

No back-out allowed once a public offer is made!

Introduction

Under the Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997¹ (“**Takeover Code**”), if an acquirer proposes to acquire 15% or more of the voting rights in a target company, it is required to make an open offer. Under the open offer, the acquirer must make a public announcement to the shareholders of the target company to acquire at least 20% of the voting capital of the company. This gives an opportunity to the shareholders to exercise a choice to either off-load their shares at a price as determined in accordance with the Takeover Code or to continue as shareholders. However, the question is, if a public offer, once made, can it be allowed to be withdrawn? Going by the view of the Supreme Court of India (“**SC**”) in *Nirma Industries Ltd. and Anr vs Securities & Exchange Board of India*, decided on May 09, 2013, it appears that it cannot be withdrawn.

This newsletter examines the SC’s judgment, the legislative intent to make a public offer mandatory and why an application for withdrawal of a public offer (once made), be treated with great circumspection.

1. The Dispute

The history of the case goes back to March 2002 when three group companies of Shree Ram Multi Tech Limited (“**SRMTL**”, alternatively referred to as “**Target**”) issued secured optionally fully convertible premium notes (“**Notes**”) to Nirma Industries (“**Nirma**”) by way of share subscription agreements as collateral against certain sum borrowed by the Target from Nirma. The three group companies pledged equity shares of the Target in favour of Nirma to secure redemption of the Notes in accordance with the share subscription agreements, failing which Nirma could invoke the pledge and acquire the pledged shares. Pursuant to the contractual arrangements, the Target’s three issuing companies were asked to redeem the Notes within thirty days which did not happen in time. Therefore, the pledge was invoked in July 2005. As the pledged shares constituted 24.25% shareholding of SRMTL, Regulation 10 of the Takeover Code got triggered. As per Regulation 10, no acquirer can acquire shares which entitle it to exercise 15% or more of the voting rights in a company unless it makes a public announcement to acquire shares in accordance with the Takeover Code. Accordingly, Nirma made a public announcement in July 2005 to acquire up to 20% shares of the existing shareholders of SRMTL and, in accordance with Regulation 18 of the Takeover Code, drafted an offer letter and submitted it before SEBI in August 2005.

¹ By way of notification dated September 23, 2011, the Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 were notified which replaced the Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. In the present case, the dispute arose when Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 were applicable.

Meanwhile, the internal audit reports of SRMTL for the quarter July-September, 2005 came in the public domain and major financial fraud committed by its promoters came to light. Thereafter, SRMTL's share value reduced significantly. Pursuant to this development, in May 2006, Nirma moved an application before SEBI to seek exemption from the operation of Regulation 10 and sought permission to withdraw the public announcement made in July 2005. Alternatively, they requested SEBI to allow them to re-fix the offer price for the shares of SRMTL on the basis of the then current market price of its shares. Nirma contended that even by conducting due diligence, these internal issues relating to poor financial situation of the target would have been impossible to find out.

Both SEBI and Securities Appellate Tribunal (“SAT”) issued unfavorable orders against Nirma and did not accede to its request to withdraw the offer or change the offer price. Nirma then moved an appeal before the SC.

2. Key contentions and SC's View

2.1 Application of Regulation 27(1)

In the SC, Nirma took recourse under Regulation 27(1) of the Takeover Code according to which no public offer, once made shall be withdrawn except where (a) the statutory approval(s) required have been refused; (b) the sole acquirer, being a natural person, has died; and (c) **such circumstances as in the opinion of SEBI merit withdrawal.**² Their first major contention was that as SRMTL's share value had reduced significantly subsequent to public offer, the case can fall under Regulation 27(1)(d) of the Takeover Code. Against this argument, SRMTL argued that the Takeover Code is a special law to regulate “substantial acquisition of shares and takeovers” in a target company and lays down a self contained code for an open offer. They further argued that the object of the Takeover Code would be frustrated if a liberal meaning is assigned to the words “such circumstances” and so if Nirma is allowed to wriggle out of the public offer on the premise of discovery of adverse facts relating to financial health of SRMTL, the interest of its investors would be seriously jeopardized.

One point which SC had to decide here was whether SEBI has the authority to grant any exemption from the requirement of making a public offer in case of “such circumstances as in the opinion of SEBI merits withdrawal” under Regulation 27(1)(d) of the Takeover Code.

The SC adopted the view that Regulation 27(1) of the Takeover Code states the general rule in negative terms. It provides that no public offer, once made, shall be withdrawn subject to three exceptions (*stated hereinabove*) which have to be construed very strictly. The exceptions cannot be construed in such a manner that would destroy the general rule that no public offer shall be permitted to be withdrawn after the public announcement has been made. Dealing with the three exceptions, the SC held: (a) Regarding statutory approval(s)- This would apply where a public offer has to be withdrawn in case of legal impossibility when the statutory approval required has been refused ; (b) Regarding the sole acquirer- This would apply where the sole acquirer being a natural person, has died. Clearly, both the exemptions under (a) and (b) are within the same genus of impossibility and therefore regarding clause (c) i.e, “such

² Regulation 27 (1)(d) of Takeover Code of 1997

circumstances as in the opinion of SEBI merits withdrawal”, **an exception to the general rule would have to be naturally construed in terms of the other two exemptions.** This exception would be restricted to a situation which would make it impossible for the acquirer to perform the public offer. Only SEBI has been accorded with the discretion to decide the same.

2.2 Nirma never intended to “take-over”

Nirma’s second most crucial contention was that its primary objective was to secure its loan and never to take over the management of SRMTL. In light of this premise, the Takeover Code should be interpreted liberally. However, the SC found merit in SRMTL’s contention, according to which, acquisition of shares by banks and financial institutions (*acting as pledgee in the normal course of business*) is exempt from the provisions of the Takeover Code. This is because in such cases banks do not acquire shares with the intention of taking over the target, but to facilitate their business operations. Such a case has to be distinguished from the situation where an acquirer acquires shares of a target to gain control over its affairs.

3. Treat withdrawal with circumspection

In this case, the SC had observed that the fact that the market price of the Target is far below the offer price **cannot** be a reason for seeking withdrawal of the offer. Nirma had made an informed business decision which, unfortunately for them, instead of generating profits, was likely to cause losses. As a result, by pulling out, it would place a burden on the other shareholders. The Takeover Code is meant to ensure fair and equal treatment of all shareholders in relation to substantial acquisition of shares and such process should not take place in a clandestine manner, without protecting the interests of the shareholders. SC added that, for the sake of orderly development of the securities market, public offers once made ought not to be allowed to be withdrawn on the ground of fall in share price of the Target which is, essentially, a business misfortune or a financial decision of the acquirer having gone wrong. If on ground of fall in prices, public offer is allowed to be withdrawn, it could lead to frivolous offers being made and withdrawn. This would adversely affect the interests of the shareholders of any target and the integrity of the securities market. Such an outcome would be wholly contrary to the intent and purpose of the Takeover Code.

Finally, the SC upheld the view of SAT and SEBI and rejected Nirma’s appeal for withdrawal of its open offer to acquire equity shares of SRMTL. SC observed that once the Takeover Code is triggered, the acquirer cannot be allowed to wriggle out of its obligations under the Takeover Code to prejudice “the public shareholders of their valuable right to have an exit option under the code”.

4. The implications for acquirers

SC has clarified that if an acquirer has made an offer for takeover of a target company, then it cannot go back on it. The larger interest is that of the minority shareholders (*who have been given an opportunity to exit*) and not the acquirer, whose business sense says that the offer once made should either be cancelled or modified! Thus, although the Takeover Code permits withdrawal of offer, refuge under clause 27(1)(d) is not going to be easily procurable. Therefore, offer must be made, once the prospective acquirer is sure of the same.

Acquirer should be diligent to conduct due diligence to know the red flags and whether hurdles, if any, can be removed by the target company before the takeover actually happens. Cleanup of the non-compliance or irregularities, if possible, should be a pre-condition before giving go ahead to the takeover. The bottom line is that the acquirer should not proceed unless the prejudicial issues are settled. It is settled law that in case an open offer is made, permission to withdraw will only be granted if the acquirer's case is genuine and minority's interests are not jeopardized. The underlying intent is to enable minority shareholders to exit on same terms as those who have sold shares to the acquirer with control over the target company. At the same time, there may be situations where SEBI may permit withdrawal owing to the situations where the primary basis on which the offer was made has become frustrated.

5. Position under the new Takeover Code

The Takeover Code of 1997 was revised in 2011 (the Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011) and a new ground has been inserted in the form of Regulation 23(1) (c) which states that an offer may be withdrawn if:

- (i) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer; and
- (ii) such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer.

Thus, assuming that the Takeover Code of 2011 was applicable to Nirma's case and the public offer had stated that Nirma will have a right to withdraw in case the market witnessed a decrease in the price of the shares (*at any stage after the public offer is made*) owing to default on behalf of SMP TL, it is possible SEBI may have granted permission for withdrawal.

Conclusion

The 2011 Takeover Code appears to have given an opportunity to avert any situation which may render the exercise of takeover futile and prejudice the business interest of the acquirers even before the takeover is completed. However, there is not enough body of judge made law to support this proposition. So far, Nirma's case will still apply and acquirers will have to retain the sanctity of their open offers.

Author

Mansi Airi Gambhir