DEFINING 'CONTROL' UNDER THE INDIAN COMPETITION ACT

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ABSTRACT

The Competition Act, 2002 proposes to regulate acquisitions of "control" over corporate entities, as distinct from acquisitions of securities. Yet, neither the Act nor the Rules thereunder provide a clear explanation of which contractual rights would result in a conferral of control.

The task of defining control has since been carried out by the Competition Commission of India on a case-to-case basis. Through this article, an attempt is made to draw out a consistent definition of the concept of "control" from the decisions of the Commission. In the second part of the article the Commission's interpretation of the "solely for investment" exemption is discussed. It is concluded that the Commission's broad interpretation of "control" and narrow interpretation of "solely for investment" has resulted in an unreasonable widening of the regulatory net under the Act. Throughout, the article compares the jurisprudence under the Competition Act with that under the regulatory regimes of the United States and the European Union.

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I. INTRODUCTION

The Competition Act, 2002 ["Competition Act"] was brought into force in order to regulate trade and corporate restructuring practices that threaten competition. In order to do so, the Act delineates the kinds of transactions that are likely to have an adverse effect on competition, and requires that parties submit such transactions to scrutiny by the Competition Commission of India ["CCI"]. "Combinations" are a category of transactions that are required to be notified to the Commission for this purpose. Combinations can arise through various kinds of acquisitions – of shares, voting rights, assets, or *control*.

While acquisitions of shares and voting rights can be objectively identified, acquisitions of control are far more difficult to discern. The first section of this paper examines the legislative framework in India surrounding the definition of control, the decisions of the Commission interpreting the threshold for control, and the regulatory regime governing acquisitions of control in the US and EU. The second section of this paper examines the categories of combinations that are considered unlikely to have an appreciable adverse effect on competition and are exempt from the requirement to notify the CCI. In particular, the paper examines the scope of the "solely for investment" exemption, and compares it to the analogous exemption under US antitrust law.

II. DEFINING 'CONTROL'

A. Legislative Framework

Section 6 of the Competition Act requires any person who proposes to enter into a combination to give notice of the same to the CCI. Section 5 of the Act defines 'combinations' to include certain acquisitions, mergers, and amalgamations which reach a specified asset or turnover threshold. Acquisitions may be of shares, voting rights, assets, or control in an enterprise.

Schedule I of the Competition Commission of India (Procedure in Regard to the Transaction of Business Relating to Combinations) Regulations, 2011 ["Combination Regulations"] lays down certain categories of transactions that are exempt from the requirement of notification under Section 6 of the Act. These include acquisitions leading to a less than 25% stake in shares when done solely as an investment or in the ordinary course of business, acquisitions by persons already holding 25% of shares when the resultant shareholding does not result in more than 50% and does not lead to the accrual of sole or joint control and acquisitions by persons already holding 50% of shares so long as it does not result in a change from joint to sole control.

The concept of control is therefore relevant for determining both whether a transaction results in a combination under Section 5 of the Act as well as whether a transaction falls within the exemptions specified under Schedule I of the Regulations. However, there is no clear definition of the concept of "control" under either the Competition Act or the Combination Regulations. An explanation to Section 5 of the Competition Act defines control in simplistic terms as "controlling the affairs or management". This fails to identify the types of contracts that would have the effect of conferring control on the acquiring entity. Thus, the task has fallen upon the Commission to formulate tests for determining the existence of "control" based on the cases brought before it.

B. Judicial Interpretation

The 2012 order of the CCI relating to the acquisition of shares by IMT in RB Mediasoft Pvt. Ltd. and other target companies[1] was one of the first decisions to shed light on the meaning of control under the Competition Act. In this case, IMT had subscribed to optionally convertible debentures in the target company. Upon conversion, IMT would hold more than 99.9% of the equity share capital in the company. Since convertible securities fall within the definition of shares, the requirement of a merger notification was triggered due to the acquisition of shares, independent of any acquisition of control.

However, the Commission went on to hold that the acquisition of the right to convert the securities would confer on IMT the ability to exercise decisive influence over the management and affairs of the target company and would amount to control for the purposes of the Competition Act. Thus, this decision appeared to raise the threshold of control from "controlling the affairs or management" in the explanation to Section 5 of the Act to "exercising *decisive influence* over the management and affairs" of the target company.

This decision of the CCI in *IMT* is very similar to the decision of the UK Monopolies and Mergers Commission ["MMC"] (the precursor to the UK Competition Commission) in *Stora/Swedish Match/Gillette*,[2] in which the issue was whether Gillette's acquisition of 22 per

[1] *Independent Media Trust*, Combination Registration No. C-2012/03/47 (28 May, 2012).
[2] *Stora/Swedish Match/Gilette*, UK Monopolies and Merger Commission, Cm. 1473 (March 1991).

cent of non-voting convertible loan stock in Wilkinson would amount to control over the affairs of Wilkinson. Though Gillette had no voting rights or board representation, the MMC held that "*a prudent Wilkinson board would be bound constantly to take into account the fact that Gillette was a major shareholder [...], was its largest creditor and had important rights in relation to significant decisions affecting the future of the company*". Thus, the fact that the non-voting loan stock could convert to ordinary shares under a number of circumstances was found to have the effect of conferring control on Gillette over Wilkinson.

In the *MSM/SPE case,*[3] the CCI had occasion to consider the role of veto or affirmative rights when held by minority shareholders. In this case, Grandway and Atlas, minority shareholders in the target company, held affirmative rights for matters such as opening new businesses, opening locations in new cities, hiring, terminating or amending the material terms of their employment of key managerial personnel, and amending the material terms of employee benefit plans. This meant that their affirmative consent was an essential prerequisite for any decision on these matters.

The Commission held that by virtue of having affirmative rights in respect of such *strategic commercial decisions*, Grandway and Atlas were in joint control of the target company. Thus, this case affirmed that certain types of affirmative rights – those relating to strategic commercial decisions – would be indicative of control.

The *Century Tokyo case*,[4] similarly, dealt with a contract granting affirmative rights to Century Tokyo over the business decisions of the Leasing Division of Tata Capital Financial Services Ltd. ["TCFSL"]. Century Tokyo had entered into a Business Partnership Agreement with TCFSL, under which certain decisions relating to the Leasing Division of TCFSL could not be taken without the approval of a Century Tokyo member. These decisions included approval of business plans, approval of budget and annual operating plans, commencing a new line of activity or discontinuing an existing line of business, appointment of Key Managerial Personnel and determination of their compensation. The Commission found that this control over *strategic affairs* would amount to joint control over the assets and operations of the leasing business of TCFSL. This finding is closely analogous to that arrived at in the *MSM/SPE case*.

[3] *MSM/SPE,* Combination Registration No. C-2012/06/63 (9 August, 2012).
[4] Century Tokyo Leasing Corporation/Tata Capital Financial Services Ltd., Combination Registration No. C-2012/09/78 (4 October, 2012).

From the aforementioned cases, the Commission appeared to have settled on a standard that emphasised the importance of veto or affirmative rights in relation to strategic commercial decisions of the target company. However, this trend was disrupted by the decision of the Commission in the *Jet/Etihad case*,[5] which served to substantially widen the scope of "control" under the Act. In this case, Etihad had acquired a twenty-four percent equity stake and the right to nominate two (out of twelve) directors to the Board of Directors of Jet.

The Commercial Cooperation Agreement between the two entities also provided certain additional rights to Etihad, such as the right to recommend candidates for senior management of Jet, as well as the right to govern certain joint initiatives with Jet. However, there were no specific provisions for veto or affirmative rights relating to key commercial decisions. Yet, the Commission found that these agreements that were aimed at enhancing business through joint initiatives had the effect of establishing Etihad's joint control over the assets and operations of Jet.

The *Jet/Etihad* decision is significant not only for departing from the Commission's prior focus on linking control to affirmative rights but also for provoking the Securities and Exchanges Board of India ["SEBI"] to differentiate the interpretation of control under the Competition Act from the interpretation under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ["Takeover Code"]. Subsequent to the decision of the CCI, the SEBI was called upon to determine whether Etihad had in fact acquired "control" over Jet, which would trigger the requirement to make an open offer under the Takeover Code.

Drawing a distinction between the object and purpose of the Competition Act and the Takeover Code, SEBI held that the requirement of "control over affairs and management" under the Competition Act was much wider than the requirement of "control over management or policy *decisions*" under the Takeover Code.[6] Thus, the fact that Etihad had no affirmative or veto rights, no quorum rights, and no casting vote rights in relation to the policy decisions of Jet indicated that it did not meet the higher threshold under the Takeover Code for establishing control.

[5] *Jet/Etihad*, Combination Registration No. C-2013/05/122 (12 November, 2013).
[6] *Jet/Etihad*, Securities and Exchange Board of India, Case No. WTM/RKA/CFD-DCR/17/2014.

The exact points of departure of the Takeover Code from the Competition Act on the definition of control remain unclear. Yet, there are certain contractual arrangements that receive distinct treatment under the competition regime and the securities regime. For instance, while affirmative voting rights are consistently considered a strong indicator of control under the Competition Act,[7] the interpretation of the Takeover Code is not as unequivocal.

The *Subhkam Ventures* case is infamous for having missed the opportunity to clarify the interpretation of the Takeover Code in this regard. In this case, the SEBI held affirmative rights to be indicative of control, the SAT reversed this finding, and the Supreme Court ultimately chose to neither confirm nor reverse the SAT's decision, deliberately leaving the question of law open.

More recently, the Whole Time Member ["WTM"] of the SEBI was once again faced with the question of whether affirmative voting rights would amount to control.[8] Ultimately, the WTM found this question unnecessary for determining the matter, since the agreement conferring affirmative rights had lapsed. Yet, the observation of the WTM in obiter that "[i]t is apparent that the scope of the covenants in general is to enable the Noticees to exercise certain checks and controls on the existing management for the purpose of protecting their interest as investors rather than formulating policies to run the Target Company" suggests that the SEBI is unlikely to arrive at a finding of control on the mere basis of affirmative rights. Another contractual arrangement that is viewed differently by these two regulatory regimes is the transfer of convertible securities. While the acquisition of convertible debentures in itself signifies control under the Competition Act,[9] it is not clear whether the same would hold true under the Takeover Code.[10]

Thus, the CCI's decision in *Jet/Etihad* stands out for substantially diluting the requirements of control and for proposing a definition of control that is markedly different from that followed by other regulatory bodies such as the SEBI or the erstwhile Foreign Investment Promotion Board ["FIPB"]. Having multiple definitions of "control" under

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[7] *MSM/SPE*, Combination Registration No. C-2012/06/63 (9 August, 2012); *Century Tokyo Leasing Corporation/Tata Capital Financial Services Ltd.*, Combination Registration No. C-2012/09/78 (4 October, 2012).
[8] In the matter of Kamat Hotels (India) Limited, Order number WTM/GM/EFD/DRAIII/20/MAR/2017 dated March 31, 2017.
[9] *Independent Media Trust*, Combination Registration No. C-2012/03/47 (28 May, 2012).
[10] *See* Mr. Victor Fernandes v. SEBI, Appeal No. 55 of 2015, SAT (13 April, 2016).

different legislations can lead to a great deal of uncertainty for parties involved in complex transactions.

At the same time, there is a need to account for the differing policy objectives of competition law and securities law.[11] The rationale behind the mandatory open offer requirement under the Takeover Code is to provide investors with an exit option since there may be a change in the management of the affairs of the company due to the change in control. Thus, it is relevant whether the "control" can be used to put in place policies unattractive to minority shareholders. However, the Competition Act is concerned with the broader economic impacts of acquisitions of control in the relevant market. Thus, competition law is concerned with whether the "control" can be used to influence price and supply in order to create an appreciable adverse effect on competition. Put simply, the SEBI focuses on the effects *within* the merged entity, while the CCI focuses on effects *external* to the merged entity, within the relevant market.

In the *Jet/Etihad case*, it was reasonable for the SEBI and the FIPB to find that there was no control by focusing on whether Etihad was acquiring significant control over the Board of Directors or other decision-making structures within Jet. On the other hand, the CCI was more concerned with intentions of Jet and Etihad to form *strategic alliances* and function as a single commercial entity for numerous projects, while maintaining their separate corporate identities. Thus, while Etihad did not exercise "control" over Jet in the strict sense, the joint control exercised by Jet and Etihad over a number of key initiatives made it a fit case for inquiry by the CCI.

Though the *Jet/Etihad* decision raised concerns that the net for merger notifications had been unreasonably widened, subsequent decisions of the CCI appear to have reverted to the standard of affirmative rights over strategic commercial decisions. In the *Alpha/Tata case*,[12] the acquirers subscribed to 17.36 percent of the equity share capital of SGSPL. The Investment Agreement further reserved certain matters in respect of which no action could be taken without prior written consent of the Acquirers. These matters included appointment and removal of key managerial personnel, modifying the annual budget or business plan, and amendments to the memorandum or articles of association.

[11] SEBI, Discussion Paper on "Brightline Tests for Acquisition of 'Control' under SEBI Takeover Regulations", para. 14, available at https://www.sebi.gov.in/sebi_data/attachdocs/1457945258522.pdf.
[12] *Alpha/Tata*, Combination Registration No. C-2014/07/192 (9 September, 2014).

The CCI held that these amounted to strategic commercial decisions and therefore the requirement of consent of the acquirers for such decisions was not merely a minority protection measure but would amount to full-fledged control. Similarly, in the *Aviva case*,[13] the CCI held that the existence of affirmative rights on resolutions regarding carrying on of business and appointment or removal of directors would amount to control as per the decisional practice of the Commission.

Thus, the decisions of the CCI on the issue of control under the Competition Act show a general trend of emphasising on the requirement of affirmative or veto rights over strategic commercial decisions, despite the jurisprudential deviation of the *Jet/Etihad* case.

C. Comparative Law Analysis

The European Council Regulation on the control of concentrations between undertakings ["The EC Merger Regulation"] lays down a requirement for notification of "concentrations" above a certain threshold value to the Commission.[14] Concentrations, similar to combinations under the Competition Act, arise *only* when one entity acquires direct or indirect "control" in another.[15] This control may be acquired through purchase of securities or assets, or through other contractual rights. Unlike under Indian law, purchase of securities and acquisition of control are not considered to be separate types of transactions. Rather, purchase of securities may *result* in the acquisition of control. Thus, the simple acquisition of a shareholding in another company is not subject to EU merger control, unless it confers upon the acquirer either sole or joint control.

The Regulation goes on to define control as (1) Ownership or right to use all or part of the assets in the company; or (2) Rights that confer the ability to exercise *decisive influence* on the composition, voting or decisions of the organs of an undertaking.[16] This language is similar to that used by the CCI in the *IMT case*.[17] The scope of control under the Regulation is further explained in the European Commission Consolidated Jurisdictional Notice under

[13] *Aviva International Holdings Ltd.*, Combination Registration No. C-2015/10/326 (9 November, 2015).
[14] Art. 4, Council Regulation (EC) No. 139/2004 on the Control of Concentrations between Undertakings (20 January, 2004).
[15] Art. 3(1)(b), Council Regulation (EC) No. 139/2004 on the Control of Concentrations between Undertakings (20 January, 2004).
[16] Art. 3(2)(b), Council Regulation (EC) No. 139/2004 on the Control of Concentrations between Undertakings (20 January, 2004).
[17] *Independent Media Trust*, Combination Registration No. C-2012/03/47 (28 May, 2012).

Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings ["EC Jurisdictional Notice"].

The Jurisdictional Notice also acknowledges that control can be acquired either through the acquisition of shares or assets or on a contractual basis. In order for control to be acquired on a contractual basis, the rights conferred by the contract should create a situation of control over management and assets similar to that in the case of share acquisition.[18] The Jurisdictional Notice also identifies the possibility of *de facto* control being established through situations of economic dependence, such as through long-term supply or credit agreements coupled with structural links.[19]

In EC law, therefore, the emphasis is on identifying situations in which *decisive influence* can be wielded over the target entity, rather than on specifying any precise shareholding thresholds. For instance, in the *News Corp/Premiere* case,[20] the acquisition of a 24.2% shareholding by News Corp was considered to confer on it a "de facto majority of the voting rights" and therefore de facto control, in light of the low attendance rates at annual general meetings. On the other hand, in *Ryanair/Aer Lingus*, the Commission found that a 25.17% stake in Aer Lingus did not grant Ryanair *de jure* or *de facto* control since Ryanair did not acquire any rights over and above those of an ordinary minority shareholder.[21]

In the US, the Hart-Scott-Rodino Act, 1976 ["HSR Act"] requires parties to mergers and acquisitions above a certain value threshold to file premerger notification reports with the Federal Trade Commission. The HSR Act stands apart from the Indian Competition Act as well as the EC Merger Regulation in that it only requires the notification of mergers when they involve the acquisition of "voting securities or assets" of a specified monetary value,[22] and not any other types of contractual rights or "control". Thus, unless there is an acquisition of voting securities beyond the threshold amount, the requirement to file a premerger notification is not triggered. This is a far narrower requirement than under Indian law, where the requirement to file a merger notification can be triggered by the mere acquisition of

[18] Para 18, Commission Consolidated Jurisdictional Notice under Council Regulations (EC) No. 139/2004 [2008/C-95/01] (16 April, 2009).
[19] Para 19, Commission Consolidated Jurisdictional Notice under Council Regulations (EC) No. 139/2004 [2008/C-95/01] (16 April, 2009).
[20] Case No Comp/M.5121 – News Corp/Premiere, European Commission (25 June, 2008).
[21] Case No Comp/M.4439 – Ryanair/Aer Lingus, European Commission (11 October, 2007).
[22] s.18a(a), Hart-Scott-Rodino Antitrust Improvements Act (1976).

convertible options or contractual rights to participate in the management and affairs of the target entity.

III. THE 'SOLELY FOR INVESTMENT' EXEMPTION

While Section 5 of the Competition Act lays down the positive test for determining whether a 'combination' for the purposes of the Act exists, Schedule I of the Combination Regulations lists certain categories of combinations that are exempt from the requirement to file a notification with the CCI since they are ordinarily not likely to cause an appreciable adverse effect on competition in India. The very first item in the Schedule refers to an acquisition of shares or voting rights which does not result in a holding of more than 25%, when done *solely for investment*. The second item in the schedule refers to an acquisition of shares by persons already holding 25% of shares when the resultant shareholding is no more than 50% and does not lead to the accrual of sole or joint control. The third item refers to acquisitions by persons already holding 50% of shares so long as it does not result in a change from joint to sole control.

In January 2016, the Competition Commission amended the provisions of Schedule I in order to further exempt transactions which are likely to have little or no effect on competition. The first item has been amended through the addition of a proviso specifying that an acquisition of less than ten percent of the total shares or voting rights shall be treated solely as an investment so long as it does not result in the acquirer gaining rights beyond those of an ordinary shareholder. Thus, the first item in the Schedule now divides share acquisitions into three different categories:

- Acquisitions up to 10%, which are to be treated as solely an investment and are therefore exempt, so long as the acquisition does not confer rights beyond those held by ordinary shareholders;
- Acquisitions between 10% and 25%, which may be exempted *if* they are shown to be solely an investment or in the ordinary course of business;
- Acquisitions by a person previously holding less than 25% of the shares that result in a holding of more than 25% of the shares, which are not entitled to an exemption.

The acquisitions covered by the exemption in item 1 do not apply if they result in an acquisition of control over the target company. Thus, for the exemption to apply, it must be shown that *first*, the acquisition resulted in a holding of less than 25%; *second*, the acquisition was solely for investment or in the ordinary course of business; and *third*, there was no acquisition of control.

The “solely for investment” exemption also exists under the United States HSR Act, where share acquisitions of up to 10% are exempt from merger notification requirements so long as they are *investment-only* acquisitions.[23] The HSR Rules state that an acquisition is investment-only if the acquirer has no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer.[24] As per the official interpretation of the exemption given in the Federal Register, if an investment is made by a *competitor*, that is sufficient to disqualify it from being investment-only. Accordingly, this exemption is widely recognised as having an extremely narrow scope. This is best illustrated by the *Third Point LLC case*.[25]

In this case, Third Point LLC made multiple acquisitions of Yahoo voting securities. Third Point did not make the requisite HSR filings, claiming that the acquisitions were exempt as investment-only acquisitions resulting in a less than ten percent holding. However, Third Point had taken certain actions that were inconsistent with an investment-only acquisition, such as contacting individuals to gauge their willingness to be CEO of Yahoo, and assembling an alternate slate for the Yahoo Board. For these reasons, the Commission found that their investment amounted to more than a passive investment, and Third Point was required to file notice with the Commission. Importantly, no actual *conduct* on the part of the acquirer is necessary to make an investment non-passive. Mere intention on the part of the acquirer to participate in the affairs of the target company is sufficient to establish a non-passive investment and prevent the applicability of the exemption.

The CCI interpreted the “solely for investment” exemption in the *SCM/DFPCL case* in August 2016.[26] In this case, the acquirers had obtained a 24.46% equity stake in MCFL. The acquirers did not file a combination notification, claiming to be exempted under the “solely for investment” exemption. The acquirers had not acquired any substantial contractual rights in respect of the management or affairs of the target company, and it could not be said

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[23] s.18a(c)(9), Hart-Scott-Rodino Antitrust Improvements Act (1976).
[24] Rule 801.1(i)(1), Rules, Regulations, Statements and Interpretations under the Hart-Scott-Rodino Antitrust Improvements Act (1976).
[25] *United States of America* v. *Third Point LLC,* Case No. 1:15-cv-01366 [District of Columbia] (18 December, 2015).
[26] *SCM/DFPCL*, Combination Registration No. C-2014/05/175 (30 July, 2014).

that they had acquired "control" in any form. However, the COMPAT, upholding the decision of the CCI, held that certain actions of the acquirers, including a press release referring to the investment as a "strategic fit with company's business", resulted in the investment taking the character of a *strategic investment* as opposed to a passive investment.[27]

The COMPAT also observed that the distinction in Schedule I between investments up to 10% and investments between 10% and 25% meant that acquisitions above 10% have to be scrutinised more rigorously in order to qualify as passive investments. Accordingly, the COMPAT upheld the finding of the CCI that the acquirers ought to have filed a combination notification. In April 2018, the Supreme Court affirmed the decision of the COMPAT.[28]

What is noteworthy in this case is that the parties were directed to file a combination notification based on the finding that the acquisition did not fall within the solely for investment exemption, in the absence of any separate finding on whether the acquisition actually resulted in *control*. The implication of this is that any case of share acquisition resulting in a holding of more than 10% will trigger a requirement to file a combination notification *unless* it is a passive investment. Given that the Supreme Court in this case has followed the extremely narrow interpretation of passive investment that was adopted under the HSR Act, this interpretation has the effect of catching a large number of unnecessary transactions within the net of combination regulation.

This case effectively renders the requirement to prove "control" redundant, since it does not even consider whether control has been established between the parties. While it is unclear whether the Supreme Court intended for its decision to have such sweeping implications, there is a need for the Commission to clarify the scope of the "solely for investment" exemption. Else, this ruling could have a chilling effect on shareholder advocacy, since investors will be wary of engaging in any level of participation in the affairs of the target company for fear of having to file a combination notification.

In conclusion, the introduction of the "solely for investment" exemption materially alters the extent of notifiable transactions under Section 6 of the Competition Act. It is worrying, however, that such a substantive amendment to the Commission's regulatory reach

[27] *SCM & DFPCL* v. *CCI*, Appeal No. 59/2015 [Compat] (30 August, 2016).
[28] SCM Solifert Ltd. & ANR. v. CCI, [Civil Appeal No(S). 10678 of 2016].

has been effected by the Commission itself through the Combination Regulations, instead of by Parliament through an amendment to the parent statute. It is worth considering, therefore, whether these Regulations suffer from the vice of *ultra vires* for having substantively amended the scope and meaning of "control" under the Competition Act.

IV. CONCLUSION

The combined effect of decisions such as *Jet/Etihad* and *SCM/DFPCL* has been to dilute the requirement for establishing control while simultaneously narrowing the scope of the "solely for investment" exemption. This has resulted in an uncertain and wide applicability of the requirement to file combination notifications under the Competition Act. While the 2016 amendments to the Combination Regulations heralded a shift toward investor-friendly regulations aimed at reducing unnecessary costs and filings, the decisions of the Commission and the COMPAT could be pulling the regulatory regime in the opposite direction.