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POST-SATYAM AMENDMENTS IN THE TAKEOVER CODE: THE LAST RECOURSE OR A HASTY ACTION?

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We all are aware of the topsy-turvy the Indian corporate industry is experiencing at present. The epicenter of the turmoil is, of course, the infamous Satyam scam. It definitely gives goose bumps to anybody who goes to the extent of determining its full scope.[1] Additionally, the Satyam saga has given a big jolt to the IT industry and is capable of changing the realm of corporate laws in India. It has posed an unending list of questions that, every now and then, boggles the mind of the regulator.[2] We have seen a lot of sudden events pertaining to Satyam, like reconstitution of the board by governmental interference, independent auditor's liability, investor's fate and, of course, the most important one, the transformations in corporate law regimes for companies in crisis.[3]

Was SEBI right in relaxing certain provisions of Chapter III[4] of the SEBI (Substantial acquisition of Shares and Takeover) Regulation, 1997 in the Satyam case or not? This seems to be a plain vanilla query with varied and complex opinions. Chapter III of the SEBI (Substantial Acquisition of Shares and Takeover) Regulation 1997, deals with a variety of

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1 The Satyam scam, in general parlance, is often referred to as Indian Enron.

2 Securities and Exchange Board of India.

3 Mainly the changes have been made to *SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997*, GAZETTE OF INDIA, Feb. 20, 1997, at Extraordinary, pt. II, §3(ii) [hereinafter *Regulations*] (S.O. No. 124(E)), and subsequent regulations.

4 Chapter III of the *Regulations*, *Id.*, deals with the substantial acquisition of shares and voting rights in and acquisition and control over a listed company.

issues including mandatory open offers,[5] entities acquiring 15% stake in a company, as well as acquisition or change of control of the company. SEBI possesses such special powers particularly in case of companies where a central, state government or any other regulator superseded the board of a company. As per the code on takeovers and acquisitions,[6] an investor must also make an open offer for 20 percent additional equity in a company once it has acquired 15 percent stake in it.[7] The regulator said that the amendment to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, provided for "relaxation from the strict compliance of provisions of Chapter-III in certain cases."[8]

It is debatable whether the present takeover regime will pose a serious hurdle for the expected bidders who are likely to submit their expression of interest (EOI)[9] in crisis ridden Satyam. One such situation may occur while deciding the offer price of the shares for the purpose of acquisition. According to the present Takeover Code[10] the pricing norms in case of an open offer on a listed company are determined on the basis of the six-month average price of the shares of that company or two immediately preceding weeks prior to the open offer, whichever is higher.[11] This means that the acquisition of shares aggregating to more than 15% will mandate the acquirer to make an open offer for acquisition of at least 20% shares of Satyam at the six-month average price of the shares.[12] In order to ascertain that, we need to trace the price of shares of fraud-ridden Satyam from September 2008 when there was no serious threat to Satyam's reputation and when it was performing smoothly in the capital markets. It

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5 *Id.* (Regs. 10, 11, 11(2)).

6 *Id.*

7 Reg. 21 of the *Regulations*, *Id.*, prescribes certain criteria with regards to the minimum number of shares which are to be acquired by the offeror in exchange for giving effect to the takeover of a company or to a substantial acquisition of its shares.

8 Reg. 3 of the *Regulations*, *Id.*

9 EOI is submitted by the acquirers to show their interest in the acquisition. It is an essential requirement before bidding takes place.

10 As mentioned under Reg. 20(2) of the *Regulations*, *Id.*

11 Reg. 20 of the *Regulations* states that, in case the shares of target company are not frequently traded, the offer price shall be determined by reliance on the following parameters: the negotiated price under the agreement, highest price paid by the acquirer or PAC with him for acquisition if any, including by way of public rights/preferential issue during the 26-week period prior to the date of the PA and other parameters including return on net worth, book value of the shares of the target company, earning per share, price earning multiple vis-à-vis the industry average. *Id.*

12 As per Reg. 20(4)(b) of the *Regulations*, *Id.*

was only in the month of January 2009 that Satyam share prices have tumbled sharply since the revelation of the Rs 7,000-crore fraud earlier in the month of January. The prices became strikingly low and fell down to Rs.19. According to the sensex data[13] a fall of 89% in the prices of the company's shares was reported after the company founder Ramalinga Raju disclosed on January 7 that he had fudged accounts for years. It was only in the end of January that the graph took an upward shift. If we go by the present data the shares are traded at 48–54 rupees per share. What is interesting to note is that the six month share price average inflates the value of share to as high as 270–275 rupees per share. To tackle the above problem a request for waiver of the six-month average price for determining the offer price was filed with SEBI which came up with certain amendments relaxing the pricing norms in the Takeover code. Apart from this, the code has been amended to empower SEBI to exempt the provisions of Regulation 25[14] and 29A[15] (the crucial disclosures) when an application is made by a target company subject to certain conditions. Regulations 10 to 29A of Takeover provide for the provisions of disclosure on crossing the prescribed limits of 15% to 55%/75% by making a public offer of shares after

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13 Aarati Krishnan, *Bumpy Road Ahead for Satyam Share Price*, HINDU BUS. LINE, Jan. 12, 2009, *available at* http://www.thehindubusinessline.com/2009/01/12/stories/2009011251220400.htm.

14 After Reg. 25(2A) of the *Regulations*, *Id.*, the following sub-regulation shall be inserted: "(2B) No public announcement for a competitive bid shall be made after an acquirer has already made the public announcement pursuant to relaxation granted by the Board in terms of regulation 29A."

15 Reg. 29A of the *Regulations*, *Id.*, states:

> SEBI board may, on an application made by a target company, relax any or more of the provisions of this Chapter, subject to such conditions as it may deem fit, if it is satisfied that:
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> (a) the central government or state government or any other regulatory authority has removed the board of directors of the target company and has appointed other persons to hold office as directors thereof under any law for the time being in force for orderly conduct of the affairs of the target company;
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> (b) such directors have devised a plan which provides for transparent, open, and competitive process for continued operation of the target company in the interests of all stakeholders in the target company and such plan does not further the interests of any particular acquirer;
>
> (c) the conditions and requirements of the competitive process are reasonable and fair;
>
> (d) the process provides for details, including the time when the public offer would be made, completed and the manner in which the change in control would be effected;
>
> (e) the provisions of this chapter are likely to act as impediment to implementation of the plan of the target company and relaxation from one or more of such provisions is in public interest, the interest of investors and the securities market.

complying with prescribed norms.

Further, after such exemption is granted and publicly announced by the Acquirer, no competitive bidding is allowed. Competitive bidding as per Regulation 25 implies a bid made within 21 days of public announcement of the first offer for the equal number of shares.[16]

So now, SEBI can exempt Satyam from not only the disclosures and public offer under this chapter but also ease the pricing norm so that it becomes easy for prospective bidders to acquire it; unreasonably high prices are no longer a constraint.

There is no doubt about it that SEBI has moved very fast, but whether this move was required to speed up the process or was just a swift step with serious repercussions is difficult to answer at this juncture. What will be wise to look at are the various conditions which SEBI has imposed for the relaxation of takeover norms. Exemption from the provisions of the takeover code would be denied if these conditions are not satisfied. These prerequisites are:[17]

- Company board needs to be replaced by central/state government body.
- Conditions, needs of competitive process, should be reasonable and fair.
- Process provides for details including time and manner in which change of control can be effected.
- No competitive bids allowed after acquirer makes public announcement.
- Acquirer making offer should be granted relaxation by the board.
- Target company board needs to apply to SEBI for relaxation.
- New board directors require coming up with transparent, open plan.

Of note is that whenever SEBI is tasked with relaxing takeover norms, it always keeps the interest of the minority shareholder at the forefront. Typically, when a company files an application with SEBI for an exemption of the open offer norms, the regulator's decision is based on whether the

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16 Reg. 25(2B) of the *Regulations*, *Id.*, inserted as a result of amendment, reads as follows: "No public announcement for a competitive bid shall be made after an acquirer has already made the public announcement pursuant to relaxation granted by the Board in terms of regulation 29A."

17 *Karnik Welcomes SEBI's Takeover Norms for Firms*, IBN LIVE, Feb 15, 2009 *available at* http://ibnlive.in.com/news/karnik-welcomes-sebis-takeover-norms-for-firms/85396-7.html?from=search (based on exclusive interview with Kiran Karnik on CNBC-TV18).

exemption sought would be in the interest of other shareholders and whether the relaxation of provisions is in the interest of the public, investors and the securities market at large.

Is it right to make an exception and surpass the regulation proposed by a well renowned committee of experts[18] after much thoughts and deliberations just because it does not suit the present case? Divergence from the existing law to the extent of putting an entire chapter in the takeover code just for one company! Is it justified?

A set of corporate experts believe that by waiving the conditions of takeover the Indian government is trying to protect Satyam and its shareholders over its contingent liabilities.[19] You cannot overlook the efforts of the committee which took a whole year to draft these regulations. Now to bring in an exemption with just one week of background, specifically for one company, can in no manner be justified.

The regulator's move is also being criticized on the point that it falls short of standards. Going by the language of the amendment, any listed company in which a government or regulatory authority has appointed new persons to act as directors "for the orderly conduct of affairs" would qualify for exemptions at SEBI's discretion. This gives a very wide interpretation to the amended regulation, for instance, it leads to automatic exemption for those public sector companies whose boards are replaced entirely by the government (without any reference to even alleged fraud). Some experts believe that since the exemption power of SEBI is discretionary, the possibility for abuse is as wide or as narrow as SEBI permits.

But what is required is that we have to view all these development not from a critical point of view but with a little objectivity. It has to be understood that nothing remains static and change is the need of the hour. It is not the first time that the takeover code is being amended. Whenever a need is felt the board has shown itself capable of changing to meet those needs, and incorporating such changes into the present code. SEBI's approach in no way makes a specific exception in the case of Satyam, but revises the rules

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18 Bhagwati Committee.

19 Contingent liability is "an obligation that may result, but is not likely to result because the event causing the obligation is improbable. For example, the award from a lawsuit against a firm is a contingent liability of the defendant if there is little likelihood the plaintiff will recover the award." DAVID L. SCOTT, WALL STREET WORDS 78 (3d ed. 2003).

altogether so that they are applicable to other companies as well. Even in the history of biggest corporate scandals like Enron, Parmalat, Worldcom, etc., there have been significant changes which were introduced in the laws of the respective countries. For example, we have witnessed the enactment of the Sarbanes-Oxley Act[20] after Enron. Additionally, after the Parmalat scam in Europe a lot of compliance and disclosure oriented legislations were passed.

Hence the current move of SEBI is very well thought out and understandable. If viewed objectively there are innumerable advantages that come to us with the recent amendments. Some of these are:

- It avoids creating special rules for individual companies. Identifying the need for special rules as well as creating those special rules from time to time is a strenuous task and often leads to a lot of ambiguities and confusion.
- The change in the code with respect to the pricing norm was long overdue and it may benefit other acquirers because the existing SEBI rules' reliance on the six-month average requires acquirers to make open offers at prices way above the current market prices, particularly as markets have been on the decline. In any event, the six-month average has already been relaxed in other, similar, situations where that average is considered for minimum pricing of various corporate transactions such as GDRs/ADRs/FCCBs and qualified institutional placements (QIP).[21]
- SEBI's move has the effect of modifying the takeover code to the extent that the whole process, which was hitherto controlled by the acquirer, is now controlled by the seller. Until now it had been the buyer or the acquirer who decides when to make an open offer and so on. This created a great deal of uncertainty and unpredictability in the whole transaction.

In the wake of the amendment, therefore, it would be extremely foolhardy to say that the amendment to the

[20] The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002, and commonly called Sarbanes-Oxley, Sarbox or SOX, was enacted July 30, 2002. Pub. L. No. 107-204, 116 Stat. 802. Sarbanes-Oxley establishes new or enhanced standards for all U.S. public company boards, management, and public accounting firms.

[21] This move was taken by the government in the year 2008 after the sudden downturn in the security market. Proposal of the finance Ministry as well as SEBI was to shorten the time period to calculate the floor price for these securities. The finance ministry decided to trim the 6 month period to 2 months. Vivek Nair, *Relief Bells Ring in Pricing of ADRs*, TELEGRAPH, Aug. 18, 2008, available at http://vv.telegraphindia.com/1080818/jsp/business/story_9706649.jsp.

takeover code is a hasty step just to suit the condition of the devastated company. Rather, it is a weapon in the hands of the regulator to make the code efficient enough to deal with similar cases in the future. The very fact that the present regulations were not enough to deal with Satyam, highlights the loopholes in the code and a need for change. The question "whether such a change in the long run would leave room for its abuse" cannot be anticipated at this juncture. This is the time of crisis and every possible technique to overcome this crisis is a welcome move.

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