Completing an M&A Transaction On-Market: Certain Key Considerations

In case of acquisitions involving listed companies, parties often choose to complete the transaction '*on-market*', that is, on the floor of the stock exchanges, on account of tax benefits.

This note analyses certain key legal considerations in completing such on-market acquisitions.

CONSIDERATIONS FOR FOREIGN ACQUIRERS

Under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, only certain categories of foreign investors can acquire shares on-market. These include (i) registered foreign portfolio investors (FPIs); and (ii) foreign investors that already have (and continue to hold) 'control' over the target company in accordance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Regulations**"). A non-FPI foreign investor seeking to acquire shares in a listed company, but that does not 'control' such company as of the closing of the proposed acquisition, can only complete such transaction '*off-market*'.

A question that therefore becomes relevant is how an investor can demonstrate 'control' in order to facilitate the completion of the transaction on-market. The Takeover Regulations define 'control' to include both *de jure* control by way of entitlement to exercise 25% or more of the voting rights in a listed company and *de facto* control through control over management and policy decisions. While the former is a relatively straightforward assessment, the determination of *de facto* control through contractually acquired rights is more complex.

In the case of *Subhkam Ventures*, the Securities Appellate Tribunal ("**SAT**") distinguished '*protective rights*' (meant to protect the interests of minority shareholders) from *participative rights* which grant day-to-day operational control over the business of the target. It held that protective rights alone would not amount to control. In the *Jet-Etihad* matter, the SEBI noted that Etihad had the right to nominate only two of the twelve directors on Jet Airways' board; Etihad did not have any veto or affirmative voting rights, quorum rights or pre-emptive or tag-along rights; and the parties had voluntarily modified the transaction documents to delete certain governance rights. The SEBI accordingly concluded that Etihad had not acquired control over Jet Airways for purposes of the Takeover Regulations. In 2016, the SEBI issued a discussion paper to consider the workability of bright line tests for determining the acquisition of 'control' under the Takeover Regulations. However, it was ultimately decided that bright line tests would not be helpful and the determination regarding acquisition of control should be made on a case-to-case basis. Recently, the Supreme Court of India in the case of *ArcelorMittal v. Satish Kumar Gupta* analyzed control under the Insolvency and Bankruptcy Code ("**IBC**") and held that the term '*control*' for purposes of this legislation denotes only positive control and the mere power to block special resolutions of a company does not amount to control. Given that this judgment was delivered in the context of the IBC, its relevance to the interpretation of the term 'control' under the Takeover Regulations may be limited.

In the absence of bright line tests to determine acquisition of control, the special rights contractually granted to an acquirer will need to be carefully considered. If the acquirer has rights to control the listed company, it will trigger a mandatory tender offer, although as a foreign acquirer it can acquire shares on-market once it has control. However, the seller may have concerns regarding the breadth of rights granted to the acquirer (particularly those that could render day-to-day decision-making more cumbersome) as well as the ease of unwinding or clawing back such rights in the event that the transaction is not completed for any reason. The parties would also need to be mindful of gun-jumping considerations where Competition Commission approval for the transaction is envisaged.

MODES OF COMPLETING TRANSACTIONS ON-MARKET

A share acquisition can be completed on-market either by way of '*block trades'* or other on-market transactions (which include large transactions categorized as '*bulk deals*'). A bulk deal and a block trade trigger additional reporting requirements to the stock exchanges.

A bulk deal is a transaction where the total quantity of shares transacted in a single trade is more than 0.5% of the equity shares of the target. A bulk deal is executed similar to any other trade on the stock exchange and there is no separate window for bulk deals. As a general matter, there are no restrictions on the price at which a bulk deal can be executed (although they are subject to the circuit filters that apply to the relevant stock to regulate price volatility in the market).

Block trades are transactions with a minimum order size of INR 100 million, executed on a separate window of the stock exchange. The window for executing block deals is open twice every day and orders placed on this window must be within -/+1% of the applicable reference price (calculated based on the closing price/trading price immediately prior to the relevant block deal window).

Bulk deals are attractive for the pricing flexibility afforded. However, since bulk deals are undertaken through the normal trading window (wherein orders with the same price and quantity are matched on a time priority basis), there is a risk of leakages; this risk is minimized in case of block trades. In 2019, there were over 16,000 bulk deals on the BSE and the NSE together, while there were just over 900 block trades in the same period.

As a general matter, negotiated transactions executed through bulk deals may be subject to greater scrutiny due to regulatory concerns surrounding 'synchronized trades', i.e., trades where the buy and sell orders are placed at substantially the same time for the same quantity and price. Courts have considered the legality of such synchronized trades under the SEBI (Fraudulent and Unfair Trade Practices) Regulations, 2003 ("**FUTP Regulations**") in several instances.

The FUTP Regulations prohibit persons from buying, selling or otherwise dealing in securities in a fraudulent manner and indulging in fraudulent or unfair trade practices in securities (including dealing in securities not intended to effect transfer of beneficial ownership but intended to operate only as a device to inflate, depress or cause fluctuations in the price of securities for wrongful gain or avoidance of loss). In the *Ketan Parekh* case, the SAT held that a synchronized trade is not illegal *per se*; a synchronized transaction will violate the FUTP Regulations only if it: (a) is executed with a view to manipulating the market; or (b) results in circular trading or is dubious in nature and is executed with a view to avoiding regulatory detection; or (c) does not involve change of beneficial ownership; or (d) is executed to create false volumes resulting in upsetting the market equilibrium. In a more recent decision in the *Rakhi Trading* case, the Supreme Court of India clarified that actual manipulation of markets is not required to prove that certain synchronized trades have violated the FUTP Regulations. A deliberate attempt to interfere with the free and fair operation of the market, whether or not actually resulting in manipulation of price in the market, will run foul of the FUTP Regulations.

ON-MARKET TRANSACTIONS DURING THE PENDENCY OF A TENDER OFFER

Where a transaction triggers a mandatory tender offer ("**MTO**") under the Takeover Regulations, there is an additional issue to consider.

The general rule under the Takeover Regulations is that the share purchase transaction that triggers the MTO cannot be completed until the expiry of the offer period. This is subject to two exceptions: (i) under Regulation 22(2), which permits parties to "act upon the agreement" and complete the acquisition of shares pending MTO completion subject to depositing in escrow the entire MTO consideration in cash (assuming 100% uptake in the MTO); and (ii) under Regulation 22(2A), which permits acquisitions through the stock exchange settlement process pending MTO completion, subject to the shares being kept in an escrow account and the acquirer not exercising any voting rights over such shares. Regulation 22(2A) specifically excludes transactions by way of bulk and block deals. This exclusion has resulted in some ambiguity as to whether an acquirer can complete a negotiated transaction under Regulation 22(2) through a bulk or block deal.

An interpretation that has been relied upon in some tender offers is that Regulations 22(2) and 22(2A) cover distinct and independent scenarios where (i) all negotiated purchases pursuant to an agreement (i.e., the MTO-triggering transaction) can be completed off-market or on-market under Regulation 22(2) and (ii) open market purchases by an acquirer (i.e., transactions other than pursuant to a negotiated agreement) can be completed through the anonymous screen-based trading systems of the stock exchanges (and not through bulk or block deals) under Regulation 22(2A).

In a February 2020 discussion paper regarding proposed amendments to the Takeover Regulations, the SEBI has acknowledged the ambiguity surrounding completion of negotiated acquisitions on-market pending MTO completion and has indicated that it "*may allow completion of acquisition through stock exchange settlement process for all types of transactions including bulk deals and block deals*". The final regulation is awaited.

CONCLUSION

Where a foreign acquirer that is not an FPI is involved, a pre-requisite for completing the transaction on-market is for the acquirer to be in *control* of the target at the time of the closing of the transaction. There is an argument that affirmative voting matters that merely seek to protect one's investment and prevent shareholding dilution are insufficient to constitute control. The SEBI has however favoured a case-by-case approach for determination of 'control' rather than a prescriptive approach.

As modes of implementing negotiated transactions, bulk deals and block trades each have their advantages and disadvantages, with bulk deals providing pricing flexibility and block deals providing transaction certainty. Bulk deals will likely continue to be more popular given the absence of pricing restrictions.

In respect of MTO triggering transactions, based on SEBI's recent discussion paper, it appears that the SEBI may recognize acquisitions through bulk and block deals pursuant to negotiated transactions pending MTO completion. It remains to be seen what form the amendments to the Takeover Regulations will take to clarify this matter.

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