that a company being acquired indirectly does not constitute 'an essential asset' of the company being acquired in the primary acquisition.[56] Such an approach permits a country to ensure the highest degree of protection for shareholders in its jurisdiction while retaining the flexibility to let through cases where the risk of shareholder harm is low.

---

[50] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004, L 142/12 (EU Takeover Directive), art 5(1).

[51] *Ibid* art 5 (3).

[52] General Regulation of the *Autorité Des Marchés Financiers*, art 234-2.

[53] Securities Acquisition and Takeover Act, s 35(1).

[54] Legislative Decree No 58 of 24 February 1998, Consolidated Law on Finance pursuant to Articles 8 and 21 of Law no 52 of 6 February 1996, art 106(1).

[55] Act on Financial Supervision 2006, s 5: 70(1).

[56] General Regulation of the *Autorité Des Marchés Financiers*, art 234-9 read withart 234-8.

III. Indirect Acquisitions in India

In the previous chapter, we traced a fairness-efficiency spectrum, plotting the manner in which various jurisdictions deal with indirect acquisitions and related aspects at different points of the spectrum. In this chapter, we shall explore the development of Indian law on indirect acquisition and examine its trajectory. As we shall see, Indian jurisprudence on indirect acquisition largely stands on the fairness end of this spectrum.

There are principally two triggers for mandatory takeover bids in India– one, a *quantitative* trigger, should one's shares or voting rights in a company exceed specified thresholds,[57] and two, a *qualitative* trigger, should one come to acquire 'control' over a company.[58] An act of 'acquisition', whether of such voting rights or control, is key to both sets of triggers.[59]

There are instances, however, where neither of these triggers is directly set off. The Linde-Praxair transaction, for instance, did not contemplate any change in the entities that held shares in Linde India, or the number of shares held by them. There was no *direct* acquisition of shares in Linde India by any entity. However, looking through the multiple layers of entities operating above Linde India and examining the manner in its immediate shareholders exercised their rights in it, it is evident that the underlying global transaction had resulted in a change in the persons which would ultimately exercise control over Linde India. In the process of consolidation of the upstream entities, Linde would be surrendering its position of effective control over Linde India in favour of the consolidated entity which was formed as a result.

Along with direct acquisitions of shares, voting rights, and control, such an *indirect* change in voting rights or control is also understood to be an 'acquisition' under the Takeover Code.[60] The legal effect of an indirect acquisition of such nature is similar to that of a direct acquisition of a company,

---

[57] Takeover Code, reg 3. Regulation 3 mandates a takeover bid where an acquirer, along with parties acting in concert, acquires 25% or more of the shares or voting rights in a company. Additionally, regulation 3 places a separate mandatory takeover obligation in instances where the acquirer along with its concert parties already holds 25% of the voting rights in listed company, acquires more than 5% of voting rights in such company during a financial year.

[58] Takeover Code, reg 4.

[59] Takeover Code, reg 3 ("No acquirer shall acquire shares or voting rights in a target company…"); reg 4 ("Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company…").

[60] Takeover Code, reg 2(1)(b) ("acquisition" means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company").

and should the thresholds for voting rights or control be met by such indirect acquisition, a mandatory takeover bid obligation may be triggered.[61]

Within our 'fairness-efficiency' paradigm, India's stance on indirect acquisitions under the Takeover Code is undoubtedly fairness-heavy. This has, however, not always been the case. In fact, takeover regulation in India did not originally contemplate even indirect acquisitions. This concept gained relevance through legislative and judicial discourse as the Indian body of law on takeover regulation developed. When, in the year 1997, the need for a mandatory takeover bid for indirect acquisitions became part of Indian law, substantiality came to play a role in whether an indirect acquisition would trigger a takeover bid. It is only thereafter that India adopted its current fairness-heavy approach. We shall explore this trajectory as we traverse through subsequent parts of this chapter.

A. India and Indirect Acquisitions: A History

Indirect acquisition, as a concept, was not contemplated by SEBI when it first formalised and introduced a takeover regime through the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1994 ("**Takeover Code 1994**"). However, SEBI's subsequent regulatory experience with takeovers helped identify several lacunae in the Takeover Code 1994.[62] Pertinently, for the purposes of this article, it was noted that the law was incapable of regulating a situation where a person would acquire an unlisted holding company (or a block of unlisted investment companies) and thereby also gain control over a listed company.[63]

The Bhagwati Committee, which was tasked with recommending changes to the takeover regulation framework, took note of this nuance and suggested recognising indirect acquisitions as a distinct concept, which would be necessary to create a more robust takeover regulation framework. While takeover regulation should not impose onerous conditions that inhibit acquisitions and takeover activity, the committee argued, it should also not allow for takeovers to be transacted in a "clandestine manner without protecting the interests of the shareholders".[64]

---

[61] Takeover Code, regs ¾ read with reg 5 and reg 2(1)(b).

[62] Justice PN Bhagwati Committee (n 25) Preface, para 5; Securities and Exchange Board of India, 'Frequently Asked Questions on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011' (*SEBI)* <https://www.sebi.gov.in/sebi_data/faqfiles/sep-2019/1567577569364.pdf>accessed 27 March 2020.

[63] Justice PN Bhagwati Committee (n 25), Applicability of the Regulations, para 3.34.

[64] *Ibid*, The Approach of the Committee, para 1.1.

The committee's recommendations led to the recognition of indirect acquisitions as a distinct concept under the Takeover Code 1997. Originally, the regulations stipulated that 'indirect acquisitions' involved the acquisition of shares or control in a listed company by way of acquisition of control in its *holding company*.[65] The provision was eventually amended in 2002 to broaden the scope of the term – it would now include indirect acquisitions through all companies, whether these be holding companies, or otherwise.[66] Separately, the Takeover Code 1997 made the acquisition of 'control' over a listed company a trigger for a mandatory takeover bid,[67] which could occur directly or indirectly.[68]

B. Proportionate Interest or Effectuality?

The introduction of the notion of indirect acquisitions gave rise to the question of when an indirect acquisition would occur, leading to a mandatory takeover bid obligation falling upon an acquirer. Consider the following example - company A holds a 35% stake in a listed company, B (the target). Company C acquires a 60% stake and a controlling interest in company A. In such a situation, would company C be required to make a mandatory takeover bid for the shares in company B? Competing arguments were made for the adoption of one of the following two tests for making this determination:

a) *Proportionate interest test:* This test involves a mathematical calculation of the acquirer's proportionate interest in the target company.[69] In the example above, therefore, company C's proportionate interest in company B would be understood as 60% of 35%, i.e., 21% - this would, therefore, not give rise to a mandatory takeover obligation.

b) *Effectuality test:* This test involves a determination of whether the upstream acquisition of shares, voting rights, or control in the intermediate company would have an effect on the manner in which the intermediate company would exercise its voting rights or control in the target company.[70] Going back to our example, since company C, by virtue of its acquisition of the 60% stake and controlling interest

---

65 Takeover Code 1997, explanation to regs 10 and 11 ("...acquisition shall mean and include: (b) indirect acquisition by virtue of acquisition of holding companies, whether listed or unlisted, whether in India or abroad.").

66 Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Second Amendment Regulations 2002, reg 6.

67 Takeover Code 1997, reg 12.

68 Takeover Code 1997, reg 2(1)(c).

69 Nishith Desai Associates, 'Public M&As in India: Takeover Code Dissected' (*Nishith Desai Associates,* August 2013) <http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Ma%20Lab/Takeover%20Code%20Dissected.pdf> accessed 1 April 2020.

70 Shroff (n 12).

in company A, would also be in a position to influence the manner in which company A exercises its control and voting rights in B. Effectively, company C does not merely control 21% of company B's voting rights, as would be its proportionate share, but the full 35% that company A holds. This would result in a mandatory takeover obligation being imposed on company C.

The proportionate interest test had gained acceptance initially and was predominantly relied upon by those within the industry.[71] However, others believed that this test lacked the subjectivity required to make a determination on the indirect acquisition of control since it was merely reflective of the economic benefit to the acquirer and failed to take into account the voting and control that could be exercised by them.[72] This led to the development of the more robust effectuality test. This test gained significant credence once it was adopted by SEBI in the *NRB Bearings* order under the provisions of the Takeover Code 1997.[73]

In *NRB Bearings*, the United States-based Timken Company (the acquirer, "**TC**") had entered into a stock and asset purchase agreement with the Bermuda-incorporated company, Ingersoll-Rand Company Limited ("**IR**"). Pursuant to this agreement, among other things, TC would acquire voting securities held by IR in IR's wholly-owned French subsidiary, Nadella S.A. ("**Nadella**"). Nadella held 26% of the shares in NRB Bearings Limited ("**NRB**"), the target, a company listed on stock exchanges in India. In response to the issue of whether TC's agreement with IR would give rise to the obligation of making a mandatory takeover bid, SEBI held that the transaction would amount to an indirect acquisition of shares in NRB and would, therefore, breach the threshold for making an open offer. It held as such since, by agreeing to purchase the voting securities in Nadella, TC had indirectly become entitled to exercise the entirety of the 26% voting rights in NRB.[74] Following *NRB Bearings*, the effectuality test has come to be accepted as the norm for determining the indirect acquisition of control.[75]

---

71 Nishith Desai Associates (n 69) 2.

72 *Ibid* 3.

73 *Timken Co., In re (Acquisition of Shares/Voting Rights/Control of* NRB Bearings India *Ltd. and SNL Bearings Ltd.)*, 2003 SCC OnLine SEBI 84.

74 *Ibid*.

75 OCL Iron and Steel Limited, 'Informal Guidance, CFD/PC/KJ/OW/5853/2013' (*SEBI*, 14 March 2013) <www.sebi.gov.in/enforcement/informal-guidance/mar-2013/informal-guidance-in-the-matter-of-m-s-ocl-iron-and-steel-limited_24462.html> accessed 1 April 2020; Arch Pharmalabs Limited, 'Informal Guidance CFD/DCR/TO/DV/19298/12'(*SEBI*, 28 August 2012) <https://www.sebi.gov.in/sebi_data/attachdocs/1346316669791.pdf> accessed 1 April 2020.

Separately, TC had also applied to SEBI seeking an exemption from making a mandatory takeover bid, relying on, among other contentions, the fact that Nadella's shareholding in NRB represented just 3.1% of its total assets and that it was merely a financial investor in NRB. While it would grant TC an exemption from making an open offer, subject to the passing of a special resolution by NRB's shareholders ratifying the indirect acquisition (with Nadella abstaining from voting), SEBI rejected the argument that NRB's inconsequentiality to the larger transaction warranted a relaxation of mandatory bid requirements.[76] As we shall see, this argument – referred to as the 'chain principle' in this article[77] – found acceptance under Indian law subsequently, if only for a short period of time.

C. The Chain Principle

The Bhagwati Committee, which first advocated the introduction of indirect acquisitions into Indian jurisprudence, also proposed the recognition of the chain principle. The chain principle, the committee suggested, was relevant to instances of acquisition of shares or control in a company[78]where either a) such company's shareholding in the target company constituted a substantial part of its total assets or b) the acquirer's primary objective for acquiring the company was to gain control of the target company. If either of these situations were to arise, the acquirer would be required to make a mandatory takeover bid for shares in the target company.[79] Despite this proposal, however, the chain principle did not find mention in the Takeover Code 1997. The Takeover Code 1997, in the manner promulgated, was not very far from current Indian law on the question of indirect acquisitions.

The principle would, however, subsequently be read into Indian takeover law in 2005 by the Indian Supreme Court, in *Technip SA* v *SMS Holding (P) Ltd.*. While *Technip* involves a complex set of facts, it is relevant for our purposes to note that Technip S.A., ("**Technip**") a company incorporated in France acquired 29.68% of the shareholding in Coflexip S.A. ("**Coflexip**"), another French-incorporated company. At the time of the acquisition, Coflexip held approximately 50% of the shares in Indian listed company, South East Asia Marine Engineering and Construction Limited ("**SEAMEC**"), which

---

76 *Timken Co., In re (Acquisition of Shares/Voting Rights/Control of* NRB Bearings India *Ltd. and SNL Bearings Ltd.)*(n 73).

77 There is no consensus, however, on what the 'chain principle' actually refers to (n 45).

78 The committee only made reference to the acquisition of a single company in this regard, possibly owing to the fact that at the time of making this recommendation, the committee envisaged indirect acquisitions to mean acquisitions where the intermediate company would be the holding company of the target.

79 Justice PN Bhagwati Committee (n 25), Applicability of the Regulations, para 3.35.

constituted 2% of its asset base at the time. This gave rise to the question of whether Technip's acquisition of shares in Coflexip would necessitate making a mandatory takeover bid for shares in SEAMEC, despite its relative insignificance. The case was brought on appeal to the Supreme Court against successive orders by the SEBI and the Securities Appellate Tribunal holding that an indirect acquisition of control had occurred, which necessitated that a mandatory takeover bid be made.

The Supreme Court, relying on foreign jurisprudence and the report of the Bhagwati Committee, held that an indirect acquisition would give rise to an obligation for a mandatory takeover bid only where either a) the object behind acquiring shareholding, voting rights, or control in the intermediate company was to secure control of the target company, or b) the shareholding of the intermediate company in the target company constitutes a substantial part of the assets of the intermediate company. Analysing the facts of the case, the Supreme Court concluded that the shareholding of Coflexip in SEAMEC did not constitute a substantial part of the assets of Coflexip and there was insufficient basis to suggest that the ultimate objective of the transaction was the acquisition of control over SEAMEC. As a result, it held that no mandatory takeover obligation would need to be imposed on Technip.[80]

With the Supreme Court's *Technip* decision, Indian law moved, for a time, towards taking a more balanced, acquirer-friendly approach, contemporaneous with jurisdictions such as the United Kingdom, Hong Kong, and Singapore.[81] Soon, however, Indian takeover law would undergo a reboot, pushing its approach on indirect acquisitions back to the fairness-heavy extreme which continues to this day.

D. The reversal post-Technip

Close to a year from the Supreme Court's decision in *Technip*, SEBI, in its order in *Everest Industries Ltd.* v *Holcim (India) (P) Ltd.*, ruled that *Technip* was to be read to mean that factors such as intention and size of the target were irrelevant to the test of indirect acquisition. While the order was ultimately set aside on appeal, the chain principle and the test for indirect acquisition were not definitively decided upon by the Securities Appellate Tribunal, thereby obscuring the standard laid down by the Supreme Court in *Technip*.[82]

---

80 *Technip SA* v *SMS Holding (P) Ltd.*, (2005) 5 SCC 465.

81 Refer to City Code, r 9.1, note 8; The Codes on Takeovers and Mergers and Share Buybacks (n 47); Singapore Code on Takeovers and Mergers 2019 (n 48).

82 Adjudication Order No. AP/AO-13/2006-07, para 23 <https://www.sebi.gov.in/sebi_data/docfiles/15393_t.html> accessed 1 April 2020.

Indirect acquisitions were deliberated upon, yet again, once the Achuthan Committee was constituted. The Achuthan Committee, set up to review the Takeover Code 1997, grappled with the question of whether a mandatory takeover bid obligation should arise only when the target company represents a material or substantial component of the primary acquisition, particularly where the primary transaction is being undertaken overseas.[83] It also considered whether the intention (or the lack of it) to acquire control over the target company would be relevant to the analysis.[84]

The Achuthan Committee concluded that irrespective of the materiality of the target company and the intention to acquire control so long as there was a change in control or thresholds for shares or voting rights were met, the obligation to make a mandatory takeover offer should arise. It arrived at the conclusion based on an empirical analysis of listed companies in India whose controlling interest was held by either another listed Indian company or by an overseas entity.[85] Since most listed companies were found to be non-material to their controlling entities, it argued that exempting such companies from mandatory takeover obligations would deprive their shareholders of their "legitimate right to get an exit opportunity". This would be particularly so in global transactions of a large scale, where the listed Indian company would invariably constitute a miniscule portion.[86] The committee further argued that a substantiality test would be discriminatory to small transactions.[87]

Detracting from the standard for mandatory takeover bids adopted in *Technip*, the Achuthan Committee recommended that, without exception, all indirect acquisitions that triggered the share or voting rights thresholds or those which resulted in a change in control would be subject to the mandatory takeover bid requirement.[88] This led to the reversal of India's position on indirect acquisitions, and the chain principle, as a concept, was entirely done away with the introduction of the Takeover Code in 2011.

IV. A Blueprint for Liberalisation

In the fairness-efficiency spectrum sketched out earlier, India has laid strong emphasis on promoting fairness. Commentators see India's takeover regime

---

[83] C Achuthan Committee (n 7), paras 5.2-5.4.
[84] *Ibid* para 5.4.
[85] *Ibid* para annexure.
[86] *Ibid* para 5.6.
[87] *Ibid* para 5.6.
[88] *Ibid* para 5.8.

as a distant outlier in comparison to its peers, with a focus on protecting minority shareholders so strong that it may inadvertently be unfriendly to acquirers.[89] With its insistence on ensuring that minority shareholders are offered an exit option for every change in control, Indian law has declined to offer acquirers safe harbours for upstream transactions, regardless of how minor the downstream listed entity may be. The costs this approach places on acquirers can be considerable. Acquirers may find themselves stranded in expensive attempts to buy out shareholders of companies, the acquisition of which was never in their contemplation. They may even have to make multiple cascading takeover bids, should they take over the listed parent company of a listed subsidiary.[90] While India's commitment to its small investors is commendable, in view of the adverse impact of its laws on takeover activity, there is a strong need for a recalibration of Indian takeover law towards a more moderate position on the fairness-efficiency spectrum.

Moreover, Indian mandatory takeover bid requirements do not merely have an impact on domestic firms. In fact, in a study of recent public announcements conducted by us, we found that in a majority of indirect acquisitions, the primary acquisition occurs overseas. Of the 15 indirect acquisitions that have triggered a mandatory takeover bid between April 1, 2017 and March 31, 2020, in 10 instances (representing 66.67% of all indirect acquisitions), the primary acquisition took place overseas.[91] Research suggests that the imposition of takeover bid requirements in such cases results in investor ambivalence and create less value for target company shareholders.[92] Occasionally, owing to differences between Indian law and that of other countries, foreign acquirers have even been unable to benefit from exemptions generally available to their Indian counterparts.[93] Even if other jurisdictions favour a more liberal outlook, therefore, Indian law can hinder mergers and acquisitions occurring in such jurisdictions, should a listed Indian entity lie somewhere down the chain of ownership. The

[89] Varottil (n 28) 221.

[90] In *Daiichi Sankyo*, for instance, Daiichi Sankyo Company Limited's takeover of Ranbaxy Laboratories Limited through a takeover bid triggered a successive takeover bid for Zenotech Laboratories Limited. While the case revolved around the offer price for the latter bid, whether such cascading bids were mandated was not in contention. Refer to *Daiichi Sankyo Co.Ltd.* v *Jayaram Chigurupati*, (2010) 7 SCC 449: AIR 2010 SC 3089.

[91] *See* (n 13) and the accompanying text.

[92] Bikram Jit Singh Mann and Reena Kohli, 'Target shareholders' Wealth Creation in Domestic and Cross-border Acquisitions in India' (2011) 21 International Journal of Commerce and Management 63. The authors argue that cross-border acquirers, in bids to escape mandatory takeover bid requirements, seek exemptions from SEBI or attempt litigation. This results in considerable uncertainty as to whether such cross-border acquisitions shall be consummated at all. The phenomenon, the authors note, is unique to India.

[93] *See* (n 4) and the accompanying text.

frustration of other countries' chosen policies in this manner lies against the principle of 'comity', which we explore further below.

A. The Comity of Nations

'Comity' is the practice amongst political entities of giving due deference to the legislative, executive or, judicial acts of another.[94] This is not a legal principle but a *political* one – while sovereign entities have no such obligation to one another, an expectation of comity flows from the respect and deference that they ordinarily confer to one another.[95] Ordinarily, Indian courts have only entertained the principle of comity in the sense of 'judicial comity'[96] – the principle that courts of one jurisdiction must give effect to laws and judicial decisions of another.[97] More relevant to us, however, is the notion of 'prescriptive comity'.[98] Prescriptive comity is the respect that nations grant one another, by limiting the reach of their laws.[99] Should a jurisdiction consider an action legal in its territory, particularly when conduct of the kind is ordinarily well regulated, prescriptive comity demands that other jurisdictions do not affect its legality through the extra-territorial application of its laws.[100]

Due to the globalised nature of markets, where individual transactions can impact multiple countries, the regulation of takeovers is an arena where prescriptive comity assumes particular importance. While India certainly has a right to impose takeover bid obligations on international acquirers if Indian entities are involved in the transaction, out of respect to other jurisdictions, this right must be exercised carefully. India should only look to obstruct a transaction permitted in another jurisdiction if its interest in doing so is at least comparable to that of such other jurisdiction. Certainly, where Indian companies are fundamental to international transactions, it is the duty of SEBI to intervene and safeguard the interests of Indian investors. Where such transactions bear only the thinnest nexus to India, however,

---

[94] *Black's Law Dictionary* (Bryan A Garner ed, 11th edn, Thomson Reuters, 2019).

[95] *World Sport Group (Mauritius) Ltd.* v *MSM Satellite (Singapore) Pte. Ltd.*,(2014) 11 SCC 639: AIR 2014 SC 968, para 20.

[96] *India Household and Healthcare Ltd.* v *LG Household and Healthcare Ltd.*, (2007) 5 SCC 510: AIR 2007 SC 1376; *CBI* v *Mulangi Krishnaswamy Ashok Kumar*, 1999 SCC OnLine Bom 179: (1999) 3 BomCR 189.

[97] *World Sport Group* (n 95), para 20.

[98] Prescriptive comity, as an idea, arises from the dissenting opinion of Justice Scalia in the American Supreme Court case of *Hartford Fire Insurance Co.* v *California*, 509 US 764 (1993).

[99] *Ibid* 817.

[100] A similar argument has been offered, in the context of antitrust law in the United States, in Stephen D Piraino, 'A Prescription for Excess: Using Prescriptive Comity to Limit the Extraterritorial Reach of the Sherman Act' (2014) 40 Hofstra Law Review 1.

Indian interference negates the will of other sovereigns. In the past, other jurisdictions have voluntarily stepped away from exercising such authority. One such case, that of New Zealand, is discussed below.

1. The Case of New Zealand

Takeovers, in New Zealand, are regulated by the 'Takeovers Code' ("**New Zealand Code**"), which forms part of the Takeovers Regulations 2000.[101] It prescribes a 'fundamental rule', pursuant to which no person that holds less than 20% of a company's voting rights may increase their holding to over 20%,[102] without one of the mechanisms it provides, most prominent amongst which is a mandatory takeover bid.[103]

Till 2009, the New Zealand Code took a similar position on indirect acquisitions as India. Any acquisition upstream, if it allowed the acquirer to control more than 20% of a company's voting rights, would come under the purview of the New Zealand Code, potentially triggering a mandatory takeover bid.[104] While New Zealand's Takeover Panel would occasionally exempt acquirers from the requirement of making a takeover bid, when applications were made in this regard,[105] the same was only on a case-by-case basis with no general policy in this regard.

In 2009, the Takeovers Panel of New Zealand released a consultation paper, mooting possible changes to its approach to indirect acquisitions. It observed that overly restrictive indirect acquisition laws would make the incorporation of listed subsidiaries an anti-takeover measure, meant to frustrate attempts by others to take control of the parent entity.[106] Noting

---

101 The name of the regulations was changed from the erstwhile 'Takeover Code Approval Order 2000', pursuant to regulation 4(2) of the Takeovers Code Approval Amendment Regulations 2018. The Takeovers Code (the "New Zealand Code") forms the schedule to the regulations and is sanctioned by reg 2 thereof.

102 New Zealand Code, r 6.

103 *Ibid* r 7.

104 Takeovers Panel, *Upstream Takeovers: A Consultation Paper Issued by the Takeovers Panel2009* (Upstream Takeovers Consultation Paper), para 6 <https://www.takeovers.govt.nz/assets/LawReform/Consultations/d7bdab45c4/Upstream-Takeovers-17-April-2009.pdf> accessed 25 March 2020 ("Upstream Takeovers Consultation Paper").

105 Instances include Takeovers Code (ABC Learning Centres Limited) Exemption Notice 2004, SR 2004/391 (exempting ABC Learning Centres Limited and its wholly-owned subsidiaries from making a takeover bid due to their indirect acquisition of Kidicorp Group Limited, since such acquisition was an incident of a significant merger between Australian entities) and Takeovers Code (Newmont Mining Corporation) Exemption Notice 2002, SR 2002/27 (exempting Newmont Mining Company and its subsidiaries from making a takeover bid due to their indirect acquisition of Otter Gold Mines Limited, since the same represented less than 1% of their primary acquisition of the Australian company, Normandy Mining Limited).

106 Upstream Takeovers Consultation Paper, para 48.

how large, high-value foreign transactions were particularly impacted by its position on indirect acquisitions, it argued that liberalising its approach was essential for compliance with the principles of international comity, which would demand that New Zealand must not impede on foreign transactions that are appropriately regulated, unless the same poses a risk to New Zealand's own investors.[107]

Without making much change to the statutory provisions that govern New Zealand's takeover law, New Zealand has since released a detailed guidance note on upstream acquisitions.[108] Among other things, the guidance note provides a detailed statement on the approach that New Zealand's Takeovers Panel in processing applications for an exemption from takeover requirements in the case of an indirect acquisition, clarifying that exemptions would ordinarily be given where such indirect acquisition was not the purpose underlying the transaction.[109] Without binding the Takeovers Panel into a position where it cannot intervene on behalf of New Zealand's investors, the guidance note gives potential acquirers a reasonable degree of certainty that indirect acquisitions in New Zealand that are incidental to a larger transaction shall not ordinarily trigger a takeover bid.

Just as New Zealand relaxed its laws on indirect acquisition in the interests of comity, due to the impact they had on foreign transactions, it is imperative for India to consider offering a path to safeguard upstream transactions that only incidentally lead to an indirect acquisition from onerous regulatory costs. Below, we discuss some of the options available to India in this regard.

B. The Way Forward

Although there is a need for India to recalibrate its approach to indirect acquisitions, this need not mark a radical departure from the past. India has made a policy choice to place minority shareholders' interests at the forefront of its takeover regulation. The dangers of an over-emphasis on this objective have been detailed across this article. These dangers do not warrant that fairness considerations are abandoned, however, but only that necessary course-corrections are made so that other vital considerations are given their

---

107 *Ibid* paras 78-79.

108 Takeovers Panel, *Guidance Note on Upstream Acquisitions 2014*, <https://www.takeovers.govt.nz/assets/GuidanceNotes/UpstreamAcquisitions/7f24047459/Guidance-Note-on-Upstream-Acquisitions-14-April-2014.pdf> accessed 26 March 2020.

109 *Ibid* para 4.3. The guidance note places a twin test for exemption: (a) whether the upstream target is listed on a stock exchange that New Zealand recognises, and (b) whether it forms the purpose of the primary acquisition. Ordinarily the value of the indirectly acquired company, as a percentage of the upstream target, serves as a proxy for identifying the purpose of the transaction.

due. Accordingly, any changes to the law must aim to reduce the cost of a change in control, while preserving India's focus on shareholder protection and ensuring that indirect transactions do not become a duplicitous avenue for effecting direct acquisitions.

With the need to maintain such a balance in mind, we see two directions available to India, should it liberalise its approach to indirect acquisitions: *(a)* modifications to the trigger for a mandatory takeover bid, in line with the international practice we have observed; and *(b)* the introduction of whitewash provisions, which have long been in the consideration of Indian law-makers.

1. Trigger Modifications

The trigger requirements for an indirect acquisition may be amended in line with international practice, in order to ensure that *bona fide* upstream acquisitions, carried out without an indirect acquisition as their focus, are exempted from a takeover bid requirement. We suggest two approaches for this purpose:

a. *Reintroducing the chain principle:* Suitable amendments may be made to regulation 5 of the Takeover Code, to restrict 'indirect acquisitions' to those that are not a significant part of the primary acquisition, or a significant motivation for such acquisition. An objective test may be put in place for such 'significance', which may be measured along a comprehensive set of factors, including assets, market capitalisation, sales, profits, etc., in order to ensure that significant Indian entities do not escape the radar merely because the wrong metric was used to judge their value. While other jurisdictions place the threshold for such substantiality at 50-60%,[110] even a much lower threshold (in the range of 10-20%), such that it operates as a *de minimis* exemption, may bring significant relief to acquirers. It is in such cases that the impact of a takeover bid requirement on efficiency considerations is particularly egregious. Ordinarily, should a company not meet this threshold, it is unlikely that it was a major target for the upstream acquisition, and upstream acquirers may not be motivated to bring in large scale policy changes in its functioning. Accordingly, the need for an exit option for existing shareholders would be less pressing. As an additional safeguard, to eliminate situations where small shareholders are likely to be side-lined, SEBI's Takeover Panel may be given the discretion to declare an exemption inapplicable, should it believe that

[110] *See* (n 49).

a takeover bid is warranted even for an insignificant indirect acquisition, in line with the power of the Australian Takeover Panel to declare 'unacceptable circumstances'.[111]

b. *Allowing exemptions:* While SEBI is empowered to grant acquirers an exemption from making an open offer in circumstances it sees fit,[112] it may be helpful to specify that exemptions may be granted on the subjective satisfaction of SEBI that the indirect acquisition of a company would be unduly restricted in case a mandatory takeover bid requirement is imposed. While this may be done through an amendment to the regulations, to mirror French law on the matter,[113] it may be simpler for SEBI to release guidelines on the same, in line with the approach of New Zealand.[114]The criteria so specified need not be binding,thereby ensuring that SEBI's Takeover Panel retains its flexibility in granting exemptions, while giving respite to acquirers. Such guidelines may detail the various factors that SEBI may consider in granting an exemption, which may include the significance of the indirectly acquired entity to the larger transaction, how dispersed the shareholding of the entity being acquired is, the frequency with which shares of the entity are ordinarily traded, or other criteria that may be deemed significant. This approach shall boost efficiency in a way that is similar to the statutory adoption of the chain principle while giving SEBI greater discretion to protect small shareholders' interests. Given the sensitivity of transactions for which such an exemption shall be sought, due care must also be given to ensure that applications are disposed of in an expeditious manner and confidentiality is maintained.

2. Whitewash Provisions

As an alternative to mandatory takeover requirements, 'whitewash provisions' may be added to the Takeover Code, whether universally or only for indirect acquisitions. Whitewash provisions allow an acquirer to avoid a takeover bid requirement, should the shareholders of the target company pass a resolution to such effect. This allows a means for the costs of a change in control to be reduced while empowering shareholders to take a decision on whether they consider a takeover acceptable. While whitewash provisions shall be of little utility where the primary acquisition is hostile, they

[111] *See* (n 44) and the accompanying text.
[112] Takeover Code, reg 11(1).
[113] *See* (n 56) and the accompanying text.
[114] *See* (n 108) and the accompanying text.

may allow takeover bid requirements to be relaxed in the case of a friendly takeover.

Whitewash provisions, a mainstay of international takeover regulation,[115] are not new to Indian law. In the Takeover Code 1997, such a provision served as an exemption from takeover bid requirements in the case of a change in control.[116] The Achuthan Committee mooted introducing similar provisions to the Takeover Code. While the Committee considered such provisions desirable,[117] it eventually relented from adding them to Indian law, given the issues that then plagued shareholder voting.[118] As times have changed, however, and e-voting mechanisms have become more robust, the time may be ripe to consider bringing such provisions back into Indian law.

For whitewash provisions to be effective in ensuring that fairness considerations are given their due, protections must be built in to ensure that minority shareholders are heard. Much like the Takeover Code 1997 (in its final, amended form),[119] a whitewash provision may provide that mandatory takeover bid requirements do not apply where the shareholders of the company being acquired pass a special resolution ratifying such change in control. In order to ensure that persons exercising control over the company, who may stand to benefit from the indirect acquisition, do not muscle out minority shareholders, the same may be combined with a "majority of minority" requirement, i.e. that in addition to 75% of a company's shareholders ratifying a change of control, a majority of the *minority* shareholders of the company must also accede to such a change of control. Interested persons, such as the upstream acquirer, may be excluded from voting for such a resolution. Additional measures may be taken to ensure that participation is broad-based. Much like the Takeover Code 1997, which mandated that the option of voting through postal ballot also be allowed in relation to such a resolution, effective participation by all shareholders of the company may be ensured by mandating that postal ballot and e-voting options are allowed to shareholders. With such safeguards in place, whitewash provisions may create a route through which companies can avoid making a takeover bid, even as fears regarding the voting process, such as those raised by the Achuthan Committee, are allayed.

---

115 Refer, for instance, to City Code, r 9, note 1 on dispensations from r 9 (United Kingdom); New Zealand Code, rr 7(c) and (d) (New Zealand);Corporations Act 2001, para 611, item 14 (Australia).

116 Takeover Code 1997, reg 12. Curiously, however, no such whitewash provision covered quantitative takeover triggers.

117 C Achuthan Committee (n 7), para 12.18.

118 *Ibid* paras 12.18-19.

119 Takeover Code 1997, reg 12.

Conclusion

The regulatory regime governing takeovers in India, unless calibrated in a manner that causes minimal inconvenience to potential acquirers, may curtail the flow of takeover activity, given the substantial costs of compliance it imposes. Shareholding in Indian companies is typically highly concentrated, which already makes contests for control difficult. Any further curtailment of such activity may have negative system-wide ramifications, including dissuading foreign investors due to the high transaction costs of doing business in India. This is of particular importance in current times, given the incumbent government's focus on encouraging increased foreign investment. As a member of a wider global community, India must also accord its international peers respect for the economic policies they choose and ensure that it does not hinder international financial activity without legitimate cause.

Achieving these targets would require making a change in the paternalistic regulatory approach we have hitherto adopted in overseeing corporate activity. Liberalising our approach to indirect acquisitions would be a significant move in this direction. This article attempts to lay the blueprint for how such change may be achieved. We recommend solutions that retain the prominence that Indian law currently offers minority shareholders, while bringing down the regulatory costs applicable to mergers and acquisitions. Striking such a balance, in our view, shall permit greater efficiency in the Indian economy, without making merger and acquisition transactions unfair to small investors.