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INDIAN COMPETITION LAW MAY STIFLE M&A

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☞ INTRODUCTION

Liberalization and opening up of Indian economy has not only opened new vistas for Indian companies, but has also led to increased competition from within and outside India. The focus of Monopolies & Restrictive Trade Practices Act, 1969 (**"MRTP Act"**) was on the control of monopolies and the prohibition of monopolistic and restrictive trade practices. It was a product of the regime of licensing and controls. MRTP became obsolete in certain respects in the light of international economic developments relating more particularly to competition, and there was a need to shift the focus from curbing monopolies to promoting competition. This led to the enactment of the Competition Act, 2002 (**"the Act"**).

This newsletter provides an outline of the competition law regime in India and the meaning of combinations under the Act. It further deals with the recent amendments to the Act that might result in the slow-down of mergers and acquisitions (**"M&A"**), and are likely to be detrimental to the interests of investors, especially outside India.

1. Competition law in India

The competition law in India is governed by the Competition Act, 2002 (**"Act"**) that attempts to make a shift from curbing monopolies (as was the object of MRTP Act) to curb practices having adverse effects on competition within and outside India. A majority of the procedural provisions of the Act relating to establishment of Competition Commission of India (**"CCI"**) are in force. However, the substantive provisions of the Act regarding abuse of dominant position, anti-competitive agreements and regulation of combinations are currently not in force as yet.

The Competition (Amendment) Act, 2007 (**"Amendment"**) introduced significant changes to the competition law regime. Some of the provisions of the Act as amended by the Amendment are impractical and inconsistent with the very objectives of the Act, and may impede industrial and economic growth. These proposed amendments are discussed in section 3 below. Further, the CCI has promulgated a draft of the Competition Commission (Combination) Regulations (**"Regulations"**) that provide a framework for regulation of combinations and also attempt to overcome some of the shortcomings of the Act.

2. Meaning of "Combination"

Section 5 of the Act defines combination by providing threshold limits in terms of assets and turnover. Any acquisition, merger or amalgamation falling within the ambit of the thresholds defined under section 5 constitutes a combination. The following transactions are considered as combination within the Act:

- Merger/amalgamation in which the assets or turnover of the merged entity exceeds INR 10 billion (*US$ 250 million*) and INR 30 billion (*US$ 750 million*) respectively in India, or assets exceeding US$ 500 million (including at least INR 5 billion (*US$ 125 million*) in India) or turnover exceeding US$ 1.5 billion (including at least INR 15 billion (US$ 375 million) in India) outside India.

- Merger/amalgamation in which assets or turnover of the acquirer group[1] exceed INR 40 billion (*US$ 1 billion*) and INR 120 billion (*US$ 3 billion*) respectively in India, or assets exceed US$ 2 billion (including at least INR 5 billion (*US$ 125million*) in India) or turnover is more than US$ 6 billion (including at least INR 15 billion (*US$ 375 million*) in India) outside India.

- Acquisition in which the assets or turnover of the parties (i.e. the acquirer and the target) exceeds INR 10 billion (*US$ 250 million*) and INR 30 billion (*US$ 750 million*) respectively in India, or assets are more than US$ 500 million (including at least INR 5 billion (*US$ 125 million*) in India) or turnover is more than US$ 1.5 billion (including at least INR 15 billion (*US$ 375 million*) in India) respectively in aggregate outside India.

- Acquisition in which the assets or turnover of the acquirer group exceeds INR 40 billion (*US$ 1billion*) and INR 120 billion (*US$ 3 billion*) respectively in India, or assets exceed US$ 2 billion (including at least 5 billion (*US$ 125 million*) in India) or turnover is more than US$ 6 billion (including at least INR 15 billion (*US$ 375 million*) in India) outside India.

The Act defines different threshold limits for a combination in case the acquirer has **control** over any enterprise engaged in identical or similar business activity as that of the target company. In such a case, section 5 of the Act defines a combination as any:

- Acquisition in which the assets or turnover of the parties, i.e., the acquirer and the target exceeds INR 10 billion (*US$ 250 million*) and INR 30 billion (*US$ 750 million*) respectively in India, or assets exceed US$ 500 million (including at least INR 5 billion (*US$ 125 million*) in India) or turnover exceeds US$ 1.5 billion (including at least INR 15 billion (*US$ 375 million*) in India) outside India.

- Acquisition in which the assets or turnover of the acquirer group exceeds INR 40 billion ((*US$ 1 billion*) and INR 120 billion (*US$ 3 billion*) respectively in India, or assets increase US$ 2 billion (including at least INR 5 billion (*US$ 125million*) in India) or turnover exceeds US$ 6 billion (including at least INR 15 billion (*US$ 375 million*) in India) outside India.

To recap, both mergers and acquisitions within and outside India will be impacted provided either the assets or turnover exceeds the prescribed limits. Therefore, a merger or acquisition in India will be considered as a "combination" if the **combined assets** of the parties exceed US$ 250 million or that of the acquiring group exceeds US$ 1 billion. Similarly, if the **turnover** of the parties exceeds US$ 750 million or that of the acquiring group exceeds US$ 3 billion, the transaction will be a "combination" within the Act.

A merger or acquisition outside India will be considered as a "combination" if the **combined assets** of the parties exceed US$ 500 million (including at least US$ 125 million in India) or that of the acquiring group exceeds US$ 2 billion (including at least US$ 125 million in India). Similarly, if the **turnover** of the parties exceed US$ 1.5 billion (including at least US$ 125 million in India) or that of the acquiring group exceeds US$ 15 billion (including at least US$ 375 million in India), the transaction will be a "combination" within the Act.

[1] The explanation to section 5 of the Act details that "group" means two or more enterprises which, directly or indirectly, are in a position to - (i) exercise twenty-six percent or more of the voting rights in the other enterprise; or (ii) appoint more than fifty percent of the members of the Board of directors in the other enterprise; or (iii) control the management or affairs of the other enterprise.

3. Norms stifling corporate deals

It is feared that the following provisions of the Act as amended by the Amendment will have a negative impact on M&A activity.

(i) Mandatory notice of combination

Reporting of a combination was optional in terms of the Act as it was originally enacted in 2002. However, the Amendment makes it mandatory to notify all combinations to the CCI within 30 days of the decision of the Board of directors of the parties to the combination or execution of any agreement for effecting the combination. Mandatory reporting of combinations applies even in the case of a merger or acquisition taking place outside India having an Indian connection, i.e., if the parties to the combination have any assets or a turnover in India as described in section 2 above.

If the Amendment goes through, the parties will be required to notify the CCI within 30 days of "*execution of any agreement or other document for acquisition…*". The meaning of the phrase "other document for acquisition" is wide enough to cover any Memorandum of Understanding ("MOU") or Letter of Understanding ("LOI") that are generally non-binding (except certain provisions like exclusivity, confidentiality etc) and are executed by parties to spell out a basic understanding based on which further negotiations are carried out. Notification of a MOU/LOI for acquisition will increase the compliance costs at a stage when it is uncertain whether the deal will actually be struck. It will also add to the bulk of notification applications to CCI and it is to be seen whether CCI will have adequate infrastructure to efficiently deal with the bulk. Needless to say, the delay will have a cascading effect and impact the ability of the parties to close on time leading to the makings of future conflicts between the industry and the government.

(ii) 210-day waiting period

The Amendment has introduced a 210-day waiting period for mergers to become effective. In terms of the amended provisions of the Act, a combination is effective only when CCI approves the combination or on the lapse of 210 days from the date of notification to CCI - whichever is earlier.[2] Timing is important in any M&A deal. It does not stand to reason why the government has elected to amend the law because the voluntary notification had not even been tested effectively.

A long waiting period means that the deal will not take effect until the clearance. Uncertainty as to the identity of the enterprise might drive away existing and potential customers. Further, no important business decisions can be taken as the deal will remain in limbo during the waiting period.

The 210-day waiting period applies in case of mergers and acquisitions taking place outside India, where one of the parties to the transaction has substantial presence in India. This means that it is mandatory for a foreign company with assets more than US$ 500 million having a subsidiary/joint venture in India with a substantial investment (above US$ 125 million) to notify CCI before acquiring a company outside India. Not only this, the company will have to wait for CCI's nod for a period that may extend to 210-days before the deal becomes effective. The waiting period may dissuade foreign investors from investing in India and force them to seek other destinations that allow acquisitions to be effected faster, thereby providing greater certainty.

(iii) Impractical thresholds

The threshold limits for combinations are low and impractical. Many transactions not affecting competition in India will require CCI's approval for the sole reason that one of the parties involved is big enough to satisfy the

[2] Section 2A of the Act.

revised combination thresholds. For instance, the Act provides that a prior approval of CCI is required to give effect to an acquisition where the combined assets of the acquirer and the target is more than INR 10 billion or turnover of the parties exceeds INR 30 billion. Large companies like Reliance Industries Ltd. (with a paid-up capital of INR 14 billion) will have to wait for a period that may extend up to 210 days in order to be able to acquire a small company having no significant presence in the market because the acquirer alone meets the minimum combined size that requires CCI's approval.

The situation becomes more critical in case of cross-border transactions, and may lead to a scenario in which a big foreign company (assets more than US$ 500 million) having a substantial presence in India (assets more than INR 5 billion) will have to wait for CCI's approval to acquire a small company in any part of the world. The draft Regulations address this scenario to a certain extent (*discussed in 4 below*).

(iv) Exorbitant filing fee

The notice of a combination to CCI is required to be accompanied with a fee of INR 2 million (*US$ 50,000*). Further, the CCI will issue a show cause notice if it is of prima facie opinion that the combination is likely to cause appreciable adverse effect on competition in India. A fee of (INR 2 million) is to be filed along with the response to the show cause notice of CCI. In case CCI directs the parties to publish the details of the combination, proof of publication is to be filed with CCI along with a further fee of INR 2 million. Clearly, the filing fees involved are exorbitant, and are likely to further act as deterrent to M&A in India.

(v) Power to declare overseas M&A void

The Act explicitly allows CCI to examine a combination already in effect outside India and pass orders against such a combination in case it has appreciable adverse effect on competition in India.[3] The power given to CCI is extremely wide and allows CCI to declare any merger/acquisition that has taken place outside India as void if it has appreciable adverse effect on competition in India. The power of CCI needs to be curtailed in this respect.

"Adverse effect" on competition means anything that reduces or diminishes competition in the market. While determining whether a combination has an adverse effect on competition in India the CCI may consider the likelihood of the combination to (1) create barriers to new entrants in the relevant market, (2) drive existing competitors out of the market, (3) cerate a monopoly that hampers improvements in production or distribution of goods or provision of services, (4) impact the interests of the consumers in any other way. However, it remains to be seen how the Indian jurisprudence develops on the concept of "combination having adverse effects on competition".

4. The Regulations

The stringent norms laid down by the Amendment received criticism from national and international industrial groups. In response, the CCI published the draft Regulations. The Regulations provide that on notification of a deal, CCI will formulate a prima facie opinion on existence of an appreciable adverse effect on competition. If there are no competition concerns, CCI is required to clear the deal within 30 days. However, if there are competition concerns, CCI can utilize the entire 210-day waiting period to clear the transaction.

Further, the Regulations exempt 13 transactions from the purview of the combinations that are likely to have appreciable adverse effect on competition in India. For instance, any acquisition of less than 26% of a company's share capital where such investment is made solely as an investment and does not lead to control of the company by the acquirer is outside the scope of the Regulations.[4] Another key transaction that has been exempted

[3] Section 32 of the Act.
[4] Section 5(2)(i) of the Regulations.

is any acquisition of a company in which the acquirer already holds more than 50% stake prior to the acquisition.[5] Further, acquisition of a company by another company or a group that is unrelated to the acquirer's business and is solely an investment is also outside the competition regulator's purview. However, this exclusion is not applicable to a complete acquisition of a brand, service or business operations.[6]

One of the fundamental concerns triggered by the Amendment is that foreign-to-foreign deals require notification and observance of the 210-day waiting period. This issue has been addressed to a certain extent by the Regulations which stipulate that at least two parties to a combination outside India must each have a minimum assets of US$ 50 million or turnover of US$ 150 million in India.[7] If the aforesaid condition is not fulfilled, it will be deemed that the combination does not adversely effect competition in India.

It is pertinent to note that the Regulations simply state that the 13 transaction will not have any adverse effects on competition in India, but do not expressly exempt the transactions from mandatory notification requirements under the Act. This implies that parties are required to report even the exempted transactions that do not have an adverse effect on competition and wait for the stipulated period of 210 days. Of course, the Regulations are in draft form at the moment and are open for comments by public, industrial groups etc. It is crucial that the industry feedback and concerns be addressed else the purpose of the CCI to promote competition will be diluted and, instead, will reduce it.

☞ CONCLUSION

Competition law is a necessity in free market economies to safeguard the interests of consumers and ensure freedom of trade. The bedrock of any competition regime is that it is the *abuse of dominance*, and not dominance per se which is bad. However, competition law should act as a tool rather than a hindrance to the economic growth and development of the country. It is hoped that all the shortcomings of the present Indian competition law will be taken into consideration and the law will be suitably amended before it comes into force. The failure to do so may lead to stifling of the M&A activity in India and could retard the overall industrial and economic growth of the country.

[5] Section 5(2)(iv).
[6] Section 5(2)(ii).
[7] Section 5(2)(iii).

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