



Comments on Discussion Paper on “Brightline Tests for Acquisition of Control under SEBI Takeover Regulations”

1. Background

1.1. The securities market regulator, Securities and Exchange Board of India (SEBI) has undertaken a commendable task of reviewing the existing regulations around change of ‘control’ of a company and has laid out potential positive and negative consequences and qualitative and quantitative approaches to regulation. It has sought public comments on most feasible approach to regulation.

1.2. CUTS International (www.cuts-international.org) is an independent non-profit non-government economic policy research, advocacy and capacity building organisation with keen understanding of financial sector regulation. CUTS’ observations on the discussion paper are set out below.

2. Indicative Positive list

2.1. While the discussion paper highlights that the Insurance Laws (Amendment) Act, 2015 defines control in a manner similar to Takeover Code, it does not delve deep into the tests prescribed under insurance guidelines to determine control.

2.2. The guidelines issued by the Insurance Regulatory and Development Authority of India (IRDA) on Indian Owned and Controlled¹ provide that an insurance company will be deemed to be under Indian control when:

- i) Majority of the directors excluding independent directors are nominated by the Indian promoter(s)/ Indian investor (s);
- ii) Appointment of key management person including Chief Executive Officer / Managing Director /Principal officer are through the Board of Directors or by the Indian promoter (s) and / or Indian investor (s). However, Key Management Person (s) excluding CEO may be nominated by the foreign investor provided that the appointment of such Key Management person is approved by the Board of Directors, wherein majority of the directors

¹ IRDA guidelines dated 19 October 2015, available at <https://www.irda.gov.in/admincms/cms/whatsNew/Layout.aspx?page=PageNo2644&flag=1>

excluding independent directors are the nominees of Indian promoter (s) / Indian investor (s).

iii) The control over significant policies of the insurance company should be exercised by the Board, provided that the constitution of the Board is compliant with para (i) above.

iv) Where the Chairman of the Board is having a casting vote, such Chairman should be nominated by the Indian promoter (s) and / or Indian investor (s).

v) Quorum shall mean and include presence of majority of the Indian directors irrespective of whether a foreign investor's nominee is present or not. The right of a Foreign Investor's nominee to constitute valid quorum for meetings is only a protective right and to that extent would not amount to control [within the meaning of Explanation to Clause (7A) (b)] as long as the presence of nominees of Indian Promoter (s) / Investor (s) are also mandatorily taken into account for the purposes of quorum.

2.3. While the discussion paper lists out protective rights that do not amount to control, and in effect provides a negative list of exclusions, it does not provides a positive list of inclusions, like the IRDA guidelines, wherein control is presumed.

2.4. Perhaps, a list of positive rights be released which could tantamount to control, so that the scope for confusion (and consequent discretion) is reduced, about what could amount to control, in addition to the proposed protective rights that explain what does not amount to control. This is also necessary as concerns have been raised about anything that is not covered under the protective rights might be deemed to be control.²

3. Management certification and ex-post review

3.1. The IRDA Guidelines also require a management declaration certifying Indian ownership and control. Similar ex-post requirements could be designed under the Takeover Code with stringent provisions on submission of false declaration.

² "it is quite likely that the list of protective rights that SEBI seeks to lay down, though illustrative, will be read literally by regulators as well as practitioners, who may tend to think that all that is not covered by the illustrative list may be falling on the other side of the bright line, and therefore, may be construed as control.", Vinod Kothari, *Choosing between a blurred line and a bright line: SEBI proposes an objective test for control*, 21 March 2016, Indian corplaw blog, <http://indiacorplaw.blogspot.in/2016/03/choosing-between-blurred-line-and.html>

3.2. Such ex-post requirements reduce the necessity to undertake ex-ante reviews and thus do not act as unnecessary barriers to business decisions and consequent growth and development of commerce. The transaction is not delayed and hence the opportunity costs of transactions are reduced. Such ex-post requirements also repose faith in transacting entities, which as a result of such faith, would be under an obligation to behave responsibly, and declare the correct nature of transaction.

3.3. However, successful enforcement of such ex-post requirements would require building adequate technical and human capacity and ensuring sufficient monitoring and supervision skills, for which financial and knowledge resources will be required to be invested.

4. Burden of proof

4.1. The discussion paper already lists down a list of protective rights which would usually not amount to change of control. In the alternative, it proposes introducing a numerical threshold of acquisition of minimum voting rights to presume control. However, the discussion paper acknowledges that none of these suggestions are fool-proof.

4.2. Consequently, the regulator might adopt both the tests to determine control and attribute presumption of control, or the lack thereof, depending on the structure of transaction.

4.3. For instance, in case the transaction has protective rights, the presumption of control not being transferred would be made and the burden of proof to establish change of control would be on the party/ agency alleging the same.

4.4. Similarly, in case the transaction breaches the numerical threshold, the presumption of transfer of control would be made, and burden of proving no change in control will be on the parties to transaction.
