

Ruling on passive buyback a boon for market players

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The year 2011 has witnessed a dramatic overhaul of the regulations governing the acquisition and takeover of listed companies. While a dampened capital market has left players with a lot to desire in terms of suitable opportunities to test the provisions of the revised Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations (takeover code) of 2011, as the year drew to an end the Securities Appellate Tribunal (SAT) has gone on to give market players and SEBI some additional food for thought.

On 21 November, the SAT at Mumbai (in the matter of *Raghu Hari Dalmia & Ors v SEBI*) passed an order that could have far-reaching consequences. It decided that an increase in shareholding due to buyback of shares by a company would not give rise to any obligations under regulation 11(1) of the takeover code of 1997.

Where it started

In the case in question, OCL India, a company promoted by the Dalmias and some others, announced and successfully carried out a scheme for the buyback of its equity shares in 2003. As a result of the buyback, the shareholding of the promoters rose from 62.56% to 75% of the company's total paid-up capital. As the promoters had not participated in the buyback, they did not make any public announcement to acquire shares as mandated under the takeover code.

Pursuant to issuing a show-cause notice, SEBI held that the promoters had violated the provisions of regulation 11(1) of the takeover code. The promoters, by way of appeal,

brought the matter before the SAT for determination.

Definition of acquirer

Based on its examination of the definition of an "acquirer" under section 2(b) of the takeover code of 1997, the SAT held that only persons who take direct or indirect positive action for the purpose of increasing their shareholding in a target company would fall under its ambit. An increase in shareholding as a result of a buyback is not due to any direct or indirect positive action of the person but rather a passive increase incidental to the buyback and therefore any beneficiary of such increase would not, directly or indirectly, be an acquirer.

On this basis, the SAT has taken the view that a beneficiary of a passive increase in shareholding in such circumstances would not be bound by any obligations under regulation 11(1) of the takeover code.

In reasoning out its order, the SAT provided an illustration which states that an increase in the percentage shareholding of a non-promoter due to a buyback, if considered a trigger for making a public announcement, would lead to a non-promoter being burdened with an onerous liability, thereby going against settled principles of legal interpretation.

Possible implications

The judgment in its essence appears to draw a line on who would fall under the definition of an "acquirer", and to exempt the application of certain provisions of the takeover code in cases where there is a passive increase in shareholding due to a buyback. However, questions abound as to the scope of this ruling and as to whether

it will hold good in other cases where similar obligations arise under the takeover code.

It is also left to be seen whether a similar outcome will result under the takeover code of 2011, which is now in force. Further, though the illustration given in the order seems relevant, questions remain as to whether promoters who control the board of a company can truly be considered to play passive roles in determining the timing of a buyback and whether this could be an opening for promoters to increase their stake when the markets are low.

Will SEBI toe the line?

SEBI has long maintained that even a passive increase in shareholding would attract provisions of the takeover code. By way of an amendment to regulation 11 made in 2008, SEBI expressly declared that an increase in shareholding of up to 5% as a result of buyback of shares via the stock market would be exempt from public announcement requirements. The idea behind this amendment clearly seems to have been that in cases of passive increase in shareholding beyond this limit, the shareholders concerned could approach the regulator to obtain a similar exemption.

This decision of the SAT may have come as a jolt to the regulator and it remains to be seen whether SEBI will accept this stance or appeal the matter to the Supreme Court. While the next step in this matter rests in the hands of SEBI, for now, market players may have reason to cheer.

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