

Corporate Finance/M&A - India

Offer price in indirect takeovers - a concept clarified

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The Supreme Court recently pronounced its judgment in *Daiichi Sankyo Company Limited v Jayaram Chigurupati*. While settling a dispute surrounding the offer price quoted by Daiichi Sankyo Co Ltd in its public announcement for an indirect acquisition of shares in Zenotech Laboratories Ltd, the court provided clarity on the interpretation of the words "persons acting in concert" as embodied in the Substantial Acquisition of Shares and Takeover Regulations 1997 – commonly known as the Takeover Code. This update examines the impact of the case in view of the interpretation accorded to the words "persons acting in concert" by the court.

Facts

On October 3 2007 Ranbaxy Laboratories Ltd entered into a share purchase and share subscription agreement with Zenotech and its promoter Mr Jairam Chigurupati to purchase shares in Ranbaxy at the rate of Rs160 per equity share. The resultant acquisition triggered the 15% threshold, which called for a public announcement under the code. Accordingly Ranbaxy made a public announcement for acquisition of shares in Zenotech, quoting an offer price of Rs160 per share. The 'open offer' closed on November 15 2007 and Ranbaxy issued a post-offer announcement on January 30 2008, whereby its post-closing shareholding in Zenotech amounted to 46.85%.

Subsequently, on June 11 2008 Daiichii Sankyo entered into an agreement with Ranbaxy and its promoters to acquire 30.91% of its paid-up capital. Once again, this triggered the requirement of a public announcement, which Daiichii Sankyo made to the shareholders of Ranbaxy on June 16 2008 to acquire 22.01% of shares at an offer price of Rs737. Since Daiichii Sankyo had acquired more than 50% of the shares in Ranbaxy on October 20 2008, Ranbaxy became its subsidiary. Consequently, Daiichii Sankyo also acquired indirect control of Ranbaxy's 46.85% stake in Zenotech triggering the requirement of a public announcement to Zenotech's shareholders. Accordingly, on January 19 2009 Daiichii Sankyo made a public announcement to the shareholders of Zenotech offering Rs113.62 per share as the offer price. This price was based on the price of Zenotech's shares as quoted on the stock exchange.

Zenotech's promoters filed a complaint with the Securities and Exchange Board claiming that Daiichii Sankyo's offer price should not have been less than Rs160 per share. While the board rejected this claim, it was upheld by the Security Appellate Tribunal.

Daiichii Sankyo appealed before the Supreme Court. The main issue considered in the appeal was whether the offer price of Rs113.62 per share made by Daiichii Sankyo for acquisition of shares in Zenotech was fair and lawful.

Controversy surrounding the offer price

Regulations governing 'offer price'

While examining the issue, the Supreme Court discussed the provisions contained in the code that deal with 'offer price' and the manner in which it must be determined.⁽¹⁾ As per Regulation 20, where an acquisition falls under Regulations 10 and 11,⁽²⁾ the offer price must be determined in the manner prescribed under Regulation 20(4) and (5).⁽³⁾ Similarly, Regulation 20(12) deals specifically with indirect takeovers and provides that

the offer price must be determined with reference to (i) the date of the public announcement for the parent company, and (ii) the date of the public announcement for acquisition of shares of the target company.

The offer price in an indirect takeover is also to be determined in accordance with Regulation 20(4) and (5). In the present case, the court observed that the share price of Zenotech was to be determined on June 16 2008⁽⁴⁾ and on January 19 2009.⁽⁵⁾

Determining the offer price

Regulation 20(4) prescribes three ways for determining the offer price. As per the regulation, it must be the highest of:

- the negotiated price under the agreement referred to in Regulation 14(1);⁽⁶⁾
- the price paid by the acquirer or persons acting in concert with the acquirer for acquisition, if any, (including by way of allotment in a public or rights or preferential issue) during the 26-week period prior to the date of public announcement; or
- the average of the weekly high and low of the shares' closing prices of the target company as quoted on the stock exchange, where the shares of the company are most frequently traded during the 26 weeks; or the average of the daily high and low of the prices of the shares as quoted on such stock exchange where the shares of the company are most frequently traded during the two weeks preceding the date of public announcement.

The first point relates to direct takeovers and is therefore irrelevant. In the present case, the controversy stemmed from the different methods applied: while Daiichii Sankyo applied the third method, Zenotech's promoters applied the second.

Contentions surrounding the offer price

Daiichii Sankyo's view was that the second method had no applicability because it was not acting in concert with Ranbaxy to purchase shares in Zenotech. Therefore, the only provision that it could apply for determining the offer price was the third method. On the other hand, the contention raised by Zenotech's promoters was that Daiichii Sankyo and Ranbaxy constituted 'persons acting in concert' when they signed the agreement on June 11 2008, and then on October 20 2008 when Ranbaxy finally became a subsidiary of Daiichii Sankyo. They argued that Ranbaxy had paid Rs160 per share for the shares in Zenotech in January 2008, which fell well within the 26-week period dating back to June 16 2008 (ie, the date on which Daiichii Sankyo made the public announcement for the shares in Ranbaxy). In light of this, Zenotech's promoters were of the view that Daiichii Sankyo should have applied Regulation 20(4)(b) to determine the offer price for the Zenotech shares, which in turn should have been Rs160 and not Rs113.62.

The controversy finally rested on the applicability of Regulation 20(4)(b) for determining the offer price quoted by Daiichii Sankyo. Regulation 20(4)(b) provides for a situation wherein the acquirer or persons acting in concert with the acquirer pays a price for acquisition of shares in the target. It was in this context that the court examined the interpretation of the words "persons acting in concert", as well as the stage at which persons may be said to be acting in concert for the purpose of the applicability of Regulation 20(4)(b).

Supreme Court's interpretation of "persons acting in concert"

One of the observations made by the court in this context was that the concept of "persons acting in concert" (as defined under Regulation 2(e)(1))⁽⁷⁾ was based on the premise that on one side there is a target, and on the other side there are two or more entities which come together with the common objective or purpose of substantial acquisition of shares in the target. Therefore, unless there is a target whose shares are to be acquired by two or more entities coming together for that very purpose, there can be no persons acting in concert. Similarly, the court also observed that there can be no persons acting in concert unless there is a shared and common objective to acquire substantial shares in the target. Such a relationship can come about only by a meeting of minds pursuant to an agreement or understanding, formal or informal.

The court concluded that the contention that by virtue of executing the agreement Ranbaxy became a person acting in concert with Daiichii Sankyo could not be accepted, since the basic precondition of a 'common objective' to acquire substantial shares in Zenotech was absent. If Daiichii Sankyo and Ranbaxy had indeed entered into the agreement with the common objective of acquiring the bulk of the shares in Zenotech, then they would have qualified as persons acting in concert. However, this was not the case.

The court also considered Regulation 2(e)(2) and observed that this sub-regulation cannot be seen as a standalone provision independent of sub-regulation (1). This meant that while sub-regulation (2) was a deeming regulation, it was a deeming provision that merely provided nine specific relationships in which one entity would be deemed to be acting in concert with the other. This implied that in such cases, if one of

the persons made or agreed to make a substantial acquisition of shares in a target, it would be presumed that it was acting in pursuance of a common objective or purpose shared with the other entity in the pair. In this situation, the two would be deemed to be "persons acting in concert". The presumption of a common objective would remain constant. Thus, the court observed that Regulation 2(e)(2) must be read in conjunction with Regulation 2(e)(1). Therefore, even under this sub-regulation, persons deemed to be acting in concert must have the intention to acquire a substantial shareholding in the target.

Further, the court also clarified that the deeming provision as embodied in Regulation 2(e)(2) can operate only prospectively and not retrospectively. Thus, the court held that in the present case, the deeming provision would give rise to the presumption that Daiichii Sankyo and Ranbaxy were persons acting in concert, provided the condition laid down in sub-regulation (1) was also satisfied post October 20 2008 (ie, the date on which Ranbaxy became a subsidiary of Daiichii Sankyo). Therefore, it cannot be said that the purchase of shares in Zenotech by Ranbaxy in January 2008 was in concert with Daiichii Sankyo.

Regarding the timing of when a person is said to be acting in concert with another, in the context of the applicability of Regulation 20(4)(b), the court held that it was irrelevant that the acquirer and the entity which had acquired shares in the target on an earlier date should be acting in concert at the time of the public announcement for the target. What was important was that the other entity was acting in concert with the acquirer at the time of purchase of shares of the target.

Decision

In light of the above discussion, the court held that, as far as Zenotech was concerned, Ranbaxy was not acting in concert with Daiichii Sankyo, neither from the date on which it entered into an agreement with Daiichii Sankyo, nor from the date on which Ranbaxy finally became a subsidiary of Daiichii Sankyo. Thus, the acquisition of shares by Ranbaxy in Zenotech in January 2008 did not fall within the scope of Regulation 20(4)(b). Hence, the offer price quoted by Daiichii Sankyo to the shareholders of Zenotech was correctly worked out. The court ordered the Security Appellate Tribunal judgment to be set aside.

Comment

With this judgment the court clarified the position of what constitutes "persons acting in concert" in the context of the code. Whether it is a direct or indirect acquisition, and whether it is pursuant to an agreement or an understanding, two essential preconditions must be satisfied in order to constitute "persons acting in concert", namely: (i) the existence of a target company; and (ii) a common objective and purpose of acquiring substantial shares in the target.

Furthermore, the point of time in a transaction when an acquirer may be said to be acting in concert with two or more persons is when shares of the target are purchased and not when the acquirer makes the public announcement.

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Endnotes

- (1) Regulation 20 lays down the manner in which the offer price is to be determined under various circumstances.
- (2) Regulations 10 and 11 prescribe thresholds (in percentage) of shareholding. When the acquirer exceeds these thresholds by acquiring shares or voting rights in the target, it is required to make a public announcement.
- (3) Regulation 20(4) provides three ways for determining the offer price (discussed above) and Regulation 20(5) lays down the method used for determining the offer price in case of a company whose shares are infrequently traded and therefore not relevant in this particular case.
- (4) The date of the public announcement of the parent company, Ranbaxy.
- (5) The date of the public announcement for Zenotech, the indirectly acquired company.
- (6) An agreement for acquisition of shares or voting rights or deciding to acquire shares or voting rights exceeding the thresholds prescribed under Regulations 10 and 11.
- (7) "Persons acting in concert" comprise persons who, for a common objective or purpose of substantial acquisition of shares or voting rights or gaining control over the target, pursuant to an agreement or understanding (formal or informal), directly or

indirectly co-operate by acquiring or agreeing to acquire shares or voting rights in the target or control over the target.

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