Working Paper on Business Implications of Gun Jumping in Combination Regulations

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1. Introduction

The growing competition law enforcement and jurisprudence developed so far in India definitely requires deal makers to revisit their strategy in conjuring M&A deals. Relying on pre-combination regulation strategy may attract onerous obligations and will need careful consideration in light of recent developments in combination regulation.

The central theme in the initial years revolves around the question of the potential delay in deal consummation that would result from the implementation of the combination regulation. Amidst the apprehensions, the Regulations with the various exemptions they provided a relaxation to the industry especially in relation to non-strategic acquisitions which would have otherwise met with an unwanted scrutiny. However, in a short span of Combination Control Regime a different situation arises. CCI having proven its capability in terms of speedy decision making, the CCI has allayed concerns of delays in the approval process but the Regulations and their various exemptions create an unclear situation. The recent orders of the CCI indicates an independent line of thought emerging from the CCI which may very well be different from how other regulators have interpreted various concepts pertaining to corporate restructuring in the past, adding implications for deal makers.

Under the Competition Act 2002, it is essential to ensure that parties entering into combination notify to CCI well on time. To give teeth to CCI, the Act provides provision of levying penalty for late filing or non-filing upto 1 percent for Jumping the gun a term refers to the practice of actualising a transaction before receiving the statutory clearance from the CCI, or unauthorised co-ordination between the merging parties prior to approval. There are two types of default in notifying to competition authority: firstly, procedural gun-jumping; secondly, substantive gun jumping. Substantive gun jumping would include an improper pre-approval integration of the parties to a transaction, for instance, sharing of commercially sensitive information, allocating customers, ceasing marketing in competition with each other during the waiting period. Procedural gun jumping occurs when the transacting parties fail to comply with the requirement of mandatory pre-merger notification, and close the transaction prior to the expiry of the waiting period. There has been an expansionist approach of CCI to include triggering factors which warrant notifying to CCI. So far, most of the cases in India are with respect to procedural gun jumping than substantive.

The rationale behind combination regulation is restricting anti-competitive conduct in proposed combinations to come into existence and allowing combinations which do not have anti-competitive effects on market. Predictability and guidance on what and when to notify is very essential to serve the purpose of combination regulation. Strategic acquisition of control is such an area which is not very clear. This paper discusses the business implications of jurisprudence developed so far in the existing legal framework for gun jumping in India.

2. The Legal Framework

Section 6(2) of the Competition Act 2002 requires that merging parties, fulfilling formalities and disclosing the details of the proposed combination, within seven days of:
(a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be; (b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

The phrase 'other document' is not explained in the Competition Act 2002 anywhere. It is explained in the Combination Regulation, 2011. It means any binding document, by whatever name called, conveying an agreement or decision to acquire control, shares, voting rights or assets[1] : In a hostile takeover, any document executed by the acquiring enterprise, by whatever name called, conveying a decision to acquire control, shares or voting rights shall be within the ambit of the 'other document'. Where such a document has not been executed but the intention to acquire is communicated to a Statutory Authority, the date of such communication shall be deemed to be the date of execution of the other document for acquisition.[2]

Where, in a series of steps or individual transactions that are related to each other, assets are being transferred to an enterprise for the purpose of such enterprise entering into an agreement relating to an acquisition or merger or amalgamation with another person or enterprise, for the purpose of section 5 of the Act, the value of assets and turnover of the

[1] The reference to the 'other document' in clause (b) of sub-section (2) of section 6 of the Act.

[2] Regulation 5(8) of the CCI (Procedure in regard to the transaction of Business relating to Combinations) Regulations, 2011. Now under the CCI Procedure for Combination, Amendment Regulation 2015 has excluded requirement to notify in case of intimation to central government or State Government.

enterprise whose assets are being transferred shall also be attributed to the value of assets and turnover of the enterprise to which the assets are being transferred.[3] Under Section 43A of the Competition Act 2002, If any person or enterprise who fails to give notice to the Commission under Section 6 (2), it is mandatory that the Commission shall impose on such person or enterprise a penalty upto to one percent of the total turnover or the assets, whichever is higher, of such a combination. So this is the broad framework of gun jumping in India.

The procedure of levying penalty is prescribed under the Regulation 48[4] : there is a three pronged approach for penalty with respect to Gun Jumping. It is mandatory to give show cause notice in an ordinary meeting of the Commission and reasonable opportunity of being to represent, before imposing penalty. Second, under the show cause notice here, the Secretary shall issue a show cause notice giving not less than fifteen days asking for submission of the explanation in writing within the period stipulated in the notice. Third, the Commission shall, on receipt of the explanation, and after oral hearing if granted, proceed to decide the matter of imposition of penalty on the facts and circumstances of the case.

3. Scenario of Gun Jumping Cases in India

It was the first case in the year 2012 for delayed notification to CCI about combination.[5] Under Regulation 48 parties were asked to show cause and represent itself within fifteen days. Considering first year of enforcement, CCI condoned the penalty.[6]

3.1 Actualising Combination before CCI Approval

Before CCI approval, a combination which comes within the purview of combinations to be approved by CCI, before approval it is just a proposed combination. The purpose of combination regulation will be diminished if parties effectuate the combination before CCI approval. Jet Etihad is the first precedent in India where a penalty was imposed on the acquirer for gun jumping. CCI imposed a penalty for delayed filing on Etihad under Section 43A of the

[3] Regulation 5(9) of the CCI (Procedure in regard to the transaction of Business relating to Combinations) Regulations, 2011.

[4] CCI (General) Regulations, 2009.

[5] *Reckitt Benkiser Investment India Private Limited and Halite Personal Care India Private Limited* Combination

[6] C-2012/2/39

Act. In Jet- Etihad, Etihad, the acquirer, on May 1, 2013, notified CCI of its proposed acquisition of 24% equity stake in Jet. The transaction was approved by CCI on November 12, 2013. CCI, while approving the transaction, observed that certain provisions of the commercial cooperation agreement ('CCA') had already been implemented; and sale of certain landing/take off slots of Jet at the London Heathrow Airport (LHR Transaction), had not been notified before consummation. These were the factoring leading to imposing a penalty on the acquirer. However, CCI also observed that parties had made full disclosure of all the other transaction agreements entered into between them, from which CCI had observed the non-compliance; the parties were under the impression that the LHR Transaction constituted an independent transaction; and while CCA was notified to CCI within the statutory time frame, parts of it were implemented while approval from CCI was pending. Based on these mitigating factors, CCI limited the penalty to INR 10m.

Hence, analysis of this case reveals that the parties to the combination cannot implement a part of the transaction before the approval from CCI. In the instant case, the rationale could have been to maintain independent businesses, in case the transaction was not approved by CCI, so that competition in the industry does not suffer.

3.2 Non-reportable but Inter-Connected Transactions

In the case of *Thomas Cook India Ltd.*, the resorts and time share business of SHRIL were proposed to be transferred by way of a demerger from SHRIL to TCISIL (a subsidiary of TCIL), in lieu whereof, certain equity shares of TCIL were to be issued to the shareholders of SHRIL. While considering the combination on 5th March, 2014, the CCI noticed that the acquisition of 9.93% shares of Sterling by Thomas Cook Insurance Services Limited (TCISL) through open market purchases between February 10 -12, 2014. CCI imposed a penalty of INR 1 Crore on Thomas Cook (India) Limited ("TCIL"), Thomas Cook Insurance Services Limited ("TCISL") and Sterling Holidays Resorts (India) Limited ("Sterling") under Section 43A of the Act, for failing to notify and consummating certain non-reportable but inter-connected transactions before taking the approval of the CCI for the reportable part of the inter-connected transactions. Parties filed a combination notice with the CCI on February 14, 2014. The CCI said that, since the transaction and the market purchases were authorized in the same Board meeting and all transactions were related to the business and shares of Sterling, the market purchases were inherently related to the other transactions and, therefore, cannot be viewed in isolation for the purpose of any exemption. The CCI held that the substance of the transaction is relevant to assess the effect on competition irrespective of the number of steps involved in the transaction.

Therefore, the Parties were required to notify all the steps and not consummate any part of the The CCI levied a penalty of INR 30 million (USD 0.5 million) on TOIL under Section 43A of the Competition Act for its failure to notify the combination within 30 days of the trigger event. On March 31, 2014, TOIL had filed a notice under sub-section (2) of Section 6 of the Competition Act 2002. The notice was given pursuant to the execution of a Share Purchase Agreement ("SPA") and a Joint Venture Agreement ("JV Agreement") between TOIL, THL and Trent Limited ("Trent").

CCI observed that TOIL had applied to the Department of Industrial Policy and Promotion ("DIPP") and Foreign Investment Promotion Board ("FIPB") on December 17, 2013 to seek requisite approval with regard to the Proposed Combination. The CCI opined that the merger control provisions in relation to the Proposed Combination are triggered within 30 days of filing such an application with a government body communicating its intention to acquire. Thus, according to CCI, TOIL should have filed merger notification within thirty (30) days of filing such an application i.e. by January 16, 2014 and not within thirty (30) days of execution of the binding documents. Considering that the merger notification was filed on March 31, 2014, the CCI concluded that there was a delay of seventy-three (73) days in filing the merger notification resulting in TOIL to be penalized under Section 43A of the Competition Act.

It is important to note that the CCI noted that the maximum permissible pecuniary penalty prescribed under Section 43A (i.e. 1 per cent. of the transaction value) would amount to INR 6 billion (USD 100 million). However, in light of TOIL's subsequent voluntary filing, CCI took a relatively lenient view and imposed a nominal penalty of INR 30 million (USD 0.5 million). TOIL stated that the application to DIPP and FIPB was merely an interim arrangement and a mere step towards negotiation of the proposed transaction.[7] However, the CCI rejected the arguments stating that TOIL had given adequate information about the proposed transaction in its application to FIPB and DIPP for it to qualify as a communication of 'intention to acquire'. Thus, the CCI while interpreting Section 6(2) of the Competition Act took note of Regulation 5(8) of the Competition Commission (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("Combination Regulations"), and considered the following to be the trigger event in case of an acquisition: (a) execution of any agreement; (b) any binding

[7] Citing Aditya Birla Nuvo Limited/ Pantaloon Retail (India) Limited/ Peter England Fashion and Retail Limited[7] and Exide/ING Vyasya Life.

document, by whatever name called, conveying an agreement or decision to acquire (not being a binding term sheet/memorandum of understanding); or (c) any communication made to the central government or state government or any statutory authority conveying its intention to acquire. Now under the CCI Procedure for Combination, Amendment Regulation 2015 has excluded requirement to notify in case of intimation to central government or State Government.

It is important to note here that this order was issued without any prejudice to the proceeding under Section 43A of the Competition Act 2002. The proceedings under section 43A of the Competition Act are independent of the CCI's evaluation of the pre-combination filing made by TOIL under Section 6 of the Competition Act. Following the CCI's order approving the combination, the CCI through a later order imposed a penalty of INR 30 million (USD 0.5 million) on TOIL for not notifying it about the Proposed Combination within 30 days of the trigger event. It is interesting to note that, it is the highest amount of penalty ever imposed so far on any party by the CCI under Section 43A of the Competition Act.

Similarly in the matter of *Exide Industries Limited v. ING*[8] *Life a*s per the details provided in the notice, Exide and ING Life have initialled three separate Share Sale and Purchase Agreements with the existing shareholders of ING Life i.e. ING International and the Indian Shareholders (hereinafter referred toas the "SSPAs"). As per the terms of these SSPAs, as already stated, Exide will acquire the remaining 50 per cent equity share capital of ING Life from the other existing shareholders. Further, as stated in the notice, pursuant to these SSPAs, ING Life has filed an application with the Insurance Regulatory and Development Authority (IRDA) on 24th January, 2013 in relation to the proposed combination. Accordingly, in terms of the second proviso to sub-regulation (8) of Regulation 5 of the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (hereinafter referred to as the "Combination Regulations"), the date of such communication by ING Life on 24th January, 2013 to IRDA, being a statutory authority, shall be deemed to be the date of execution of the initialled SSPAs, hence, a potential acquirer will have to ensure that it files combination notification within 30 days of communicating its intention to acquire an

[8] C-2013/01/108.

enterprise to any statutory authority (such as Reserve Bank of India, Insurance Regulatory and Development Authority, FIPB, DIPP etc.).[9]

While CCI has strictly interpreted and enforced Regulation 5(8) of the Combination Regulations, by holding that the trigger event in case of an acquisition is the date on which the enterprise communicates its intention to acquire to any statutory body, this position is likely to add to the cost of evaluating and making acquisitions for an acquirer whose acquisition requires a pre-combination notification under Section 6 of the Competition Act. A potential acquirer would now be required to make combination notification even when it is in pre-merger negotiations but has communicated its intention to make an acquisition to a regulator or statutory body due to the need for pre-transaction regulatory clearance. Thus, a CCI pre-merger investigation would be conducted even if parties are unable to get the regulatory clearance to proceed with the transaction.

This is also likely to lead to commercially absurd situations when such an acquirer is in negotiations with multiple sellers where each of them requires a pre-sale clearance from its regulator or another statutory body. In such a situation, the potential acquirer will be required to make a notification in respect of each of the potential transactions when it is fully aware that it will proceed with only of the transactions in question. The CCI's order while being an instance of good law enforcement has resulted in creating a situation that may lead to poor market economics. The potentially higher costs of acquiring an Indian enterprise when compared to similarly placed targets in other jurisdictions may well create a disincentive for a potential acquirer to consider Indian targets.

CCI approved TOIL acquiring 50 per cent share capital of THL due to absence of horizontal overlaps between the parties. CCI fined TOIL INR 30 million for delay in filing merger notification. CCI held that trigger for filing a merger notification is the date on which the acquirer expresses its intention to acquire an enterprise to an Indian statutory authority. Hence, parties to the combination now need to be extra cautious concerning the initiation of the 30 day threshold prescribed by the Indian merger control regime.

3.3 Public Interviews by Management of Merging Entities

[9] Intimation or approval of State Government will not trigger requirement of notification to CCI.

The orders of the CCI levying heavy fines on both the architects of the hostile bid of Mangalore Fertilizers and Chemicals Limited ("MFCL") is one such example which emphasizes on the considerable issues in the Merger Control Regime that deal makers will have to wrestle with. Mindful of the lurking danger, Kingfisher brought in a white knight in the form of *Saroj Poddar/Adventz Group* and between April, 2013 and July, 2013 the Adventz Group acquired approximately 16% stake in MFCL through various open market purchases. In July, 2013 *Deepak Fertilizer* acquired 24.46% in MCFL through a combination of bulk and block deals. Thereafter almost after a year in April, 2014 Deepak Fertilizers acquired another 0.8% triggering a mandatory open offer under the takeover code for the acquisition of another 26% of the voting capital MFCL from the public shareholders. In defense of the hostile bid by *Deepak Fertilizers*, the promoters of MFCL (Vijay Mallya and UB Group) entered to an agreement with the *Adventz Group* to jointly launch an open offer to acquire 26% of MFCL from the public shareholders.

While, CCI approved both the offers of *Deepak Fertilizers* and the *UB/Adventz Group* without an adverse finding, it levied a heavy penalty on both the groups for consummating parts of the transaction i.e. the open market purchases without the prior approval of the CCI resulting inot gun jumping. The CCI held that the 16% acquisition made by the *Adventz Group* through open market purchases in four tranches was in violation of the Act since such acquisitions were strategic in nature and with *intent* to acquire control over the MFCL. In arriving at this conclusion, the CCI relied on a televised interview of *Saroj Poddar* where he had said that the open market purchases were made after consulting *Vijay Mallya* and with intent to enter into a joint venture with the *UB Group* at a future date.

The CCI further held that the acquisition of 24.46% and 0.8% shares of MFCL by *Deepak Fertilizers* through open market purchases was in violation of Act and was an act of gun jumping. The CCI relied on the filings made by *Deepak Fertilizers* with the stock exchanges wherein it had said that the acquisition was made because MFCL was a "*very strategic and good fit with company (Deepak Fertilizers)*". In both the cases CCI discarded the contention of the *Adventz Group* and *Deepak Fertilizers* that the respective acquisitions were exempt under the Regulations. The Regulations exempts a combination (which meets the financial asset and turnover thresholds prescribed under the Act) involving an acquisition of shares from the prior approval of CCI if (a) solely made as an investment or (b) is in the ordinary course of business and (i) does not result in an acquisition of more than 25% of the shares or voting rights of the target company and (ii) does not give the acquirer control over the target company ("Exemption"). In this case, CCI found based on the evidences discussed above that the open market purchases of 16% and 24%

(and subsequent 0.8%) by the *Adventz Group* and *Deepak Fertilizers* respectively were strategic in nature and were not acquisitions solely as investment.

The Exemption is commonly availed by private equity players and other acquirers acquiring minority positions. While the CCI has in its decisions analysed one of the limbs of the Exemption i.e. control, in this instance for the first time CCI has examined the scope of the word 'solely made as an investment' in the Exemption. The CCI has observed that the phrase '*solely made as an investment*' indicates '*passive investment*' and any investment in a target enterprise which is done with a strategic intent cannot be treated as '*solely made as an investment*'. Since an investment that is not made '*solely an investment*' or in the '*ordinary course of business*' does not qualify for the exemption even if no control or less than 25% of the shares or voting rights are being acquired, interpreting these terms is critical for examining when the acquirers can rely on the exemption. Given that the Exemption permits for acquisition of shares up to 25% of the shares or voting rights of the target company, it is questionable whether such a large threshold can ever be acquired without a plausible 'strategic intent'. However it appears that the conduct of the acquirer will play a decisive role in the determination of the nature of investment with the CCI even possibly relying on TV interviews as evidence.

While the finding of the CCI may seem excessive in the Indian context, in fact it appears to be in line with the global position on the issue. For e.g. the US anti-trust law has a similar exemption for acquisition of shares that are made '*solely for investment purposes*'. In the US context the exemption has been interpreted quite narrowly and the intention of the parties is considered in order to ascertain whether the acquisition of shares was '*solely made as an investment*' or a strategic one. Analysis of US combination regulation regime reveals that any acquisition which gives the acquirer the right to (a) nominate a director on the board or (b) propose any corporate action which requires shareholder approval is considered *prima facie* strategic under the US law. Even if the acquisition is made with intent to solicit proxies or appoint directors of the board, such acquisitions are considered strategic. In fact, at times acquisition of a miniscule stake in a competitor could be deemed a strategic acquisition under US anti-trust laws.

4. Conclusion

Basis of CCI's enforcement should be sustaining competition and consumer welfare. Clearly, the recent rulings will change the business implications for M&A in India. For instance, several companies acquire miniscule shares in some of their competitors (sometimes less than 5% since public disclosure is required of a shareholder who acquires more than 5% in a listed entity). Henceforth such acquisitions will have to be carefully examined from a competition law perspective whether particular purchase of share is strategic or not. Further, the strategy in the case of hostile bids has to be carefully examined since building positions with the intent to acquire control at a future date may not be possible without a CCI approval. However, two factors on which the recent orders are likely to have a significant impact are activist shareholders/hedge funds and private equity investors. Hedge funds who intend to acquire shares and solicit proxies may be viewed as 'activist shareholders' not being able to avail the Exemption prescribed unless they are registered as FPIs. Similarly private equity investors who typically have exhaustive rights in the target company may not be able to avail the Exemption.

While the CCI's action against *Deepak Fertilizers* and the *Adventz Group* may have legal justifications, there are a number of fundamental questions that CCI will have to provide greater clarity on such as (1) what if there is change in intent from *solely for investment* when the acquisition is made and thereafter, will the initial investment be deemed strategic?, (2) how will open market purchases for strategic reasons be made without disclosing the same to the market prior to the purchase given that will almost always be the case if all such open market purchases require prior CCI approval? CCI has recently changed combination regulation in 2015 stating that communication to State Government or Central Government will not trigger notification requirement to CCI.