

## COMPARATIVE TAKEOVER REGULATION AND THE CONCEPT OF ‘CONTROL’

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The mandatory bid rule (MBR), one of the basic tenets of takeover regulation, obligates an acquirer who obtains ‘control’ over a target company to make an offer to acquire the shares of the remaining shareholders. What amounts to ‘control’ is far from clear; some jurisdictions follow a quantitative approach based on a specific shareholding threshold such as 30% voting rights, while others follow a qualitative approach through a subjective determination based on several factors, such as the specific rights available to an acquirer under a shareholders’ agreement or the constitutional documents of a target.

The goal of this article is to consider the merits and demerits of these approaches. It seeks to do so by examining various models adopted in jurisdictions for pegging ‘control’ so as to invoke the MBR. It delves into the regulatory experience in India as that jurisdiction not only adopts a combined approach (taking into account both the quantitative and qualitative tests for control), but has also been subject to a great deal of controversy and litigation in recent years that have helped tease out the jurisprudential contours of the concept. It concludes with a normative assessment that points towards partial harmonisation.

### I. INTRODUCTION

The idea of corporate control has occupied the attention of corporate law scholars for some time now. Beginning with the relationship between ownership and control,<sup>1</sup> the discourse has transcended into the realm of corporate governance (observed through the lens of agency problems)<sup>2</sup> and also to the market for corporate control.<sup>3</sup> While the philosophical and theoretical underpinnings of the concept continue to hold considerable sway in corporate jurisprudence, the notion of ‘control’ also carries a

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<sup>1</sup> Adolf A Berle & Gardiner C Means, *The Modern Corporation and Private Property* (New York: Harcourt, Brace & World, Inc, 1968).

<sup>2</sup> Michael C Jensen & William H Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” (1976) 3 *Journal of Financial Economics* 305; Reinier Kraakman *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 2004).

<sup>3</sup> Henry G Manne, “Mergers and the Market for Corporate Control” (1965) 73 *Journal of Political Economy* 110; Frank H Easterbrook & Daniel R Fischel, “The Proper Role of a Target’s Management in Responding to a Tender Offer” (1981) 94 *Harv L Rev* 1161.

concrete application under takeover regulation as the means by which one company (the acquirer) acquires another company (the target).<sup>4</sup>

A more specific tenet of takeover regulation is that of the mandatory bid rule (MBR), which operates in most jurisdictions.<sup>5</sup> It obligates acquirers who obtain effective control over a target to make an offer to the remaining shareholders of the target to acquire their shares. Since the MBR is based on acquiring 'control' in the target, its trigger can be associated with a number of factors that vary by jurisdiction. It can be premised either on a (i) bright-line test based on a specific shareholding threshold such as 30% voting rights (the quantitative approach) or (ii) subjective determination of control based on the shareholding pattern of the target, specific rights available to the acquirer under a shareholders' agreement or the constitutional documents of the target and other relevant factors (the qualitative approach). While the quantitative approach operates in pursuit of *de jure* control (or at least a proxy thereof) as a matter of legal principle, the qualitative approach aims at *de facto* control that is a fact-based determination (or at least a mixed question of law and fact).

Most jurisdictions (*eg* the European Union (EU), Singapore and Hong Kong) have opted for the quantitative approach, which not only introduces certainty, but also the required ease of interpretation and implementation both for regulators and market participants. Other jurisdictions (principally Brazil, India, Indonesia and Spain) have instead opted for the qualitative approach that enables the courts and regulators to make a determination on the basis of the facts and circumstances of individual cases. This would ensure that persons acquiring shares are unable to circumvent the MBR by structuring their transactions through ingenious methods to stay outside the purview of the rule.

The goal of this article is to consider the merits and demerits of the quantitative and qualitative approaches. It seeks to do so by examining various models adopted in jurisdictions for pegging 'control' so as to invoke the MBR. Evidently, the models are rather varied in nature. Although there are common threads among the jurisdictions that follow the quantitative approach, the threshold limits for the trigger swing wildly in shareholding percentage terms. Even among jurisdictions that follow the qualitative approach, the nature and scope of the definition of 'control' are vastly different. While some developments point towards efforts to harmonise the definition of 'control' for the purposes of the MBR, each jurisdiction follows its own strategy to define the 'control' threshold.

The elusiveness of a coherent approach towards harmonisation is somewhat perplexing given the increasing incidence of cross-border takeovers, where a single transaction involving the acquisition of one company might have implications in respect of group companies or subsidiaries listed in several jurisdictions across the

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<sup>4</sup> In this article, the expression 'controller' is used interchangeably with that of 'acquirer', principally to denote someone who has already acquired control over a target.

<sup>5</sup> The only major jurisdiction that has not adopted the MBR is the United States (US), although certain states (principally Pennsylvania and Maine) have prescribed rules that carry a similar effect to the MBR. Jeremy Grant, Tom Kirchmaier & Jodie A Kirshner, "Financial Tunnelling and the Mandatory Bid Rule" (2009) 10 *European Business Organization Law Review* 233 at 236-237; John Armour & David A Skeel, Jr, "Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of US and UK Takeover Regulation" (2007) 95 *Geo LJ* 1727 at 1734; Marco Ventoruzzo, "Takeover Regulation as a Wolf in Sheep's Clothing: Taking UK Rules to Continental Europe" (2008) 11 *University of Pennsylvania Journal of Business Law* 135 at 136 [Ventoruzzo, "Takeover Regulation"].

world whose control may also be altered as a result. Surely, it is not a desirable state of affairs if the same transaction receives widely differing treatments depending on the jurisdiction involved. At the same time, it is not prudent to lose sight of the fact that a fluid concept such as ‘control’ is incapable of universal definition, and must necessarily take into consideration local factors that may be at play, such as corporate structures, governance norms, the state of legal regulation and the scope of the market for corporate control. While it is not the goal of this article to advocate a uniform definition of ‘control’ against the backdrop of the MBR, this survey of various models aims to capture the concept of ‘control’ and thus distil some key principles that could be assimilated into various jurisdictions. This will restore the necessary balance that not only brings about the required uniformity and certainty to facilitate cross-border takeovers that may be value-enhancing in nature, but also adequately protects the minority shareholders of the target who may be affected by the acquisition of, or change in, its control.

Part II of this article introduces the various shades of control and discusses the use of the ‘control’ concept for the MBR, which is principally aimed at providing equality of treatment to the minority shareholders of the target. Part III discusses the quantitative approach to control, and Part IV the qualitative approach. In each case, various sub-models are considered with examples from relevant jurisdictions. Part V delves into the regulatory experience in India in respect of takeovers as that jurisdiction not only adopts a combined approach (taking into account both the quantitative and qualitative tests for control), but has also been subject to a great deal of controversy and litigation over the last decade that have helped tease out the jurisprudential contours of the concept. Part VI sets out some normative observations containing the lessons from the survey in this article, and Part VII concludes.

## II. ‘CONTROL’ AND ITS RELEVANCE FOR THE MBR

### A. *The Various Shades of Control*

Despite its elusiveness, ‘control’ is capable of being dissected in various ways within the sphere of corporate law.<sup>6</sup> The board of directors is considered to be the “immediate decision-making authority”, due to which control becomes generally associated with the influence or constraint exercised on the board, and thereby the managers functioning under the delegated authority of the board.<sup>7</sup> Shareholders usually exercise control that accompanies their ownership of shares.<sup>8</sup> But this is not necessarily

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<sup>6</sup> But, before attempting that, it would be useful to consider a more generic concept of control, which Herman finds to be “...a term used in many disciplines as well as in common parlance. It relates to power—the capacity to initiate, constrain, circumscribe, or terminate action, either directly or by influence exercised on those with immediate decision-making authority.” Edward S Herman, *Corporate Control, Corporate Power: A Twentieth Century Fund Study* (Cambridge: Cambridge University Press, 1981) at 17.

<sup>7</sup> Herman further notes: “Because the legal power to control corporate affairs rests with the board of directors (and ultimately the stockholders), analysis of the dynamics of the board must be a linchpin of any analysis of corporate control.” *Ibid* at 30.

<sup>8</sup> Adolf A Berle, Jr, “‘Control’ in Corporate Law” (1958) 58 Colum L Rev 1212 at 1213 (observing that “[c]ontrol is a function of the ownership of voting stock”).

the case, as control may exist in a form that is either partially or completely dissociated from ownership of voting shares in a company.

In order to address these issues in a more concrete setting, the concept of control is categorised along various shades of a spectrum.<sup>9</sup>

**Table 1.**  
Shades of Control.

Type of Control	Controller's Shareholding	Rights of Controller
Absolute or total	100% voting rights	Flexibility to manage the company in any manner the controller deems fit
Special or super-majority	75% or two-thirds voting rights	Ensure passage of significant decisions that require a special resolution
Legal or statutory	More than 50% voting rights	<i>De jure</i> control, that enables the appointment and removal of directors
<i>De facto</i>	Less than 50% voting rights	The ability to control the composition of the board due to the diffused nature of the remaining shareholding in the target resulting in apathy and collective action problems among minority shareholders
Negative	More than 25% or one-third voting rights	The ability to block special resolutions proposed by a controller <sup>10</sup>
Management	No controlling shareholding	Control vests with the management in the absence of a significant shareholder

Of the above, *de facto* control may be supplemented further through other means. For instance, a shareholder with less than a majority of voting rights may acquire rights under the constitutional documents of the target or a shareholders' agreement (entered into with all or a significant majority of the target's shareholders) that confer upon it the right to nominate or appoint a certain number of the target's directors (including possibly a majority of them). Further, such a shareholder may obtain the rights to nominate key managerial personnel or initiate policy proposals. These rights further embellish the *de facto* control held by virtue of voting shareholding (albeit less than a majority). Similarly, although negative control is generally available through exercise of voting rights (by blocking a special majority), it can also be exercised through other means. For instance, where an exercise of veto rights under

<sup>9</sup> For similar and other categorisations of control, see Wan Wai Yee & Umakanth Varottil, *Mergers & Acquisitions in Singapore: Law & Practice* (Singapore: LexisNexis, 2013) at paras 2.61-2.67; Berle & Means, *supra* note 1 at 67-84; Laurence Rabinowitz, ed, *Weinberg and Blank on Take-overs and Mergers*, 5th ed, (London: Sweet & Maxwell, 1989 and Supplement, 2008) at para 1-2003. This categorisation is framed largely in the context of Commonwealth countries such as the UK, Singapore and India and could very well operate differently in other jurisdictions, particularly in the civil law world.

<sup>10</sup> A variant of negative control is when two or more shareholders jointly hold up to 50%, but no individual constituent holds more than 25%. In such a case, it is difficult for individual constituent shareholders to control the board or initiate key changes in the company without the concurrence of the other constituents. In other words, collective action problems may operate in a more focused manner.

corporate law requires more than 25% voting rights, a holder of 20% voting rights may nonetheless be in a position to exercise them contractually if those affirmative or veto rights are contained either in the constitutional documents of the target or in a shareholders' agreement.

While the shades of control discussed above are relevant under corporate law and governance, yet another concept is relevant solely for the purposes of takeover regulation, which is the subject matter of this article. The concept of 'effective control' is introduced by regulation as a proxy for *de facto* control. Under takeover regulations promulgated in different jurisdictions, effective control is defined by utilising the quantitative approach or the qualitative approach or a combination of the two. Upon achieving effective control, the MBR is triggered thereby obligating an acquirer to make a public offer to acquire the shares of the remaining shareholders in the target. The quest for the appropriate concept of control for takeover regulation will necessarily be driven by the underlying rationale governing the MBR.

### B. The Implications of 'Control' for the MBR

The rationale for the MBR was articulated in corporate law literature even before it was accepted from a statutory or regulatory standpoint.<sup>11</sup> This principle was also recognised in early decisions of the US courts imposing certain duties on selling controlling shareholders.<sup>12</sup> However, these exhortations have not found much sway in the US context where the MBR has never really found its place.<sup>13</sup>

Elsewhere, however, the storyline is different. The MBR has rather become the mainstay of takeover regulation. It was first introduced in the City Code<sup>14</sup> in the UK in 1972.<sup>15</sup> Since then, the MBR has become omnipresent in takeover regulation in most leading jurisdictions, both in the common law and civil law domains. The rule has been well entrenched in Asia, including in Singapore,<sup>16</sup> Malaysia,<sup>17</sup> Hong Kong,<sup>18</sup> and India.<sup>19</sup> It has also achieved tremendous popularity among regulators in continental Europe who have legislated it into their own legal systems, particularly because it is an integral part of the EU Takeover Directive that was given effect to

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<sup>11</sup> William D Andrews, "The Stockholder's Right to Equal Opportunity in the Sale of Shares" (1965) 78 Harv L Rev 505 at 515-56.

<sup>12</sup> *Perlman v Feldmann*, 219 F 2d 173 (2d Cir 1955). See Andrews, *supra* note 11 at 506-8.

<sup>13</sup> See Ronald J Gilson & Jeffrey N Gordon, "Controlling Shareholders" (2003) 152 U Pa L Rev 785 at 793-794.

<sup>14</sup> The Panel on Takeovers and Mergers, *The City Code on Takeovers and Mergers*, London: The Panel on Takeovers and Mergers, 2013 [*City Code*].

<sup>15</sup> Ventrizzo, "Takeover Regulation", *supra* note 5 at 145.

<sup>16</sup> Securities Industry Council (SIC), *Singapore Code on Take-overs and Mergers*, Singapore: SIC, 2012, r 14 [*Singapore Code*]. The current version came into effect on 9 April 2012.

<sup>17</sup> *Capital Markets and Services Act 2007*, Act 671, s 218(2) (Malaysia) read with Securities Commission, *Malaysian Code on Take-overs and Mergers 2010*, Kuala Lumpur: Securities Commission, 2010.

<sup>18</sup> Securities and Futures Commission (SFC), *The Codes on Takeovers and Mergers and Share Repurchases*, Hong Kong: SFC, 2010, r 26.

<sup>19</sup> Securities and Exchange Board of India (SEBI), *Securities and Exchange Board of India (SEBI) (Substantial Acquisition of Shares and Takeovers) Regulations, 2011*, Mumbai: SEBI, 2011, regs 3(1), 4 [*SEBI Takeover Regulations*].

after years of debate.<sup>20</sup> While Australia has not expressly adopted the mandatory offer rule, acquirers are not permitted to acquire more than 20% shares in a company without following certain procedures, one of which is a takeover offer made to acquire the shares of all remaining shareholders.<sup>21</sup>

The popularity of the mandatory offer rule is supported by its strong rationale.<sup>22</sup> First, its genesis within the framework of the equal opportunity rule<sup>23</sup> suggests that shareholders who sell their shares to an acquirer that enables it to cross the prescribed thresholds must share their private benefits of control with all other shareholders.

Second, the mandatory offer rule operates to provide an avenue for exit to minority shareholders in the event of a change in control of the target. This is necessary because a bidder may acquire *de facto* control over the company without acquiring legal control and may thereby determine the management and policies of the target. In other words, the bidder is able to acquire control over the target without necessarily incurring the financial costs of acquiring all of the shares of the target. Hence, there is a strong justification to provide exit opportunities for minority shareholders, especially since there is no assurance that they will be able to obtain an exit on favourable terms following the takeover if the new controller's policies for the company are considered by the minority to be adverse to their interests.

The strong rationale for the MBR is met with some critique as well. This rule may act as an impediment to takeovers that are otherwise economically efficient and in the overall interests of the economy. The MBR may unwittingly provide assistance to incumbents by operating effectively as a takeover defence and perpetuating the concentration of shareholding.<sup>24</sup> The increased cost that the MBR imposes on takeovers reduces the chance that bidders might pose an attack on targets through a hostile offer. Questions may be raised as to whether this unintended effect of the MBR is justifiable.

Despite some critique of the MBR, its rationale as founded on the basis of the equal opportunity principle is unassailable,<sup>25</sup> with the caveat that it must naturally be invoked only when it benefits the minority shareholders and not when it might impede a change in control that is otherwise beneficial to shareholders. In other words, the MBR must facilitate exit for minority shareholders when a change of control is value-reducing in nature for them, but it must not impede a change of control that is value-enhancing to the target as well as the shareholders and stakeholders in general.

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<sup>20</sup> *Commission Directive 2004/25/EC of 21 April 2004 on takeover bids*, [2004] OJ, L 142/12 [EU Takeover Directive]; Guido Ferrarini & Geoffrey P Miller, "A Simple Theory of Takeover Regulation in the United States and Europe" (2009) 42 *Cornell Int'l LJ* 301 at 312.

<sup>21</sup> RP Austin & IM Ramsay, *Ford's Principles of Corporations Law*, 14th ed (Australia: LexisNexis Butterworths, 2010) at 1219.

<sup>22</sup> For a detailed discussion of the theoretical and economic bases of the mandatory offer rule, see Andrews, *supra* note 11; Ruth Lüttmann, "Changes of Corporate Control and Mandatory Bids" (1992) 12 *Int'l Rev L & Econ* 497.

<sup>23</sup> One of the essential principles of takeover regulation in most jurisdictions is that shareholders of the same class in a target must be treated equally. See *eg*, *City Code* in the UK, the current version of which came into effect on 20 May 2013; *Singapore Takeover Code*, *supra* note 16, General Principle 3. See also Lan Luh Luh, Ho Yew Kee & Ng See Leng, "Mandatory Bid Rule: Impact of Control Threshold on Take-over Premiums" [2001] *Sing JLS* 433 at 435.

<sup>24</sup> Lüttmann, *supra* note 22 at 497; Ventrizzo, "Takeover Regulation", *supra* note 5 at 140.

<sup>25</sup> One recent study has reevaluated and reaffirmed the efficiency of the MBR. See Edmund-Philipp Schuster, "The Mandatory Bid Rule: Efficient, After All?" (2013) 76 *Mod L Rev* 529.

One of the modulators that play a crucial role in deciding when the MBR can be invoked is the definition of the ‘effective control’ trigger. If the threshold for ‘effective control’ is too high, then it has the effect of permitting acquirers to obtain *de facto* control while staying below the radar and denying exit mechanisms to the minority shareholders that would otherwise be available through the MBR. On the other hand, if the threshold is too low, then it has the effect of triggering the MBR for even relatively insignificant acquisitions of control that may have a chilling effect on takeovers, thereby impeding a market for corporate control that could potentially act as a significant check on the existing management and controlling shareholders. The remainder of this article focuses on the nature and types of ‘control’ thresholds that trigger the MBR.<sup>26</sup>

### III. THE QUANTITATIVE APPROACH TO ‘CONTROL’

The quantitative approach utilises a specific numerical percentage threshold of voting rights in a target as the determining factor for whether an acquirer has obtained control over the target. To be sure, the quantitative approach was not the preferred regulatory strategy to begin with. The MBR was first introduced in the UK utilising a broader conception of control without specifying any numerical percentage.<sup>27</sup> A mandatory offer was required when a target came under the *de facto* control of an acquirer as determined by the Takeover Panel.<sup>28</sup> However, within the first few years, difficulties became evident in the implementation of the MBR using this concept of ‘control’. The Panel had to decide cases based on their individual facts, thereby giving it a substantial amount of discretion.<sup>29</sup> Due to the severe concerns raised regarding the ambiguity of a subjective definition of control, the City Code in the UK was amended to introduce a numerical formula that continues to hold good to this day. Several other countries, both in the common law and civil law worlds have undergone a similar experience. These include Hong Kong,<sup>30</sup> Austria,<sup>31</sup> Belgium<sup>32</sup> and Italy,<sup>33</sup> all of whom began with a qualitative definition of the control trigger for the MBR, but subsequently converted their takeover regimes that are now guided by the quantitative approach.

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<sup>26</sup> Connected with the MBR is the regime pertaining to disclosure of significant shares in a target. This aspect is also governed through takeover regulation and is a precursor to the MBR as it provides advance warning to the target’s shareholders of the significant acquisition of shares by an acquirer, which could potentially result in a takeover offer for the target. The disclosure requirements are elaborate in most jurisdictions, and they have acquired a great deal of complexity in some due to the tendency of acquirers using complex derivative instruments to stay outside the scope of disclosure. Given that the focus of this article is on the MBR and aspects of ‘control’, a more detailed discussion of disclosure requirements is outside its scope.

<sup>27</sup> Chidambaram Chandrasegar, *Take-overs and Mergers*, 2nd ed (Singapore: LexisNexis, 2010) at 180.

<sup>28</sup> Rabinowitz, *supra* note 9 at para 2-3005.

<sup>29</sup> *Ibid* at para 2-3006.

<sup>30</sup> Chandrasegar, *supra* note 27 at 180-182.

<sup>31</sup> Albert Birkner & Clement Hasenauer, “A new takeover law in Austria” (2007) 69 *European Lawyer* 62 at 62; Marco Ventoruzzo, “Europe’s Thirteenth Directive and US Takeover Regulation: Regulatory Means and Political and Economic Ends” (2006) 41 *Tex Int’l LJ* 171 at 195 [Ventoruzzo, “Europe’s Thirteenth Directive”].

<sup>32</sup> Steven De Schrijver & Hans Vandendael, “Belgium implements EU takeover directive” (2007) 69 *European Lawyer* 60 at 60.

<sup>33</sup> Ventoruzzo, “Europe’s Thirteenth Directive”, *supra* note 31 at 195, 196.

The attractiveness of the quantitative approach is evident in the EU Takeover Directive,<sup>34</sup> which suggests a numerical percentage threshold.<sup>35</sup> While the EU adheres to the quantitative approach, it reserves some level of flexibility to its Member States to determine the exact shareholding percentage depending upon corporate shareholding structures and other local factors. In that sense, there is partial harmonisation on this account.

It is beyond doubt that the quantitative approach has acquired much prominence. Nearly all countries around the world that impose the MBR have opted for that approach in one form or the other. Nevertheless, similar to the situation in the EU, there appears to be considerable variance in the fixation of the shareholding percentage threshold for voting rights which would trigger the MBR. There is no uniformity whatsoever, as there is a considerably wide spread from 20% to 50% voting rights.

Table 1 in the Annex provides an indication of the initial thresholds<sup>36</sup> that trigger the MBR in various jurisdictions.

Although at first blush there appears to be a wide range of shareholding percentages considered across the world for the MBR threshold, it also witnesses a fair level of harmonisation. Most jurisdictions congregate around the 30% to 33.33% mark.<sup>37</sup> Rather than viewing the thresholds in absolute terms, it would be necessary to examine them contextually taking into account the shareholding pattern in each jurisdiction and whether the MBR threshold bears any correlation with such shareholding pattern. In pegging the quantitative MBR threshold, the natural proposition would be that where shareholding is dispersed the threshold must be lower, and where shareholding tends to be concentrated it must be higher.<sup>38</sup> This is because in a dispersedly-held company change of control is likely to occur with the acquisition of a lower number of shares by an acquirer<sup>39</sup> rather than in a company with concentrated shareholding wherein the acquirer must obtain at least one share more than the largest shareholder so as to obtain any element of control in such company.<sup>40</sup>

Anecdotal evidence suggests incongruence in the determination of thresholds. For instance, one might argue that a 30% threshold in the UK appears too high given that shareholding is largely dispersed in that jurisdiction compared to most

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<sup>34</sup> *Supra* note 20.

<sup>35</sup> *Ibid*, art 5(1).

<sup>36</sup> Some countries also impose the “creeper” rule whereby an acquirer whose shareholding is beyond the initial threshold for triggering the MBR may also be obligated to make a mandatory offer if it acquires more shares over a period of time so as to consolidate its control. It is not proposed to deal with the “creeper” limits in this article, but the broad discussion of the different approaches for triggering the MBR for the initial acquisition of control would also apply equally to the “creeper” rule for the consolidation of control.

<sup>37</sup> See Marc Goergen, Marina Martynova & Luc Renneboog, “Corporate Governance Convergence: Evidence from Takeover Regulation Reforms” (Working Paper No 33/2005, European Corporate Governance Institute, 2005) at 23.

<sup>38</sup> Ventrizzo, “Europe’s Thirteenth Directive”, *supra* note 31 at 197.

<sup>39</sup> For example, if in a dispersedly-held Company A no individual shareholder or group of shareholders owns more than 5% of the voting rights, then Acquirer X might very well acquire control by building up its stake to obtain 20% voting rights in Company A.

<sup>40</sup> For example, if in Company B, its controlling shareholder C holds 35% voting rights, then acquirer X must realistically acquire more than 35% voting rights so as to unseat C from its controlling position.

others.<sup>41</sup> Conversely, several jurisdictions with concentrated shareholding carry lower thresholds. For instance, the 25% threshold in India seems counterintuitive given the much higher concentration of shareholding.<sup>42</sup> The fact that India follows a combined approach to determine control by including a qualitative approach that may trigger when an acquirer holds even less than 25% is all the more perplexing.<sup>43</sup>

The quantitative approach is not free from criticism. The use of shareholding percentage thresholds as proxies for *de facto* control might be imprecise, and therefore induce an element of arbitrariness. It effectively decouples the MBR trigger from *de facto* control.<sup>44</sup> The wider the decoupling, the further the MBR strays from its philosophy of equality of opportunity to the minority shareholders. Moreover, the predictability of the quantitative approach also begets its primary weakness. The availability of a bright-line rule enables parties (ably advised by lawyers and investment bankers)<sup>45</sup> to structure their affairs so as to work around those rules.

Take the case of Company C in jurisdiction J where the MBR threshold is 30% voting rights. It is well likely that an acquirer A may acquire up to 29.9% voting rights in C and stay at that level so as to not trigger the MBR, which would have compelled A to incur the cost of acquiring all the tendered shares in an offer. A's economic sense would suggest to it that it is better off paying for 29.9% of the total value of C in order to obtain control rights that are far in excess of the economic cost, rather than to trigger the MBR. In such circumstances, A's ability to exercise *de facto* control over C would depend, among other things, on the shareholding pattern of C. If there is no other shareholder with similar voting rights, then A effectively exercises *de facto* control. With such control rights, A may also be in a position to nominate and appoint the board of directors, and through it the other key managerial personnel, thereby influencing the management and policy decisions of the company. In this scheme of things, despite obtaining substantial control over C, A is not obligated to make a mandatory offer and the minority shareholders are not provided an exit on comparable terms.

Therefore, due to the rigour of the quantitative approach, the rationale for the MBR as well as the rights of the minority shareholders are forsaken in favour of certainty and predictability to the acquirer. In such circumstances, what more does

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<sup>41</sup> For a discussion on the dispersed nature of shareholding in the UK, see Stilpon Nestor & John K Thompson, "Corporate Governance Patterns in OECD Economies: Is Convergence Under Way?" (Paper delivered at the OECD and Korea Development Institute Conference, Corporate Governance in Asia: A Comparative Perspective, 3 March 1999), online: OECD <<http://www.oecd.org/corporate/ca/corporategovernanceprinciples/1931460.pdf>>; Bernard S Black & John C Coffee, Jr, "Hail Britannia? Institutional Investor Behavior under Limited Regulation" (1994) 92 Mich L Rev 1997 at 2001.

<sup>42</sup> For a discussion on the concentrated nature of shareholding in India, see Shaun J Mathew, "Hostile Takeovers in India: New Prospects, Challenges, and Regulatory Opportunities" (2007) 3 Colum Bus L Rev 800; N Balasubramanian & RV Anand, "Ownership Trends in Corporate India 2001–2011: Evidence and Implications" (Working Paper No 419, Indian Institute of Management Bangalore, 2013), online: SSRN <<http://ssrn.com/abstract=2303684>>.

<sup>43</sup> This aspect is discussed later in Part V.

<sup>44</sup> Ventrizzo, "Takeover Regulation", *supra* note 5 at 139, 140; Grant, Kirchmaier & Kirshner, *supra* note 5 at 250.

<sup>45</sup> Grant, Kirchmaier & Kirshner, *supra* note 5 at 251; Luca Enriques, "The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?" (2004) 1 European Company and Financial Law Review 440 at 452.

the acquirer need to exercise *de facto* control? The quantitative approach pays short shrift to these issues. Pragmatism trumps equity.

This is supported by empirical evidence as well as case studies. Extensive literature posits that acquirers in the UK tend to remain below the 30% trigger for MBR so as to enable them to exercise *de facto* control without triggering the rule.<sup>46</sup> This perhaps explains (at least partially) the absence of block holdings in the UK beyond the 30% mark.<sup>47</sup> Elsewhere in Europe, the potency of the MBR is dependent upon its implementation by the regulatory authorities as well as the availability of a broad range of exemptions from mandatory offers.<sup>48</sup> One analysis of three European case studies finds that acquirers have managed to circumvent the MBR so as to pay less to acquire targets, much to the detriment of the minority shareholders, a phenomenon the authors refer to as 'financial tunneling'.<sup>49</sup>

Often, such evasion is achieved through clever structuring, the use of complex investment instruments or by the acquirer simply remaining below the MBR threshold.<sup>50</sup> For example, acquirers invest in shares of the target up to the MBR threshold and take positions in derivative instruments such as swaps and options for the remaining stake they are interested in acquiring. This would also enable acquirers to avoid disclosure obligations by stealthily acquiring positions and thereafter springing a surprise on targets' management by launching a voluntary offer.<sup>51</sup> At the same time, some jurisdictions such as the UK have begun to legislate measures to curb the use of complex financial instruments such as equity derivatives to skirt the MBR.<sup>52</sup> Other jurisdictions have sought to enable disclosure of such derivative instruments, although not necessarily bringing them within the scope of the MBR.<sup>53</sup>

Asian jurisdictions have not been spared this trend either. Similar to the UK, China has a quantitative threshold of 30% voting rights that triggers the MBR.<sup>54</sup> Apart from difficulties in strict enforcement of the MBR, its utility is also undermined by the wide exemption powers available to its securities regulator, the China Securities

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<sup>46</sup> Paul L Davies & Sarah Worthington, *Gower and Davies' Principles of Modern Company Law*, 9th ed (London: Sweet & Maxwell, 2012) at 1061; Rabinowitz, *supra* note 9 at para 4-8006.

<sup>47</sup> Fabrizio Barca & Marco Becht, *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001) at 12, 36; John Armour & Jeffrey N Gordon, "The Berle-Means Corporation in the 21<sup>st</sup> Century" (2008) [unpublished, online: [http://www.law.yale.edu/documents/pdf/Intellectual\\_Life/Armour\\_BerleMeansCorp091021.pdf](http://www.law.yale.edu/documents/pdf/Intellectual_Life/Armour_BerleMeansCorp091021.pdf)] at 23, 24.

<sup>48</sup> Ventoruzzo, "Europe's Thirteenth Directive", *supra* note 31 at 197.

<sup>49</sup> Grant, Kirchmaier & Kirshner, *supra* note 5 at 251.

<sup>50</sup> *Ibid* at 238-47.

<sup>51</sup> For a more detailed discussion, see Wan & Varottil, *supra* note 9 at paras 7.73-7.84.

<sup>52</sup> Following revisions made to the *City Code* in 2005-2006, the definition of 'interests in securities' now includes options and derivatives and they are considered for the purposes of disclosures as well as triggered the MBR: *City Code*, *supra* note 14, C13.

<sup>53</sup> For example, in Singapore, while derivatives instruments are counted for the purposes of disclosure of substantial shareholding, the takeover regulator, the Securities Industry Council, will determine in individual cases whether the acquisition of such instruments would trigger the MBR: *Singapore Takeover Code*, *supra* note 16, Rule 14.1, Note 16. For similar issues pertaining to the US, see *CSX Corporation v The Children's Investment Fund Management (UK) LLP et al*, 562 F Supp (2d) 511 (SDNY 2008); *CSX Corporation v The Children's Investment Fund Management (UK) LLP*, 654 F 3d 276 (2d Cir 2011).

<sup>54</sup> See Hui Huang, "China's Takeover Law: A Comparative Analysis and Proposals for Reform" (2005) 30 Del J Corp L 145 at 171 (also containing a comparative analysis of China's takeover law).

Regulatory Commission (CSRC), which it exercises quite frequently.<sup>55</sup> A case study involving some Chinese takeovers concludes that the grant of exemptions by the CSRC has become the rule rather than the exception.<sup>56</sup> It raises some misgivings about the operation of the MBR in China, finding that it “exists only in name in China”.<sup>57</sup>

This discussion demonstrates that while the quantitative approach is beneficial as it introduces certainty and predictability, its decoupling from *de facto* control undermines the rationale for the MBR. Moreover, its operation in several jurisdictions has not been free from difficulty given the ability of acquirers to avoid its bite. Finally, the success of the rule depends upon various exemptions available in different jurisdictions and how the regulators exercise them. As discussed above, the experience not only varies significantly, but the results are far from desirable.

#### IV. THE QUALITATIVE APPROACH TO ‘CONTROL’

A handful of jurisdictions adopt the qualitative approach, either by itself or in combination with a numerical test. This approach consciously avoids any correlation with a voting rights threshold, and therefore makes it much less likely to be capable of circumvention. A subjective definition of control enables courts and regulators to make a determination based on the individual facts and circumstances of each case. Despite being an anti-abuse measure, its lack of popularity may be attributable not only to the uncertainty and unpredictability to acquirers, but also to the wide discretion conferred upon courts and regulators. It is, however, clear that in jurisdictions where the qualitative approach has been retained, regulators have preferred to preserve the discretion to ensure that the objectives of the MBR are more meaningfully attained.

Compared to jurisdictions that follow the quantitative approach where the principal variance relates to the actual threshold limits for triggering the MBR, those following the qualitative approach display a multitude of approaches to rein in the concept of control. Based on various regulatory models observed in these jurisdictions, they can be classified into two broad types: (i) board control; and (ii) management (or operational) control.<sup>58</sup>

##### A. Board Control

Here, the question is whether an acquirer can appoint or remove a majority of the board of directors so as to control it. This conception of control is not unique to takeover regulation and is quite commonly used in corporate law, for example,

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<sup>55</sup> John Armour, Jack B Jacobs & Curtis J Milhaupt, “The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework” (2011) 52 Harv Int’l LJ 219 at 275.

<sup>56</sup> Wei Cai, “The Mandatory Bid Rule in China” (2011) 12 European Business Organization Law Review 653 at 665.

<sup>57</sup> *Ibid* at 672.

<sup>58</sup> For a detailed analysis of these concepts and that of the qualitative approach to control, albeit from a tax perspective, see Robert Couzin, “Some Reflections on Corporate Control” (2005) 53 Can Tax J 305 (discussing the hesitation among Canadian courts to deviating too far astray from shareholding as a measure of determining control).

to determine whether a company is a subsidiary of another company.<sup>59</sup> Whether an acquirer or controller can appoint or remove directors and thereby control the composition of the board can be subject to further analysis as it carries with it different degrees of control. Due to the lack of uniformity in jurisdictions that follow the qualitative approach, these differences can assume significance.

*First*, an acquirer may obtain the *right* to control the composition of the board. This right may be obtained in two ways. The first and most obvious is through a holding of the majority of voting shares, which correlates with the quantitative approach.<sup>60</sup> This is uncontroversial as the test is both *de jure* and tangible in nature. The second is where an acquirer owning less than a majority of voting rights enters into a shareholders' agreement with other shareholders or obtains special rights in the constitutional documents of the target so as to obtain board control.<sup>61</sup> This too is less contentious as a review of the legal rights under the corporate and contractual documentation will reveal the extent of control an acquirer might possess over the composition of the board.

*Second*, and moving away from shareholding or contractual rights, an acquirer may possess the *ability* to control the board. Although such language has been used in regulations governing takeovers and control,<sup>62</sup> the degree of assertiveness is arguably less than that of a *right*. For example, a shareholder holding less than a majority of the shares may not have the right to appoint and remove directors, but may have the ability to do so if it holds sufficient shares to be in a position to exercise *de facto* control given the remaining shareholding in the company and other factors.

*Third*, an acquirer may have board control if it in fact appoints and removes directors.<sup>63</sup> This is purely a factual test that can be determined through previous conduct, and may not necessarily bear any correlation with voting rights or the legal capability to control the board. However, it is not possible to contemplate a board being controlled by an acquirer who does not have at least a minimum shareholding in the company in the form of a 'toe hold'.

While the tests for board control are varied, the principal subjectivity lies in the second test involving the *ability* of the acquirer to appoint and remove directors. The other tests appear fairly straightforward. But, the same is not true for the next type of control, which continues to attract a fair amount of disagreement.

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<sup>59</sup> See *eg*, *Companies Act 2006* (UK), c 46, s 1159(1)(b); *Companies Act* (Cap 50, 2006 Rev Ed Sing), s 5(1)(a)(i); *Indian Companies Act, 2013*, s 2(87)(i).

<sup>60</sup> For example, in Brazil, the definition of controlling shareholder encompasses the need for majority voting rights as a means to obtain board control, and also that such control is in fact exercised: Law no 6.404 of December 15, 1976, art 116 (Brazil). See also Pedro Testa, *The Mandatory Bid Rule in the European Community and in Brazil: A Critical View* (LLM Dissertation), London School of Economics and Political Science, 2006) at 6, online: SSRN <<http://ssrn.com/abstract=943089>>.

<sup>61</sup> The takeover law in India encapsulates such contractual measures within the scope of board control. *SEBI Takeover Regulations*, *supra* note 19, reg 2(e).

<sup>62</sup> For Indonesia, see Yozua Makes, "Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis" (2013) 8 *University of Pennsylvania East Asia Law Review* 83 at 97, 98.

<sup>63</sup> For example, in Spain, an acquirer is deemed to have attained control if, within 24 months following an acquisition of shares in the target, the acquirer appoints more than one-half of the board. See CMS Legal Services EEIG, "CMS Guide to Mandatory Offers and Squeeze-Outs" (April 2011) at 80, online: CMS <<http://www.cms-cmck.com/CMS-Guide-to-Mandatory-Offers-and-Squeeze-outs>>.

### B. Management (or Operational) Control

Understandably, regulators may fear that the board control test may be subject to manipulation and abuse. What prevents an acquirer from appointing one-half of the board (short of a clear majority) and still continuing to pull the strings as regarding the management and policy of the target through other means? It is to close the door on such potential abuses by acquirers who may obtain operational control over the company that certain jurisdictions have further expanded the subjective definition of control.

For instance, the regulations in Indonesia confer control upon an acquirer who “directly or indirectly has the ability to determine in any way whatsoever the management and/or policy of the public company”.<sup>64</sup> Similarly, in India, an acquirer may be said to be in control of a target if it has the right to “control the management or policy decisions” exercisable by the target, wherein the acquirer may exercise such right whether “by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner”.<sup>65</sup> This requirement targets not control at the board level, but on matters beyond that. While control over the board would help the acquirer determine the strategic direction of the target, the takeover regulations in these jurisdictions also aim at exploring whether an acquirer is able to exercise any influence over the management and policy decisions of the target without necessarily possessing board control. The difficulty with this approach is its innate subjectivity and unpredictability due to the excessive discretion conferred upon the regulators to determine on a case-by-case basis whether a change of control has occurred or not.

A number of scenarios could potentially emerge. One could relate to *de facto* control exercised by a significant shareholder without holding a majority of voting rights. The board may be accustomed to acting in the shadow of the controller (who may not necessarily have the right to control the composition of the board). One can visualise a significant shareholder holding say 20% shares in the company performing this role so long as the remaining shareholding is dispersed with no other shareholder holding a substantial percentage. But, the more tricky situations relate to strategic and financial investors who may seek protective rights in targets through shareholders’ agreements and corporate constitutional documents. Given the wide nature of the definition of control in the jurisdictions discussed above, such rights may transpose the nature of investment into one of a control position, even though such an investor may not have any intention to seek control in the first place.<sup>66</sup> The result is that the regulatory treatment of an investment transaction may be at dissonance with the commercial intention of the parties.

Due to the many variables at play in the qualitative approach, it is not surprising that many countries have chosen either to transition away from it into the quantitative approach or not to adopt it in the first place. The complications surrounding the qualitative approach are diametrically opposite to that of the quantitative approach; while the rigidity of the quantitative approach often causes it to fall short of capturing within its scope acquisitions of *de facto* control, the corresponding downside of the

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<sup>64</sup> Makes, *supra* note 62 at 98.

<sup>65</sup> *SEBI Takeover Regulations*, *supra* note 19, reg 2(e).

<sup>66</sup> The Indian context is replete with examples, as discussed in detail in Part V.

qualitative approach is that it might bring within its broad fold several transactions that do not truly constitute a change in control. If the problem of the quantitative approach was too little bite on acquirers, with the qualitative approach it is its overarching nature. Matters such as board control (or even the *ability* to achieve board control) as well as influence over management and policy decisions of a company are too subjective in nature. Acquirers such as private equity firms and other strategic and financial investors may refuse to take up significant minority positions in targets that might otherwise be beneficial to all the shareholders. Moreover, it causes a tremendous amount of uncertainty as to when the MBR will be triggered, which is not desirable in the equity and financial markets.

The advantages and difficulties of the qualitative approach will become clearer in the analysis of the MBR in India, which follows.

#### V. THE COMBINED APPROACH: THE EXPERIENCE OF INDIA

The study of the MBR in India is important for several reasons. India is a large player in the cross-border takeover markets with its companies acting both as acquirers as well as targets.<sup>67</sup> Given the frequency of takeovers in the Indian markets, their regulations have been subject to constant testing.<sup>68</sup> More specifically, from the perspective of the MBR trigger, India follows a combined approach. It has both a numerical limit of 25% voting rights and also a subjective definition of control: acquirers would trigger the MBR if they satisfy either of the two conditions. The relatively low numerical threshold and a broad subjective definition places the Indian takeover regime as one of the distant outliers among various jurisdictions. It might be thought of as overwhelmingly favouring minority shareholders and as being unfriendly to acquirers. Moreover, the concept of 'control' has attracted the close attention of regulators, courts as well as commentators in recent years, thereby generating a wide discourse worthy of study.<sup>69</sup>

<sup>67</sup> For a detailed analysis of the mergers and acquisitions markets in India from a legal market perspective, see Afra Afsharipour, "Rising Multinationals: Law and the Evolution of Outbound Acquisitions by Indian Companies" (2011) 44 UC Davis L Rev 1029; Umakanth Varottil, "The Impact of Globalization and Cross-Border Mergers & Acquisitions on the Legal Profession in India" (Research Paper No 2013-3, HLS Program on the Legal Profession, 2012), online: SSRN <<http://ssrn.com/abstract=2344272>>.

<sup>68</sup> The Indian markets have witnessed over 900 takeover offers in the last decade between 2004 and 2013. India, SEBI, *Handbook of Statistics on Indian Securities Market* (Mumbai: SEBI, 2013) at 52, online: SEBI <[http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1404362427338.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1404362427338.pdf)>.

<sup>69</sup> For news reports and brief commentaries, see Nandish Vyas & Pranati Ishwar, "The Viewpoint—The Anatomy of Control" *Bar & Bench* (12 July 2012), online: Bar & Bench <<http://52.74.31.40/view-point-anatomy-control>>; Menaka Doshi, "Column: 50 shades of control" *The Financial Express* (24 May 2013), online: The Financial Express <<http://archive.financialexpress.com/news/column-50-shades-of-control/1119849>>; Umakanth Varottil, "Defining 'Control' in Takeover Regulations" *IndiaCorpLaw Blog* (29 May 2013), online: IndiaCorpLaw <<http://indiacorplaw.blogspot.sg/2013/05/defining-control-in-takeover-regulations.html>>; Rajesh Mascarenhas & Apurv Gupta, "Sebi frowns control practice of private equity investors" *The Economic Times* (11 February 2013), online: <[http://articles.economictimes.indiatimes.com/2013-02-11/news/37039372\\_1\\_takeover-regulations-open-offer-private-equity-investors](http://articles.economictimes.indiatimes.com/2013-02-11/news/37039372_1_takeover-regulations-open-offer-private-equity-investors)> [Mascarenhas & Gupta]; Sudipto Dey, "Legal quirks: When control overtakes ownership" *Business Standard* (25 June 2013), online: <[http://www.business-standard.com/article/companies/legal-quirks-when-control-overtakes-ownership-113062500038\\_1.html](http://www.business-standard.com/article/companies/legal-quirks-when-control-overtakes-ownership-113062500038_1.html)>; Anup P Shah, "The Conundrum of Control in Corporate Law" *Bombay Chartered Accountants Journal* (August 2013), online: <<https://www.bcasonline.org/articles/artin.asp?1103>>.

At this point, a thought might nonetheless arise in the reader's mind as to whether the choice of India for this analysis is indeed appropriate. Not only is she a rank outlier, but she might also be behind the curve compared to other jurisdictions that have transitioned to or established regimes based on the quantitative approach. Perhaps she is yet to learn the lesson the hard way as others have.<sup>70</sup> But, the narrative is not at all that straightforward. The current scheme of regulation is a conscious choice and not merely a fortuitous outcome. The *SEBI Takeover Regulations* were framed through extensive consultations.<sup>71</sup> Although the regulations are only two decades old,<sup>72</sup> they have been entirely revamped twice during this period<sup>73</sup> and subjected to several other extensive amendments in the interim. The overhaul of the regulations has also been done after extensive consultation processes.<sup>74</sup> At each such point, due to the public nature of the consultation process adopted, India's securities market regulator, the Securities and Exchange Board of India (SEBI), profited from a wide range of suggestions from market players, including legal advisors. The committees that recommended the Indian takeover regime had the benefit of surveying comparable models of takeover regulation from other jurisdictions, and also receiving the collective wisdom of experts from those jurisdictions.<sup>75</sup> Not only is India's present dispensation a well-considered choice, her regulator appears to treat the qualitative approach to the MBR as an important power to be exercised in the interests of minority shareholders and is not predisposed to jettisoning it in favour of a pure numerical threshold.<sup>76</sup> The combined approach towards the MBR trigger in India has been subject to interpretation both by SEBI as well as the appellate authorities, which merit discussion as they seek to ferret out the rationale behind the 'control' provision and its regulatory objective.<sup>77</sup>

To begin with, the definition of 'control' in the *SEBI Takeover Regulations* is considerably wide. It reads:

<sup>70</sup> See *supra* notes 30 to 33 and accompanying text.

<sup>71</sup> A committee headed by a retired chief justice of India, Mr PN Bhagwati, framed the first set of regulations.

<sup>72</sup> The first comprehensive takeover regime was introduced through the *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1994*, Mumbai: SEBI, 1994.

<sup>73</sup> The two restated versions are the (i) *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997*, Mumbai: SEBI, 1997 [*SEBI Takeover Regulations 1997*]; and (ii) *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011*, Mumbai: SEBI, 2011 (which are currently in force).

<sup>74</sup> The overhaul in 1997 was pursuant to the recommendations of the same committee that recommended the first set of regulations: India, SEBI, *Justice PN Bhagwati Committee Report on Takeovers*, (Mumbai: SEBI, 1997), online: SEBI <<http://www.sebi.gov.in/commreport/bagawati-report.html>>. The revamp of 2011 was pursuant to a Takeover Regulations Advisory Committee Report under the chairmanship of Mr C Achuthan: India, SEBI, *Report of the Takeover Regulations Advisory Committee*, (Mumbai: SEBI, 2010), online: SEBI <[http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1287826537018.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1287826537018.pdf)>.

<sup>75</sup> See *eg*, Amarchand Mangaldas *et al*, *Handbook on Comparative Takeover Laws: Compiled for the Reference of the Takeover Regulations Advisory Committee* (30 October 2009) (copy on file with the author).

<sup>76</sup> VS Sundaresan, "The Changing Landscape of Corporate M&A in India" (Address delivered at the International Bar Association Conference, Mumbai, 21 March 2014), video available online: The Firm <[http://thefirm.moneycontrol.com/video\\_page.php?autono=1060566&video\\_flag=1](http://thefirm.moneycontrol.com/video_page.php?autono=1060566&video_flag=1)> (last accessed 10 July 2014) at 71:35/78:17 (in response to a specific question from the author).

<sup>77</sup> In fact, even the Supreme Court of India was seized of the issue in a case involving indirect control over a French company that in turn provided the acquirer with control over its Indian listed subsidiary: *Technip SA v SMS Holding (Pvt) Ltd* (2005) 5 SCC 465 (SC).

'[C]ontrol' includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner: ...<sup>78</sup>

This definition encompasses both board control and management control.<sup>79</sup> By this definition, the MBR might potentially be triggered in two circumstances. The first arises when an acquirer obtains a substantial shareholding in the target, which is below the quantitative threshold, but where the acquirer is the single largest shareholder. The second is when the acquirer obtains a significant shareholding in the company, but is faced with another shareholder or group that holds a significant shareholding in the target. In these circumstances, it is likely that the acquirer will have to share control with the existing substantial shareholder. More specifically, in such a case, the acquirer (if it is a strategic or financial investor such as a private equity firm) may obtain additional protective rights, in which case the question of whether it obtains control gets accentuated further. The remainder of this Part analyses the case law in India under these two categories.

#### A. Single Largest Shareholder

The Securities Appellate Tribunal (SAT)<sup>80</sup> had the opportunity to consider the position of an acquirer who obtained a significant shareholding constituting marginally below the MBR threshold without any additional contractual rights. In one case,<sup>81</sup> the Ambuja Group (acquirer) acquired 14.45% shares<sup>82</sup> in ACC Cement (the target) from the Tata Group (seller). One of the shareholders of the target complained to SEBI that this constituted a change in control because the Ambuja Group stepped into the shoes of the Tata Group that was already in control of the target.

From the purview of *board* control, it was clear there existed none. The Ambuja Group had nominated only two out of a total of 16 directors. But the question was whether a change of control occurred through other means. The SAT elucidated the rationale for the subjective definition of control and reiterated that the open-ended definition of control in the *SEBI Takeover Regulations* was understandable as it is a "term of wide connotation and amplitude"<sup>83</sup> having regard to the object and scheme of takeover regulation in India. Although the SAT made these observations and remanded the dispute to SEBI without deciding on the question on facts, the width of its interpretation suggests its willingness to recognise considerable discretion in the hands of the regulator to be exercised based on the facts of each case.

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<sup>78</sup> *SEBI Takeover Regulations*, *supra* note 19, reg 2(e).

<sup>79</sup> For a discussion of these concepts, see Parts IVA and IVB.

<sup>80</sup> The SAT hears appeals against the orders of SEBI on matters involving securities regulation, including takeovers: *Securities and Exchange Board of India Act, 1992*, s 15-T.

<sup>81</sup> *Ashwin K Doshi v Securities and Exchange Board of India* (25 October 2002), Appeal No 44 of 2001, online: Securities Appellate Tribunal <<http://www.sebi.gov.in/satorders/ashwin.html>> [*Ashwin K Doshi*].

<sup>82</sup> At the relevant time, the MBR trigger in India operated at 15% voting rights: *SEBI Takeover Regulations 1997*, *supra* note 73, reg 10.

<sup>83</sup> *Ashwin K Doshi*, *supra* note 81, at para 155.

The philosophy of the *SEBI Takeover Regulations* as interpreted by the SAT gives SEBI considerable leeway to invoke the MBR against acquirers who may have acquired voting rights that are less than the quantitative threshold. If, in jurisdictions with the quantitative approach, acquirers can skirt the MBR by staying below the threshold, that is not an option in India as the regulators may nonetheless unravel the transaction based on a factual analysis of *de facto* control.

### B. Contractual Rights: Active vs Passive Control

The scenario that has proved to be somewhat more controversial in India relates to one where an investor (either strategic or financial) acquires a stake in the target that is below the quantitative threshold. Here, such investor typically invests into the target against an issue of new shares as opposed to acquiring the existing shares of another shareholder. The purpose of the transaction is to fund the company for capital expansion or other business needs. Moreover, given the concentrated shareholding setting in India, the target is likely to have an incumbent controlling shareholder (or promoter)<sup>84</sup> who exercises dominance over the board and management, with such promoter holding at least as much or even more voting rights than the investor. It is therefore obvious that due to the substantial financial investment it sinks into the target, the investor will seek additional protective rights by way of contract, including board representation, quorum rights and veto rights.

In this context, the investor at most acquires joint control over the target, which it will have to share with the promoter. More importantly, it is almost never the intention of the investor (especially one whose investment is financial in nature) to seek any control over the company. In fact, often the investor expressly disclaims any control.<sup>85</sup> In any event, the investor is incapable of exercising any unilateral influence over the board or management of the target given that its position and rights operate under the shadow of the promoter's dominance. The rights sought by the investor are therefore only to protect its own economic interest in the company rather than to assert any positive influence. In other words, the contractual documents and the right structure so established seek to balance out the interests of two large shareholders—the incoming investor and the incumbent promoter—such that one might not act in a manner that erodes the commercial interest of the other.

Despite the well-established global practice of substantial investors seeking protective rights, SEBI has been steadfast in its insistence that these rights confer the investors with 'control' over the target. It is able to do so due to the subjective definition of the concept under Indian takeover law. Despite strong resistance and protestations from the investing community and their advisors, SEBI has been unwilling to budge from its stance. Investors have therefore sought legal remedies before appellate fora. Although the issue has been deliberated and dealt with extensively

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<sup>84</sup> Controlling shareholders in India are referred to as 'promoters', who have a specific legal status recognised under Indian corporate and securities laws. See *Indian Companies Act, 2013*, *supra* note 59, s 2(69); *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*, Mumbai: SEBI, 2009, reg 2(za).

<sup>85</sup> This it may do so either in the contractual documentation or in any public documents to be filed with the regulator, or both.

before the authorities, a conclusive resolution to the issue has been elusive, as examined below.

In one of its early decisions,<sup>86</sup> the SAT found that the contractual requirement that the target obtain the prior approval of the acquirer on certain major matters concerning its affairs (such as structural and strategic changes) conferred control rights to the acquirer thereby attracting the MBR.<sup>87</sup> This arguably provided too wide a construction to the concept of 'control' and failed to take into account the reality of the relationship between the acquirer and the target or its promoter. Gradually, however, the SAT's stance has become somewhat more liberal in favour of the investors, bearing in mind the commercial realities. For instance, in *Sandip Save v Securities and Exchange Board of India*,<sup>88</sup> a lending bank that was also a financial investor had approval rights over significant decisions such as appointment and removal of directors, changes to projects and other key matters. Given that the company had promoters who were in charge of the company's affairs and the defensive nature of the rights conferred upon the lender investor, SAT held that the latter could not be said to enjoy control.<sup>89</sup>

The most elaborate exposition of the principles relating to such investments and their implications on control over the target came much later. In *Subhkam Ventures (I) Private Limited v Securities and Exchange Board of India*,<sup>90</sup> the SAT was concerned with the typical case that had been confronting the question of 'control' under the takeover regulation. Here, a financial investor took up a 19.91% stake in the target.<sup>91</sup> The SAT closely analysed the contractual arrangements between the parties. It concluded that investor's right to nominate one among several directors on the board of the target did not confer upon it any control.<sup>92</sup> Similarly, the fact that the investor has affirmative or veto rights whereby the approval of the investor is required for the target to undertake several actions was insufficient to constitute control.<sup>93</sup> These rights were in the form of protective provisions to safeguard the investment and therefore do not confer any control on the investor. More than SAT's ruling that went in favour of the investor, its reasoning is illuminating:

Control, according to the definition, is a proactive and not a reactive power. It is a power by which an acquirer can command the target company to do what he wants it to do. Control really means creating or controlling a situation by taking the initiative. Power by which an acquirer can only prevent a company from doing what the latter wants to do is by itself not control. In that event, the

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<sup>86</sup> *Rhodia SA v Securities and Exchange Board of India* (7 November 2001), Appeal No 36 of 2001, online: Securities Appellate Tribunal <<http://www.sebi.gov.in/satorders/Rhodia.html>>.

<sup>87</sup> *Ibid* at paras 58, 62.

<sup>88</sup> [2003] 41 SCL 47 (SAT).

<sup>89</sup> *Ibid* at para 32.

<sup>90</sup> (15 January 2010), Appeal No 8 of 2009, online: Securities Appellate Tribunal <<http://www.sebi.gov.in/satorders/subhkamventures.pdf>>.

<sup>91</sup> In this case, the contractual documentation expressly stipulated that the investment is only financial in nature and that the existing promoter of the company is in control: *ibid* at para 3.

<sup>92</sup> *Ibid* at para 7. The availability of quorum rights to the investor's nominee was also insufficient to point towards the existence of control: *ibid* at para 8.

<sup>93</sup> *Ibid* at para 8.

acquirer is only reacting rather than taking the initiative. It is a positive power and not a negative power.<sup>94</sup>

This decision provided considerable relief to the investing community in India, who were able to successfully advocate their position seeking a narrow definition of control.<sup>95</sup> But, the euphoria was short-lived, as SEBI preferred an appeal to the Supreme Court of India.<sup>96</sup> Although a ruling from the highest court was expected with great anticipation, that was not to be as the parties settled during the pendency of the appeal. An added disappointment arose when the Supreme Court clarified that the order of SAT will not be treated as precedent and that the question of law was being kept open.<sup>97</sup> Hence, the seeming approach by SAT to resolve the issue was set at naught by the Supreme Court.

The jurisprudential vacuum has not deterred SEBI from continuing to pursue acquisitions of shares where the question of *de facto* control has been uncertain, whether or not the acquirer has crossed the quantitative threshold. Similar to past cases,<sup>98</sup> it has continued to examine the specific contractual arrangements of investors and pronounce on the issue of control based on the facts and circumstances of individual cases.<sup>99</sup> It has also adopted a strict stance that prevents substantial shareholders investing in listed targets from obtaining meaningful protective provisions. It has not hesitated to conduct a microscopic clause-by-clause analysis of contractual documentation to arrive at its conclusion.<sup>100</sup> Hence, SEBI continues to have the leeway to exercise a subjective determination of control, which it does in fact exercise quite widely. From an investor's perspective, this situation is riddled with uncertainty that may chill the market for financial equity investments in listed targets.<sup>101</sup>

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<sup>94</sup> *Ibid* at para 6.

<sup>95</sup> See Umakanth Varottil, "Relief for Investor Community on 'Control' Debate" *IndiaCorpLaw Blog* (17 January 2010), online: IndiaCorpLaw <<http://indiaincorpplaw.blogspot.sg/2010/01/relief-for-investor-community-on.html>>.

<sup>96</sup> This is also indication of the tenacity with which SEBI has been (and continues to be) advocating its position.

<sup>97</sup> *Securities and Exchange Board of India v Subhkam Ventures (I) Private Limited*, MANU/SC/1587/2011 (SC) at para 4.

<sup>98</sup> See *Order in the Matter of Proposed Acquisition of Equity Shares of Daikafill Chemicals India Limited* (5 February 2007), WTM/GA/134/CFD/2/07, online: SEBI <<http://www.sebi.gov.in/cmorder/daikafill.html>>.

<sup>99</sup> Mascarenhas & Gupta, *supra* note 69.

<sup>100</sup> A recent investment by Abu Dhabi-based Etihad Airways into an Indian airline company Jet Airways (India) Limited further demonstrates this phenomenon. Even though Etihad acquired only a 24% stake in Jet Airways, which was below the quantitative threshold, not only did it have to forsake the customary rights available to minority shareholders in targets that are required to protect their own interests (rather than exercise any control), but it was subjected to investigations by multiple regulators (sometimes on repeated occasions) before its investment was cleared. For a detailed analysis of this transaction, see Abhinav Harlalka *et al.*, "M&A Lab—Jet-Etihad: Jet Gets a Co-Pilot" (27 December 2013), online: Nishith Desai Associates <<http://www.nishithdesai.com/information/navigation/navigation2/ma-lab/ma-lab/article/jet-etihad-jet-gets-a-co-pilot.html>>.

<sup>101</sup> Such investments, popularly known as "private investment in public equity", fill an important gap when access to public markets for funding is either unavailable or undesirable: John D Hogboom, "Private Investment in Public Equity: An Overview" *New Jersey Law Journal* (16 August 2004), online: Securities and Exchange Commission <[http://www.sec.gov/info/smallbus/gbfor25\\_2006/hogboom\\_invest.pdf](http://www.sec.gov/info/smallbus/gbfor25_2006/hogboom_invest.pdf)>; Robert B Thompson & Donald C Langevoort, "Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising" (2013) 98 *Cornell L Rev* 1573 at 1598-1604.

In concluding this Part, the concept of 'control' continues to complicate matters under the Indian legal regime, particularly with respect to takeover regulation and the MBR. What ensues is a mix of factors at play: a subjective definition of control, which has not been resolved by the courts or appellate authority, being implemented by a regulator that seeks to retain as much freedom to splice open transactions to examine the aspect of control based on the facts and circumstances of each case.<sup>102</sup>

## VI. EVALUATING THE APPROACHES TO CONTROL; THE WAY FORWARD

As the discussion thus far demonstrates, neither the quantitative approach nor the qualitative approach is optimal. Each suffers from deficiencies both conceptually and operationally. That leads to the question as to how one might assimilate the findings of this survey of various approaches in order to devise an optimal regulatory strategy for triggering the MBR.

A possibility would be to prefer one approach as superior to the other. For instance, it might be a matter of convenience to prefer the quantitative approach as the vast majority of jurisdictions, which have stamped their approval, are following it. Moreover, several countries transitioned to this after having tried and tested the qualitative approach that did not meet with success. However, this article does not advocate such a binary strategy. Harmonisation cannot lead to a single preference that is to be universally applied. Hence, the choice of approach must continue to be exercised by jurisdictions depending upon their own corporate background, factors and circumstances. Nevertheless, the quest for harmonisation may take into account some broad principles, which are enunciated below.

### A. *Quantitative Approach*

In jurisdictions that follow the quantitative approach, it is important to set the MBR threshold appropriately taking into account the general shareholding pattern of listed companies in those jurisdictions. In case of dispersed shareholding, the threshold must be fairly low as the acquisition of a small percentage of voting rights can put the acquirer in the driver's seat. On the other hand, in case of concentrated shareholding, a higher threshold is required to signal a change in control given the existence of incumbent controlling shareholders who tend to own a large percentage of shares. The percentage threshold must be monitored on a periodic basis as changes in shareholding structures in a given market over a period of time may make a constant threshold meaningless.

Moreover, a quantitative threshold works for a jurisdiction or its markets as a whole, and not in the context of individual targets that may display shareholding structures that are not in line with the vast majority representing the general pattern.

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<sup>102</sup> At one level, it may be argued that the qualitative approach may be desirable in a jurisdiction where the regulator employs a specialist panel (such as the Takeover Panel in the UK) that decides on specific cases in a timely and efficient manner and whose decisions are subject to limited review by the courts, all of which promote the smooth operation of the takeovers market. However, in India, SEBI does not operate through specialist panels and there could be significant delays in its decision-making, which are then subject to appeals before appellate fora.

The rigidity of the quantitative threshold may be watered down through a set of supplemental mechanisms. For instance, if the threshold is found to be too low in the context of a target with concentrated shareholding, then the regulator may be conferred the discretion to grant an exemption to an acquisition that exceeds the MBR threshold but does not surpass the shareholding of the incumbent controller. Similarly, when the threshold is found to be too high in the case of a target that is dispersed, then the regulators may have to be conferred some residual discretion to examine the transaction, but this must be available only in the rarest of cases. Given the subjectivity in this approach, considerable caution must be exercised in the grant of power to the regulator and the implementation on its part.

### B. *Qualitative Approach*

As for the qualitative approach, it is here to stay. Jurisdictions such as Brazil, India and Indonesia have been dogmatic in its embrace.<sup>103</sup> They seem unlikely to part with this approach or the regulatory discretion that accompanies it. There is no indication that these jurisdictions are likely to transition to the quantitative approach. Given that the qualitative approach does have certain merits (especially in catering for the interests of the minority shareholders), the pathway for the future must accommodate that philosophy.

#### 1. *Defining 'control' strictly*

The prime focus must be on defining 'control' with greater clarity and certainty so as to curtail and cabin the concept. While some amount of discretion is required for the regulators to ensure protection of the minority shareholders' interests through the MBR, it must be evenly balanced with the need to provide comfort to acquirers (especially those intending to obtain a minority stake without much influence on the target) so as to encourage acquisitions of equity stakes that may be beneficial to the target as well as its shareholders as a whole. In so defining, greater emphasis must be placed on board control, such as the right or the ability of the acquirer to influence the composition of the board of directors of the target. The concept of management control (through influence on policy and management of the target) must be used extremely sparingly as this can be a fairly wide concept. Management control can be said to occur only when the acquirer can have a say (whether through shareholding or contract) in the day-to-day affairs or the regular business of the target. It ought not to be invoked when the acquirer may have some say over crucial matters such as significant corporate transactions (*eg* mergers, restructuring, amendment to the constitutional documents, dissolution of the target, and the like), which may directly

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<sup>103</sup> Although these are not developed markets, they not only hold a large part of the world's population, but their economies are critical to the cross-border takeover markets, with companies located within these jurisdictions continuing to be prime targets for takeovers. Juergen Rothenbuecher & Joachim von Hoyningen-Huene, "The Rise of Emerging Markets in Mergers and Acquisitions" (2008), online: Siemens <[http://www.siemens.com/industryjournal/pool/02-2012/04\\_study-emerging-markets-industryjournal-02-2012-en.pdf](http://www.siemens.com/industryjournal/pool/02-2012/04_study-emerging-markets-industryjournal-02-2012-en.pdf)>; BCG, "As the Pace of M&A Picks Up, Emerging Markets Stand Out" (29 August 2013), online: BCG <<http://www.bcg.com/media/PressReleaseDetails.aspx?id=tcm:12-142304>>.

affect the acquirer's interests as a substantial shareholder. A distinction must be drawn between day-to-day management (in which the acquirer must not have a say) and crucial life-changing corporate transactions that are akin to investment decisions (in which the acquirer must have a say). While influence in day-to-day management is an indication of control, in other cases it is not.

## 2. *Positive vs negative control*

As a general rule, control must be said to exist when it is active rather than passive, providing initiation powers to the holder than veto or blocking powers. If negative rights are said to exist, usually the presumption would be that the acquirer has sought for and obtained this power in order to protect its own interest whereby it can prevent another controller from carrying out actions in the target that may impinge upon the acquirer's interest. Negative control, therefore, as a rule, must be kept outside the purview of 'control' that operates to trigger the MBR. Jurisdictions that follow the qualitative approach must expressly clarify this in their definition of control because situations involving negative control are all too common especially in strategic or investment transactions where the acquirer takes a substantial, but minority, stake in the target. Capital raising for the benefit of the company (and in turn its shareholders) must not be confused with a takeover or acquisition of control that might require exit options to be conferred upon the minorities. The distinction must be crystal clear.

## 3. *Other mechanisms; exemptions*

Furthermore, the qualitative approach must be accompanied by certain other mechanisms that constrain its expansive scope. Certain presumptions could operate to indicate the lack of *de facto* control on a qualitative basis upon the existence of circumstances. For instance, when the acquirer is not the single largest shareholder in the target, the presumption ought to be that it is not in control. The regulator may nonetheless discharge the burden of rebutting the presumption based on the facts and circumstances of individual cases.

The severity of the qualitative approach must be tempered with the introduction of a wider range of exemptions to acquirers, either automatic or discretionary. One of the most significant automatic exemptions would be a 'whitewash' mechanism, whereby the change of control may be approved by a resolution of independent shareholders. In this way, the opinion of the shareholders may be sought on whether they perceive the change of control to be in their interest or not. Of course, emphasis must also be placed on providing adequate information to the shareholders before seeking their opinion. This is an important balancing function that currently does not exist in all the jurisdictions following the qualitative approach. Other exemptions may be based on seeking the specific approval of the securities regulator, which may be granted on the facts of individual cases. It is hard to constrain the discretion of the regulator in these circumstances, but such discretion must be exercised keeping in view the rationale for MBR as well as balancing the interests of the minority shareholders and the acquirer and a market for acquisition of minority stake in target.

The measures discussed above are not intended to be prescriptive in nature. A suitable mix of these measures may be incorporated in the takeover regulation of each jurisdiction that is commensurate with various factors such as shareholding pattern, local institutional and economic considerations, and the focus and capabilities of the securities regulator. More importantly, measures or approaches that are appropriate at one time may not hold good in the future in a dynamic takeover market, and must be subject to review and amendment from time to time.

Finally, the idea of harmonisation discussed in this article is not intended to remain in the realm of abstract theory. An avenue does exist for these harmonisation measures to be developed into palpable action. The International Organization of Securities Commissions (IOSCO)<sup>104</sup> is tasked, among other things, with the achievement of consistency in standards of regulation in the securities markets. As it is represented by a substantial number of the leading securities regulators around the world, this body is well placed to develop the harmonised conception of control advocated herein. The IOSCO has already undertaken comparative studies of takeover regulation in member jurisdictions.<sup>105</sup> At the same time, harmonisation of takeover regulation continues to be challenging, as IOSCO's work has not extended much into takeovers as much as it has in other areas of securities regulation and capital markets.<sup>106</sup> Nevertheless, coordination between various countries will enable each jurisdiction to adopt local changes initially in the lead up to more international guidelines on takeover regulation.

## VII. CONCLUSION

The issue of 'control', though somewhat technical in nature to begin with, has confounded regulators, acquirers, targets and minority shareholders worldwide in the context of its application as a trigger for the MBR. While there is some homogeneity among jurisdictions around the quantitative approach, the numerical thresholds vary quite significantly. The use of the qualitative approach suggests greater disparity with several different approaches adopted in the jurisdictions that employ them. As the discussion in this article suggests, complete harmonisation of the concept of 'control' is not only impractical, but it is also undesirable, as several domestic factors play a role in shaping the concept. Nevertheless, this article has sought to identify the experience of various jurisdictions in implementing the concept of control for the MBR, and has distilled a common set of principles that may be applied by them in a manner that suits their own individual circumstances.

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<sup>104</sup> International Organization of Securities Commissions (IOSCO), *About IOSCO*, online: <<http://www.iosco.org/about/>>.

<sup>105</sup> See *eg*, Emerging Markets Committee of the IOSCO, "Takeover Regulation in the Jurisdictions of Some IOSCO EMC Members" (June 2008), online: Capital Markets Board (Turkey) <[http://www.spk.gov.tr/filesys/iosco\\_emc/report2008.pdf](http://www.spk.gov.tr/filesys/iosco_emc/report2008.pdf)>; Emerging Markets Committee of the IOSCO, "Takeover Regulation in the Jurisdictions of Some IOSCO EMC Members" (January 2006), online: USAID <[http://www.finrep.kiev.ua/download/ioscopd210\\_en.pdf](http://www.finrep.kiev.ua/download/ioscopd210_en.pdf)>.

<sup>106</sup> See Edward F Greene, Andrew Curran & David A Christman, "Toward a Cohesive International Approach to Cross-Border Takeover Regulation" (1997) 51 U Miami L Rev 823 at 865, 866.

**Annex. Table 1.**  
Numerical Thresholds for Effective Control.

No MBR	Quantitative Approach Only						Qualitative Approach Only	Combined Approach <sup>107</sup>
	20%	25%	30%	33-33.33%	35%	50%		
Bermuda	Australia <sup>109</sup>	Croatia	Austria	Greece	South	Bulgaria	Brazil	Denmark
US <sup>108</sup>	Canada	Serbia	Belgium	Hungary <sup>111</sup>	Africa	Saudi-Arabia	Estonia	(50%)
	New Zealand <sup>110</sup>	Slovenia	China	Japan		Ukraine		Ghana
			Czech Republic	Luxembourg				(30%)
			Finland	Malaysia				India
			France	Norway				(25%)
			Germany	Poland				Indonesia
			Guernsey	Portugal				(50%)
			Hong Kong	Romania				Spain
			Ireland	Slovakia				(30%)
			Italy	Switzerland				
			Jersey					
			Netherlands					
			Russia					
			Singapore					
			Sweden					
			UK					

<sup>107</sup> This indicates the presence of both quantitative and qualitative approaches, either of which could trigger the MBR. Only the numerical trigger is indicated in this table. The qualitative aspect is discussed in Part IV of this article.

<sup>108</sup> However, certain states prescribe the MBR, *supra* note 5.

<sup>109</sup> For a discussion on the operation of the MBR in Australia, see Austin & Ramsay, *supra* note 21.

<sup>110</sup> The position in New Zealand for MBR is somewhat similar to that of Australia. See *Takeovers Code Approval Order 2000* (NZ), 2000/210, r 6(1); Glenn Joblin, "New Zealand" in Simon Robinson, ed, *The Mergers & Acquisitions Review*, 2nd ed (London: Law Business Research Ltd, 2008) at 367.

<sup>111</sup> However, this limit is reduced to 25% if there is no other shareholder holding more than 10% of the voting rights.