Corporate Finance/M&A - India

Merger Review under the Competition Act: Regressive or Progressive Steps?

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Introduction

On August 28 2009 the Ministry of Corporate Affairs issued a notification pursuant to which the Monopolies and Restrictive Trade Practices Act 1969 was repealed and replaced by the Competition Act 2002 with effect from September 1 2009. Under the Monopolies Act, the emphasis of antitrust law in India was mainly on the prohibition of restrictive and unfair trade practices and the law was designed to guard against different aspects of market imperfections leading to the creation of monopolies. In contrast, the Competition Act attempts to make a shift from curbing monopolies to curbing practices that have adverse effects on competition both within and outside India. It is interesting to see that under the new regime the legislature has chosen to regulate unfair trade practices under only the Consumer Protection Act 1986 and not the Competition Act.

In 2007 the Competition (Amendment) Act introduced significant changes to the competition law regime. Most noteworthy of these changes was the introduction of a mandatory notification process for persons undertaking combinations above the prescribed threshold limits. In early 2008 the Competition Commission of India also promulgated and circulated a draft of the Competition Commission (Combination) Regulations. Partly in response to public and industry comments, significant changes were made and a new version of the regulations was circulated in 2009. The regulations provide a framework for the regulation of combinations which include M&A transactions or amalgamations of enterprises. The merger provisions are not yet in force. Nonetheless, it is only a matter of time before the relevant provisions will be notified. As it is, a large part of the procedural provisions of the Competition Act relating to the establishment of the Competition Commission are already in force.

Position on Combinations

Before considering combinations, it is necessary to look at two important sections of the Competition Act. On May 15 2009 the government formally notified certain provisions in the Competition Act relating to anti-competitive agreements and abuse of dominance, covered in Sections 3 and 4 of the act respectively, which came into force on May 20 2009. Section 3 of the act governs anti-competitive agreements and prohibits:

"*agreements involving production, supply, distribution, storage, acquisition or control of goods or provision of services, which cause or are likely to cause an 'appreciable adverse effect on competition' in India.*"

This provision covers both horizontal and vertical agreements. Section 4 of the act prohibits the abuse of a dominant position by an enterprise. Under the Monopolies Act, a threshold of 25% constituted a position of strength. However, this limit has been eliminated under the Competition Act. Instead, the Competition Act relies on the definitions of "relevant market", "relevant geographic market" and "relevant product market" as a means of determining an abuse of a dominant position.

Under Section 6, the Competition Act prohibits enterprises from entering into agreements that cause or are likely to cause an "appreciable adverse effect on competition within the relevant market in India". Under the new regime, the Competition Commission has investigative powers in relation to combinations. Various factors are provided for determining whether a combination will or is likely to have an appreciable adverse effect on competition in India, and penalties are provided for such violations.

Criteria under Section 5
The most important section - Section 5 of the Competition Act, which defines 'combination' by providing threshold limits in terms of assets and turnover - has yet to be notified. As yet, there is no clarity as to when it will be made effective, but it is expected to come into force by the end of 2009 or in early 2010. At present, any acquisition, merger or amalgamation falling within the ambit of the thresholds constitutes a combination. Essentially, a transaction must satisfy two conditions before Section 6 is triggered: (i) it must involve total assets or turnover, with separate criteria for domestic and international entities; and (ii) it must have a territorial nexus with India. The following transactions will constitute a combination:

- transactions among Indian companies with combined assets of $250 million or $750 million in turnover of the merged entity;
- cross-border transactions involving both Indian and foreign companies with combined assets of $500 million or $1.5 billion in turnover; and
- transactions that have a territorial nexus with India, where the acquirer has $125 million in assets or $375 million in turnover in India.

For acquiring groups, the threshold figures are much higher:

- $1 billion in assets and $3 billion in turnover in India respectively;
- assets in excess of $2 billion; or
- turnover of more than $6 billion outside India.

The Competition Act takes a threshold of assets and turnover as the judging criterion for a combination to be covered under the act. This will be troublesome in capital-intensive industries such as oil and gas, where even an inconsequential merger may be covered by the act. The threshold criterion could create a deadlock because once an entity or group grows to a size of the prescribed limits, all combinations - however small - will be covered by the regulations.

Progressive or regressive norms
The Competition Act intends to establish merger review and control procedures designed to prevent anti-competitive combinations. The recent amendments have significantly changed the review process and stirred up global controversy. Much has been articulated about the negative impact on M&A activity in India. It is pertinent to examine and evaluate the obstacles.

Implications of mandatory notification
Under the originally enacted Competition Act 2002, the reporting of a combination was optional. However, the act now mandates notification within 30 days of the decision of the parties' boards of directors or of execution of any agreement or other document for effecting the combination. The terms 'agreement' and 'other document' are not defined. The general industry perception is that a memorandum of understanding or a letter of intent will qualify as an 'agreement'. However, these are generally executed to spell out a basic understanding among the transacting parties and to enable the acquirer to conduct due diligence, based on which further negotiations are carried out. Going forward, execution of such a document shall trigger merger filings. This will increase compliance costs at a premature stage when it is uncertain whether the transaction will close. It will also add to the bulk of notification applications submitted to the Competition Commission. It remains to be seen whether the Competition Commission will have adequate internal capacity to handle and dispose of such applications efficiently. If it does not have the resources, the delay will potentially have a cascading effect and affect the ability of parties to close on time. Therefore, it would be prudent to insert a clause in all future transaction documents stating that closing will be subject to any prior regulatory clearance that may be required from the Competition Commission.

Implications of 210-day waiting period and thresholds
The Competition Act now provides for a post-filing review period of 210 days, during which the merger cannot be consummated and within which the Competition Commission is required to pass its order with respect to the notice received. If the commission fails to pass an order within the time limit, the proposed combination will be deemed to be approved. While the principles behind the review process are similar to those applied in many other countries (including the Hart-Scott-Rodino pre-merger filing and review process in the United States), fears abound about both the length and scope of the process. The duration is longer than that established in most countries and may prove burdensome. Clearly, timing is critical in any M&A transaction. Factoring this in, the draft regulations envisage that the Competition Commission may form an initial opinion within 30 to 60 days of receipt of notice and not necessarily wait for the expiry of 210 days, particularly when it is of the *prima facie* opinion that the combination will not have an appreciable effect on competition.

The 210-day period applies in case of cross-border transactions outside India where one of the contracting parties has a substantial presence in India. Regardless of the size of the transaction, notification is required where the combined asset value or turnover in India exceeds a certain value. This means that it is mandatory for a foreign company with assets of more than $500 million that has a subsidiary or joint venture in

India with a substantial investment (above $125 million) to notify the Competition Commission before acquiring a company outside India. Basing the threshold on combined value only where there is no economic consequence in India seems rather restrictive for the transacting parties, because there is no rationale behind subjecting the parties to the merger review and making them incur substantial costs triggered by the notification. For example, a UK manufacturer with large operations in India would have to notify the Competition Commission of the acquisition of a small domestic operation within the United Kingdom despite the fact that the transaction would have zero economic effect on its Indian operations. Not only this, the company would have to wait for the Competition Commission's approval for a period that could extend to 210 days before the deal could become effective. This waiting period may dissuade foreign investors from investing in India and force them to seek other destinations.

The threshold limits are unrealistic. Many transactions not affecting competition in India will require Competition Commission approval for the sole reason that one of the parties involved is big enough to satisfy the thresholds. For instance, the Competition Act provides that prior Competition Commission approval is required to give effect to an acquisition where the combined assets of the acquirer and the target are more than $250 million or where the turnover of the parties exceeds $750 million. Large Indian conglomerates will have to wait for the mandatory 210 days in order to be able to acquire a small company that has no significant presence in the market where the acquirer alone meets the minimum combined size that requires Competition Commission approval.

Filing costs and process
The regulations prescribe certain exhaustive forms through which the Competition Commission is to be notified. However, there is no clarity about how pieces of information which may be classified as confidential and difficult to disclose will be addressed. Once privileged information is in the public domain, competitors can keep track of significant M&A transactions that are underway, which may jeopardize successful closure. Moreover, the fees payable are staggering. The notice must be accompanied by a fee of approximately $50,000, which may increase to $100,000 in certain cases. Further, the Competition Commission will issue a show-cause notice if it is of a *prima facie* opinion that the combination is likely to cause an appreciable adverse effect on competition in India. A fee of $40,000 is to be filed along with the response to the show-cause notice. In addition, the Competition Commission has the power to compel parties to publish the details of a proposed combination to enable any person from the public to raise objections to such combination. Such publication burdens parties with an additional sum of $40,000. Clearly, the filing fees involved are exorbitant and need to be revised.

Competition Commission's extra-territorial powers
Section 32 of the Competition Act explicitly allows the Competition Commission to examine a combination already in effect outside India and pass orders against it provided that it has an 'appreciable adverse effect' on competition in India. This power is extremely wide and allows the Competition Commission to extend its jurisdiction beyond the Indian shores and declare any qualifying foreign merger or acquisition as void. An 'adverse effect' on competition means anything that reduces or diminishes competition in the market. When determining whether a combination has an adverse effect on competition in India, the Competition Commission may consider the likelihood of the combination to:

- create barriers to new entrants in the relevant market;
- drive existing competitors out of the market;
- create a monopoly that hampers improvements in production or distribution of goods or provision of services; and
- affect the interests of consumers in any other way.

However, it remains to be seen how the Indian jurisprudence will develop the concept of a combination having an 'adverse effect on competition'.

Exemptions

The regulations exempt 13 transactions from the purview of the combination. As an example, under Section 5(2)(i), no notification is required for the acquisition of shares of up to 15%, provided that the acquisition is for investment purposes only and the acquirer does not gain control over either the affairs or the management of the target. However, while the regulations state that the 13 transactions will have no adverse effects on competition in India, they do not expressly exempt the transactions from mandatory notification requirements under the Competition Act. In other words, the net effect is that parties are required to report even exempted transactions and wait for the stipulated period of 210 days. The regulations are in draft form at the moment and are open for comment by public and industrial groups. It is crucial that industry feedback and concerns be addressed; otherwise the Competition Commission's purpose of promoting competition will be significantly diluted.

Comment

The question is whether India in fact needs a mandatory merger notification regime. What was the rationale behind eliminating voluntary disclosures? At present, many types of combination are brought within the mandatory notification process. The regulators and the Competition Commission need to ensure that the regulations are implemented only after all the gaps are filled. Critics of the merger control provisions have been urging the Competition Commission to implement the new law in two stages - a volitional notification for a predetermined time period should precede the second mandatory notification process. The existing legal regime will subject a large number of mergers, with little or no connection to India, to Competition Commission review. In this context, it is imperative and critical for the Competition Commission to be sensitive to the concerns of interested parties and ensure that combinations are regulated in a manner that is conducive to national growth, while remembering that competition law is a necessity in free market economies to safeguard the interests of consumers and ensure freedom of trade. Undoubtedly, the Competition Act will play a significant role in the development of the Indian economy. Indian markets cannot function in isolation; they need to align themselves with their investors in an increasingly flat world.

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