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Resolving the Conundrum surrounding the Notification of Minority Shareholdings: Where does the Indian Law stand?

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In the Indian Jurisdiction, Item I of Schedule I of the 2011 Combination Regulations exempts minority investments made "solely for investment purpose" and not leading to a change of control from notifying to the Competition Commission. However, the exact standard for assessment of the investment purpose and nature of conduct inconsistent with the exception is ambiguous. Hence, it is pertinent to analyze the decisions dealing with the exception and determine whether the adoption of the foreign standards into the Indian Jurisdiction is appropriate or not, in terms of the correctness of the foreign standards and their applicability to the Indian scenario.

Combinations

A 'Combination' can be defined as any acquisition of voting rights, shares, assets, or control of an enterprise or as a merger or an amalgamation of enterprises. A combinations leads to a change in composition of the enterprises involved and, therefore, creates a possibility of a much wider effect on the overall competition in the market(s), within which the enterprises operate. Thus, regulation of combinations becomes indispensable to prevent the competition in the market from getting adversely.

However, it is pertinent to note that there are certain combinations which are not capable of effecting the competition in the market. Accordingly, there are certain thresholds and tests that have been adopted by different jurisdictions to exempt such combinations. This not only allows the regulator to avoid looking into innocuous transactions but also saves them the time and cost of carrying out an extensive investigation.

Minority Investments

Acquisition of shareholdings where the percentage of shares acquired is lower than 50%, are called Minority Investments.[1] Minority investments are not required to be notified if they meet certain thresholds and tests in terms of the percentage of shareholdings acquired and the nature of transaction. The tests concerned with the nature of transaction, generally include the following:-

(i) "Investment only test": The investment is notifiable if it is *strategic* in nature

ii) “Control test”: The investment is notifiable if it effectuates a *transfer of control* from the target company.

A Strategic Investment is defined as an acquisition of shares made with the intention of participating in the direction, formulation and determination of the issuer’s basic business decisions.[2] On the flipside, the acquisitions falling under the category of Passive Investments are the transactions that are solely made with an intention or purpose of investment.[3]

A transfer of control constitutes transfer of rights, contracts or any other means which confer a decisive influence over the assets or of the working of the undertaking being acquired. An acquisition resulting in a transfer of control can either be effectuated on a legal basis (De Jure) or on actual basis (De Facto).[4]

Due to their capability to enable the acquirer to influence the competitive conduct of the issuer, minority investments can affect the competition in the market and thus, require scrutiny by the concerned competition regulator.[5] Other harmful effects of minority investments include, namely, the unilateral and the coordinated effect. The former is created when the acquisition of minority shareholding reduces the incentive of the target firm to compete aggressively,[6] and the latter is created if the acquisition leads to sharing of sensitive information, facilitating collusive behavior between the undertakings involved[7].

Issue

While the criterion adopted across different jurisdictions to exempt minority shareholdings from notification differ, the Indian criterion comes out as an amalgamation of the European and the US approach. However, this, along with open-ended conditions enumerated in the statute, makes the application of the exemption in India problematic.

EU Law

Under the European Jurisdiction, the power to adjudicate combinations lies with the European Commission [**“EC”**] which derives its regulatory powers from the European Commission Merger Regulation [**“ECMR”**][8].

Paragraph 11 of the ECMR specifies that the transactions which exceed a certain ***turnover threshold (called the Union Dimension)*** have to be subjected to a test of “***Control***” for determining their notifiability. Further, Article 4(1) and 7(1) of the ECMR make it amply clear that in most cases; only the combinations which lead to a “**lasting change in the form of control”** of an existing enterprise are required to be notified to the Commission.[9]

As mentioned previously, this transfer of control can either be in the form of “de facto” control, i.e. control in form of special voting or management rights or “de jure” control, i.e. control by way of being the largest stakeholder in the target company. This control can be exercised either positively or negatively; by making decisions of the acquired undertaking in the former case and by preventing the materialization of decisions in the latter case.[10]

Indian and US Law

Under the US Law, the Hart-Scott-Rodino Antitrust Improvement Act of 1976 [“**HSR Act**”] deals with minority investments and exempts an acquisition of shares of less than 10%, provided it is ‘passive’ in nature, i.e., it has been made “*solely for investment purpose*”. Rule 801.1(i)(1) of the HSR Act further specifies that the acquirer should have “*no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer*”[11] for the exception to become applicable. As can be observed, the key element here is the ‘intention of the acquirer’ at the time of the acquisition which if found to be ‘strategic’ and not ‘passive’ would make the exception inapplicable.

Moreover, the Federal Trade Commission [“**FTC**”] through various decisions and guidelines has classified certain types of conduct to be inconsistent with the exception. They include **but are not limited to**:-

“*Nominating a candidate for the board of directors of the issuer, proposing corporate; action requiring shareholder approval; soliciting proxies with respect to such issuer; having a representative serve as an officer or director of the issuer; **being a competitor of the issuer**; doing any of the above activities with regard to an entity controlled by the issuer; asking third parties about interest in being a candidate for the board or CEO of the issuer and not abandoning such efforts; communicating with the issuer about potential candidates for the board or CEO of the issuer, and not abandoning such efforts; assembling a list of possible candidates for the board or CEO of the issuer, if done with the knowledge of the CEO*”[12]

In India, for an acquisition of shares to be exempt from notification, it must fall under one of the heads of Schedule I of the Combination Regulations, 2011 [“**Combination Regulations**”]. In case of minority investments, the exemption from notification specifically lies under Item I of this Schedule, which is along the lines of the exception existing under the US Law.[13]

An acquisition of not more than 25% shareholdings, ‘***solely for investment purpose or in the ordinary course of business***’, not leading to a transfer of **control**, is exempted from notifying to the Competition Commission of India [“**CCI**”]. In the India too, the exception is subject to the no intention of participating in the “***formulation, determination or direction of the basic business decisions***” of the issuer test.[14]

Further, an acquisition of less than 10% shareholding is ‘***deemed***’ to be made solely for investment purpose, except for two riders mentioned in Item I itself.[15]

The test of ‘control’ applied in the Indian Jurisdiction differs from the one existing under the EU Law. An acquisition leading to transfer of control is mandatorily notifiable in both India and EU. However, it is pertinent to note that this test does not apply the other way round. While, the EU law exempts notification in case there is no transfer of control, the Indian law might still require the parties to notify to the competition authorities.

The Indian courts have consistently upheld the US standard through various decisions.

In the case of *ZFCL/ZACL*[16], the CCI held that an investment should not have been made with an intention of participating in the “***formulation, determination or direction of the basic business***

decisions" of the issuer for it to qualify for the Item I exemption.

Further, in the case of *New Moon/Mylan*[17], the commission held that where an acquirer and the target are involved in the '***same, substitutable or competing businesses***' or where their businesses are vertically related, such investments **below 25%** are not eligible for the exception mentioned under Item I.

Analysis

Firstly, the applicability of 'investment only' exception is much more limited under the US Law when compared to the Indian Law. The exemption is only provided to investments below 10% whereas it extends to investments below 25% in the Indian scenario. Further, no category of investments under US is presumed to be 'passive', unlike the Indian Law[18] where an investment under 10% is deemed to be passive except for the two following riders:-

"*Provided that in relation to the said acquisition,- (A) the Acquirer has ability to exercise only such rights that are exercisable by the ordinary shareholders of the enterprise whose shares or voting rights are being acquired to the extent of their respective shareholding; and (B) the Acquirer is not a member of the board of directors of the enterprise whose shares or voting rights are being acquired and does not have a right or intention to nominate a director on the board of directors of the enterprise whose shares or voting rights are being acquired and does not intend to participate in the affairs or management of the enterprise whose shares or voting rights are being acquired.*"

While the *New Moon* case upheld the US Law principle of treating an investment in a competitor to be inconsistent with the exception; the extension of the principle to every investment under 25% in this case was not problematic, considering that the sub 10% presumption rule was only added after the decision. But this then makes the *EMC/McNally*[19] decision problematic which came after the addition of the presumption rule. The decision upholds and reiterates the principle laid down in the *New Moon* case, therefore making an acquisition below 10% also ineligible for the exemption if made in a competitor. Extending such a requirement to the sub 10% category, which is deemed to be passive, is clearly contrary to the statute. The regulations provide for only two riders to the presumption rule which nowhere include being a competitor of the issuer.

Secondly, the narrow interpretation given to the exception under the US and the Indian law is also denying its benefit to cases which might not pose any antitrust concerns. A certain amount of involvement and participation in affairs of the issuer has to be considered reasonable, since any reasonable investor would want to be informed about the financial matters of a corporation where an investment of substantial amount has been made.[20]

A similar view was expressed by the two dissenting Commissioners in the case of *U.S. v. Third Point*, who held that a narrow interpretation of the investment-only exception is against public interest as the disallowance of shareholder advocacy would not only cause a chilling effect on investors, but also would deter investments which would then invariably require an HSR filing and the costs associated with it.[21] Citing significant evidence for the fact that shareholding acquisitions of less than 10% are highly unlikely to result in a substantive antitrust challenge under the law, the Commissioners expressed the need for efficiently utilizing the limited resources of the Commission to prevent transactions which substantially lessen competition.[22]

Thirdly, due to the open-ended nature of the term "*solely for the investment purpose*", there is no limit upon the *nature of conduct* which might be considered inconsistent with the exception. The FTC, for instance, has enumerated several types of conducts which are inconsistent with the investment-only exception. However, it is interesting to note that the list is not restricted to the categories mentioned, thereby, giving absolute discretion to the courts in judging the type of conduct incompatible with the exception.

This can be observed through the case of *SCM Soilfert*[23] where the Hon'ble CompAT held that a mere press release stating the investment to be strategic was sufficient to consider it ineligible for the exemption.

Conclusion

With increasing antitrust litigation, it is crucial that the resources available with the competition agencies are utilized efficiently for preventing activities which pose genuine antitrust concerns. Hence, it is pertinent that certain guidelines need to be laid down in order to bring certainty to the scope of the '*investment only exception*', which would simplify the entire process for the investors as well as the regulators. Further, it is required that the *nature of conduct* which can be considered inconsistent with the exception provided is clarified so as to prevent the arbitrary treatment.

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[1] *ANNEX to the COMMISSION STAFF WORKING DOCUMENT Towards more effective EU merger control*, European Commission (June 25, 2013), http://ec.europa.eu/competition/consultations/2013_merger_control/consultation_annex1_en.pdf.

[2] *Definition of Transaction for the Purpose of Merger Control Review*, POLICY ROUNDTABLES,

OECD (Jan 24, 2014), http://www.oecd.org/daf/competition/Merger-control-review-2013.pdf.

[3] SCM Soilfert Limited and Others v. Competition Commission of India, (2016) Comp. L.R. 1111.

[4] *ANTITRUST ISSUES INVOLVING MINORITY SHAREHOLDING AND INTERLOCKING DIRECTORATES*, European Commission (February 13, 2008), http://ec.europa.eu/competition/international/multilateral/2008_feb_antitrust_issues.pdf.

Case IV/M.258, CCIE/GTE [1992] O.J. C 258/10.

[5] *Support study for impact assessment concerning the review of Merger Regulation regarding minority shareholdings*, European Commission (2016), http://ec.europa.eu/competition/publications/reports/KD0416839ENN.pdf.

[6] *Supra* note 4.

[7] *Ibid.*

[8] Council Reg. (EC) 139/2004 (O.J. 2004 L24/1, 29.1.2004).

[9] Case T-282/02, *Cementbouw Handel & Industrie* v *Commission* [2006] E.C.R. II-319.

[10] *DEFINITION OF TRANSACTION FOR THE PURPOSE OF MERGER CONTROL REVIEW*, European Commission (May 31, 2013), http://ec.europa.eu/competition/international/multilateral/2013_june_definition_transaction_en.pdf.

[11] 157 Rules, Regulations, Statements and Interpretations Under the Hart-Scott-Rodino Antitrust Improvements Act, 16 C.F.R. §§ 802.1 – 802.80 (2011).

[12] Debbie Feinstein et al., *"Investment-only" means just that*, Federal Trade Commission (Aug 24, 2015 5:25 PM), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just.

[13] *Supra* note 2.

[14] Combination Registration No. C-2014/06/181, order dated 10 February 2015.

[15] *Supra* note 3.

[16] *Id*. at 14.

[17] Combination Registration No. C-2014/08/202, order dated 10 November 2014.

[18] The Competition Commission of India (Procedure in regard to the transaction of business relating to

combinations) Regulations, 2011, No. 3, Acts of Parliament, 2011.

[19] Combination Registration No. C-2015/07/293, order dated 26 April 2017.

[20] United States v. Tracinda Inv. Corp., 477 F. Supp. 1093 (C.D. Cal. 1979).

[21] *Dissenting Statement of Commissioners Maureen K. Ohlhausen and Joshua D. Wright in the Matter of Third Point File No. 121-0019*, Federal Trade Commission (August 24, 2015), https://www.ftc.gov/system/files/documents/public_statements/777351/150824thirdpointohlhausen-wrightstmt.pdf.

[22] *Ibid*.

[23] *Supra* note 3.

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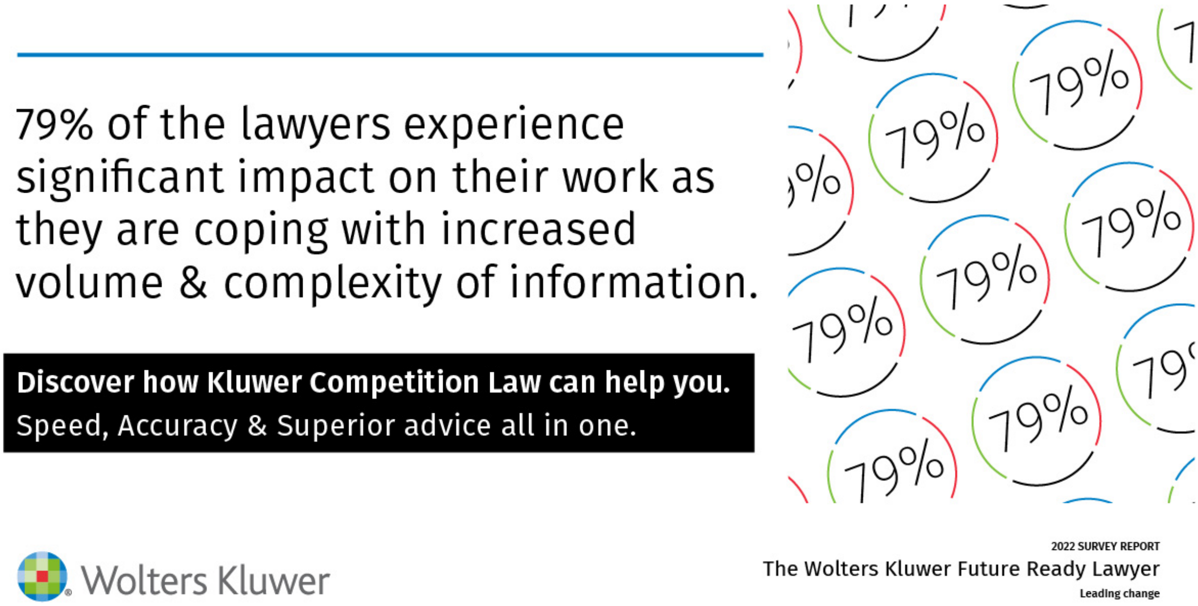

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