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GREY MATTERS

Financial Investors and the Indian Merger Control Regime

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A. Background

The Indian merger control regime was introduced nearly a decade ago in June 2011. The Competition Commission of India (the ***CCI***) has since then established an efficient merger review system and has cleared approximately 800 transactions to date without blocking any transaction so far. The CCI's merger control regulations have also been amended on several occasions in the last decade to bring it in line with the CCI's decisional practice. In doing so, the CCI has often adopted a collaborative approach by way of which they often seek public (or informal) consultations and invite comments from stakeholders prior to giving effect to the amendments.

Under the Indian merger control regime, a merger filing is required to be made in case of acquisitions or mergers exceeding certain assets and turnover based jurisdictional thresholds prescribed under the Competition Act, 2002 (the ***Act***). In carrying out the notifiability analysis under the Act, the first step is for the parties to assess whether the proposed acquisition or merger could potentially avail of any prescribed exemptions.

The only fool-proof exemption available under the Indian merger control is the *de minimis* or "target" exemption. This exemption, unlike the others (some of which we discuss below), is based purely on a numerical threshold and without any element of subjectivity. This exemption is available in case of small targets having a "*de minimis*" asset or turnover base in India.

However, apart from the *de minimis* exemption, the scope of other exemptions (as provided under Schedule I of the merger control regulations) remains ambiguous even after nearly a decade of the implementation of the regime. One such exemption, and often the most discussed, is the "financial investor" exemption. In theory, this exemption is meant to exempt minority non-controlling investments. However, the ambiguity in the language coupled with the CCI's decisional practice means that, in practice, the applicability of this exemption is often riddled with uncertainty. As a result,

even insignificant minority investments end up having to be notified to the CCI.

This note discusses the provisions under the Indian merger control regime that are relevant for financial investors (including sovereign wealth funds, private equity investors and pension funds) in determining whether a proposed acquisition is likely to trigger a merger filing in India and, if so, the level of information they might be required to disclose to the CCI as part of such merger filing.

B. The "financial investor" exemption

In simple terms, the merger regulations provide that acquisitions of shares and/or voting rights of less than 25% that are made either "solely as an investment" or in the "ordinary course of business" are exempt from making a merger filing as long as such an acquisition does not lead to acquisition of "control" over the target entity. This is the so-called "financial investor" exemption. Alas, if only the interpretation and practical application of this exemption was so straightforward!

Tracing back the origin of this exemption, when the merger regime was made effective, the threshold referred to in this exemption was 15% (and not 25%). Within a year this threshold was increased from 15% to 25%, in line with the Indian Takeover Code (which applies to listed entities and works off the 25% threshold). The relief, however, was short-lived as what was given by the one hand was gradually and quite literally taken away by the other over the next few years.

In 2014, the CCI through one of its decisions took the view that the financial investor exemption ought not to apply in case of acquisitions where the acquirer and target have pre-existing horizontal overlaps or vertical relationships. This was the first time that the CCI had officially recognized that additional conditions were to be "read into" the exemption to assess its applicability.

Then in 2016, an explanation was added with a view to clarifying the scope of this exemption. This explanation provided that an acquisition of less than 10% shall be treated as being made solely as an investment as long as the acquirer: (i) only has the ability to exercise rights that are exercisable by the ordinary shareholders to the extent of their shareholding; (ii) does not have the right or intention to nominate a director on the board of directors of the target; and (iii) does not intend to participate in the target's affairs or management.

Whilst the explanation clarified the position with respect to investments below 10% to some extent, it raised, possibly inadvertently, several other issues as discussed below:

(a) It raised a significant question with respect to the availability of the financial investor exemption for acquisitions of stakes of more than 10% but less than 25%. Does the addition of the explanation now mean that acquisitions of more than 10% but less than 25% (even if they satisfy the three conditions mentioned in the explanation) cannot avail of the exemption? In other words, is the financial investor exemption now available only in case of acquisitions of less than 10%? If that is indeed the case, wouldn't a better (and less round about) way have been for the threshold in the exemption itself to be amended rather than add an "explanation"?

(b) The explanation does not deal with cases where the parties may have pre-existing horizontal or vertical relationships. Does

this mean that the CCI's previous decisional practice which raised a question mark on the availability of the financial investor exemption to such cases now stands overruled? Assuming that the decisional practice still applies, would it be an issue only if the pre-existing investment is also one that cannot be classified as being "solely as an investment" or would any prior investment in a horizontally or vertically overlapping entity automatically disentitle a subsequent investment even if it is "solely as an investment"?

(c) There is no specific exemption with respect to further or bolt-on investments by an existing shareholder within the 25% threshold. For instance, the merger control regulations provide a specific exemption for further acquisitions by an existing shareholder holding between 25% to 50% that does not result in the acquisition of sole or joint control. The absence of a similar exemption for further acquisitions of up to 25% raises a question over whether "creeping acquisitions" within the 25% threshold without acquiring any additional controlling rights would trigger a merger filing?

(d) The interpretation of "ordinary course of business" remains unclear. In the absence of a statutory explanation for this term, it is not clear whether this refers to the ordinary course of business for the acquirer or for the industry in which the target operates. The other question is whether the presence of any existing investments in a horizontally or vertically overlapping entity will disentitle an acquirer from availing of this exemption for subsequent investments?

Prior to this explanation, the only decisional practice that was relevant in ascertaining the applicability of the financial investor exemption was in relation to the interpretation of the term "control". Whilst that continues to be the case even now, the explanation raises more questions than it answers. The financial investor exemption has, as a result, become highly subjective in its application, with its scope having been significantly diluted by the decisional practice of, and the explanation issued by, the CCI over the years. The net of portfolio investments made by any sophisticated financial investor in an economy such as India's is typically spread far and wide and the conditions attached to the availability of the financial investor exemption often makes it difficult to provide the level of comfort that a sophisticated financial investor would ordinarily require to take a view that a merger filing is not triggered.

It is possible to engage with the CCI by way of pre-filing consultations on interpretational issues. However, whilst such pre-filing consultations are encouraged in theory, it is often the case that the feedback received during such consultations is ambiguous or less than satisfactory.

Once the notifiability assessment is completed and given the uncertainties highlighted above, the conclusion more often than not is to err on the side of caution and make a merger filing. The next important question is the type of merger filing that can be made (and whether the "green channel" route can be availed of) and the scope of disclosures required from financial investors in case of a short form filing in Form I.

C. Green channel

The green channel route is one of the most positive recent developments in the Indian merger control regime. It was introduced by

the CCI in August 2019 for transactions where the acquirer and the target on a consolidated basis do not exhibit horizontal overlaps or vertical or complementary relationships. The good news in this regard is that the CCI has allowed a *de minimis* threshold below which it will be deemed that there is no overlap or relationship. For this *de minimis* to be applicable, the parties to a proposed transaction (and their group entities / joint venture entities / any other entity in which they directly or indirectly hold shares or control) should: (a) have a shareholding of less than 10%; (b) no right or ability to exercise any right (or an advantage of a commercial nature) that is not available to an ordinary shareholder; and (c) no right or ability to nominate a director or observer in another enterprise, in businesses that could be considered as horizontally overlapping or vertically or complementarily related to each other.

Under the green channel, the parties have the discretion to consummate the acquisition simply by making a short form filing with, and by providing a declaration to, the CCI. The advantage of a filing under the green channel route, and a big one at that, is that a filing made under this route is deemed to have been approved immediately upon receipt of an acknowledgment of the filing having been made. Such filings are not processed or reviewed by the CCI and as a result the waiting period for receiving clearance is eliminated. In addition to saving between 4 – 8 weeks in a best case scenario, the greater level of deal certainty and timing that this route provides the parties is a welcome development.

D. Scope of disclosure in Form I filings

Along with the introduction of the green channel route, the CCI also amended the format of Form I (i.e. the short form filing). The CCI subsequently also revised its guidance notes, clarifying the scope of the information required to be provided in the revised Form I. As a result of these amendments, the scope of disclosures required to be made by the notifying parties has changed in certain aspects, as discussed below:

(a) Disclosures re "affiliates": The parties to a proposed transaction are now required to disclose details about their "affiliates", which was not the case under the previous Form I (or even under the revised Form I!).

Affiliates have been sweepingly defined in the revised guidance notes to include all entities where the parties to a proposed transaction (or their group entities / joint venture entities) have a shareholding of 10% or more or the right or ability to exercise any right (even an advantage of a commercial nature) that is not available to an ordinary shareholder or the right or ability to nominate a director or observer in another enterprise.

This requirement in relation to disclosure of details about affiliates was only brought about in the revised guidance notes. Earlier, corporate disclosures by the notifying parties were relatively simpler as they were only required to submit information related to their "group" entities, which had a higher threshold. Now, with the introduction of the revised guidance notes, notifying parties have to consider a much broader set of entities in respect of which information needs to be provided to the CCI and which need to be taken into account for the competition assessment. In practice, we often find institutional financial investors struggling to identify

affiliates on the basis of the subjective elements of the definition, i.e. the nature of the contractual rights.

It is also relevant to note that when it comes to disclosures, the CCI is likely to disregard any internal organisational structures that financial investors might have put in place – such as different public and private arms, or separate divisions, each with its own investment mandate and with Chinese walls in place. The disclosures will need to be made on the basis of the prescribed definitions which unfortunately do not provide any leeway to take into account these internal structures. Having said that, with the definition of affiliates setting the shareholding threshold at 10%, the disclosure norms for acquirers with public trading arms (that invest in publicly listed companies) may get slightly liberalized since their public investments are unlikely to meet any of the affiliate thresholds.

Earlier, prior to the revised guidance notes being issued, bespoke exemptions had to be sought from the CCI from disclosing certain *de minimis* investments including investments in listed entities. Even now, it could be possible to have discussions with the case officers to try and reduce the scope of disclosures to be made in a merger filing. However, obtaining such bespoke exemptions is likely to be an uphill task due to a majority of the case officers wanting to "play by the book", with the flexibility provided earlier in the absence of any detailed guidance having now been taken away.

(b) Disclosures re acquired rights: The scope of disclosures with respect to the rights proposed to be acquired has also now increased. Earlier, the typical disclosures about such rights would be largely restricted to veto / affirmative rights, board seats and high-level information rights in the target. However, after the issue of the guidance notes, the notifying parties now also need to disclose details such as any other right or advantage of a commercial nature being acquired, any right or ability to appoint an observer and information sharing rights in any other entity.

The scope of disclosures in this regard has possibly been increased in view of minority acquisitions that are coupled with "strategic" rights that, in line with the CCI's decisional practice, are likely to be viewed as providing the acquirer with a degree of influence over the affairs and management of the target enterprise.

(c) Disclosures re relevant markets: Whilst assessing relevant markets, the revised Form I (along with the guidance notes) now require the parties to provide details in relation to *all plausible alternative relevant markets* (including explanations for accepting or rejecting a particular market).

These changes highlight a greater need for financial investors to now conduct a holistic competitive assessment of their existing investments whilst making merger filings. The CCI could also potentially require investors to volunteer remedies in case of a scenario where an acquisition could potentially result in an appreciable adverse effect on competition in India (including any that could arise out of common ownership in two or more competitors).

E. Confidentiality

A legitimate concern for financial investors could be with respect to the confidentiality

of the commercially sensitive information they are required to disclose to the CCI whilst notifying their proposed investments.

In this regard, the parties can claim confidentiality over all the commercially sensitive information that they disclose in their filings (although the final grant of confidential treatment rests with the CCI). Moreover, the CCI has so far maintained a better track record of granting and maintaining confidentiality of commercially sensitive information as compared to other Government regulators.

F. Better days ahead?

Whilst addressing a conference on 4 December 2020, the CCI's Chairperson announced that they are planning to launch a study to understand the trends and patterns of common ownership by private equity investors across various sectors. This study would also focus on the rights that financial investors receive as a result of their investments and whether such rights can translate into their ability to influence the decisions of the firm. Interestingly, a couple of years ago, an ex-Chairperson of the CCI, in an interview with a news channel, had also expressed concerns over the "strategic investments" by private equity investors in companies involved in the same sector.

It is worth noting that in 2018, whilst dismissing an allegation of anti-competitive conduct by two leading cab-aggregators in India owing to the presence of a common institutional investor between them, the CCI observed that there was no evidence at the time to suggest that anti-competitive effects had played out in the market due to such common ownership.

However, in view of the increasing trend of minority acquisitions by financial investors (which are viewed as being "non-controlling" by such investors, but are typically coupled with "strategic" rights as the CCI's decisional practice has shown these to be), the CCI now perhaps feels the need to understand their ownership patterns better. This will hopefully lead to better competitive assessment of transactions involving such investors and could potentially also have an effect on the scope and level of information required to be disclosed by such investors to the CCI.

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