2015 SCC OnLine CCI 210

Competition Commission of India

Order u/s 43A of the Competition Act, 2002 (“Act”)
in the notice given u/s 6(2) of the Act given by
SCM Soilfert Limited

Combination Registration No. C-2014/05/175

Decided on February 10, 2015

ORDER U/S 43A OF THE COMPETITION ACT, 2002 (“ACT”) IN THE NOTICE GIVEN U/S 6(2) OF THE ACT GIVEN BY SCM SOILFERT LIMITED

1. On 22nd May 2014, the Competition Commission of India (“Commission”) had received a notice under sub-section (2) of Section 6 of the Act, given by SCM Soilfert Limited (“SCM”) pursuant to a public announcement (“PA”) dated 23rd April 2014, issued in terms of the relevant provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares & Takeovers) Regulations, 2011 (“Takeover Regulations”) by SCM, as acquirer, and Deepak Fertilizers and Petrochemicals Corporation Limited (“DFPCL”), as person acting in concert, for acquisition of upto 26 per cent of the equity share capital of Mangalore Fertilizers and Chemicals Limited (“MCFL”). It is noted that SCM is a wholly owned subsidiary of DFPCL. Hereinafter SCM and DFPCL are collectively referred to as the “Acquirers”.

2. As stated in the notice, the proposed combination related to: (i) acquisition of 0.8 per cent equity share capital of MCFL through open market transactions (“Second Acquisition”); and (ii) acquisition of upto 26 per cent of the equity share capital of MCFL through an open offer as per the relevant provisions of the Takeover Regulations (“Open Offer”), by the Acquirers (“Proposed Combination”). Hereinafter, the Acquirers and MCFL are collectively referred to as the “Parties”.

3. In this regard, it was observed by the Commission that the Acquirers also held 24.46 per cent equity share capital of MCFL, prior to giving notice under sub-section (2) of Section 6 of the Act, which was acquired by them on a single day, i.e., on 3rd July 2013, through a number of block and bulk deals on the Bombay Stock Exchange (BSE) (“First Acquisition”). It was further observed that DFPCL in its press release dated 3rd July 2013 filed with the BSE and the National Stock Exchange (NSE), had stated that “given DFPCL's considerable strengths in the fertilizer business”, the purchase of 2,89,91,150 equity shares amounting to 24.46 per cent of the share capital of MCFL was a “very strategic and a good fit with the company's [i.e. DFPCL's] business”

and that, "DFPCL looks forward to working closely with MCFL to enhance long term value for the shareholders of both companies." Further, in this context, the Commission noted that this press release indicated that the First Acquisition was not made solely as an investment or in the ordinary course of business, and hence did not fall under Item 1 of Schedule I to the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("Combination Regulations"). The Commission noted that the notice in terms of sub-section (2) of Section 6 of the Act was not filed for the First Acquisition, and as per Section 43A of the Act, failure to file notice in terms of Section 6(2) of the Act is liable for penalty.

4. Further, it was observed that on 23rd April 2014, i.e., 29 days prior to filing of the notice, under sub-section (2) of Section 6 of the Act, the Acquirers acquired shares constituting the Second Acquisition, stated to be part of the Proposed Combination, raising their stake in MCFL to approximately 25.3 per cent. In this regard, the Commission also observed that the Second Acquisition was not only a part of the Proposed Combination, but it also raised the stake of the Acquirers in MCFL beyond 25 per cent and, therefore, the consummation of the same, without prior approval of the Commission, was considered to be in contravention of the provisions of sub-section (2) of Section 6 of the Act.

5. In view of the foregoing and material placed on record, the Commission in its meeting held on 30th July 2014 directed that penalty proceedings under Section 43A of the Act may be initiated against the Acquirers. Accordingly, on 12th August 2014 show cause notices under Regulation, 48 of the Competition Commission of India (General) Regulations, 2009 ("General Regulations") read with Section 43A of the Act were issued to the Acquirers, requiring them to show cause, in writing, within 15 days of the receipt of the show-cause notice as to why penalty, in terms of Section 43A of the Act, should not be imposed on them.

6. The Acquirers filed their reply on 1st September 2014 after seeking extension of time. In their reply to the show-cause notice, the Acquirers requested for an oral hearing. The Commission, therefore, heard the Acquirers in its meeting held on 30th October 2014. The Commission thereafter considered the submissions of the Acquirers and other material available on record in its meeting held on 10th February 2015.

A. First Acquisition

7. With regard to the First Acquisition, the Acquirers in their reply filed on 1st September, 2014 contended that:

7.1. The UB group, the promoters of MCFL, were in financial difficulty

and hence various lenders started selling shares of various companies belonging to the UB group including those of MCFL, pledged to them by the UB group. This resulted in availability of a considerable number of MCFL's shares in the open market, thus presenting an excellent opportunity for potential buyers, including the Acquirers, to acquire the shares of MCFL from the market. The Acquirers made the First Acquisition knowing fully well that it would not secure any right to influence or control the management or affairs of MCFL and that this acquisition would not benefit them in any way other than in terms of earning dividends. According to the Acquirers, they viewed the First Acquisition as strategic only to a limited extent.

7.2. The Acquirers have stated that notwithstanding the statement of DFPCL to BSE, the Acquirers intention at the time of First Acquisition was to make an investment in MCFL. The Acquirers also stated that “while the possibility of a partnership with MCFL or its shareholders in the future had been considered, however there was no such intention of entering into a strategic partnership at the time of making the First Acquisition”.

7.3. The Acquirers have stated further that at the time of making the First Acquisition, they had not entered into any strategic relationship with MCFL, despite operating in the same sector. They contended that even till date, there had been no co-operation between SCM and MCFL on the operation of the latter. The Acquirers only acquired a pure shareholding stake in MCFL, which did not confer on them control over MCFL from a corporate governance perspective, nor did they have the ability to govern or steer the business strategy and management of MCFL in any manner, whatsoever. The Acquirers further contended that if they had the intention of acquiring anything more than a financial investment in MCFL at the time of making the First Acquisition, they would have acquired such additional number of shares that would have triggered an open offer in terms of the Takeover Regulations to acquire additional 26 per cent shares in MCFL, and concurrently filed a combination notification with the Commission under sub-section (2) of Section 6 of the Act.

7.4. The Acquirers also contended that in certain other combination notices, the Commission had looked into the corporate governance rights and other joint initiatives contemplated by the parties to those combinations to determine that such combinations were “strategic” in nature.

7.5. The Acquirers have stated that the First Acquisition was neither made with any intention to acquire control of MCFL, nor did the Acquirers envisage any involvement in the business and

management of MCFL. Accordingly, the First Acquisition was "solely for investment" purpose, as given under Item 1 of Schedule I to the Combination Regulations.

7.6. The Acquirers have contended that "Regulation 4 of the Combination Regulations [read with] Item 1 of Schedule I to the Combination Regulations exempts transactions involving an acquisition of shares or voting rights, if: (a) they are made solely as an investment; or (b) in the ordinary course of business; and (c) the acquisition does not entitle the acquirer to hold 25 per cent or more of the total shares or voting rights of the target enterprise; and (d) the transaction does not lead to an acquisition of control." With regard to applicability of Item 1 of Schedule I to the Combination Regulations to the First Acquisition, the Acquirers contended that: (a) the First Acquisition did not entitle them to hold 25 per cent or more of the total shares/voting rights in MCFL; and (b) the First Acquisition did not lead to an acquisition of control and that it was merely a purchase of shares, and that no additional management rights, such as affirmative voting rights, were attached to the same.

7.7. The Acquirers have further contended that they had exercised all due diligence to ascertain that the First Acquisition was not notifiable by virtue of the exemption available to them under Item 1 of Schedule I to the Combination Regulations and therefore, they did not notify the First Acquisition to the Commission, under the bona fide good faith belief that the First Acquisition had not triggered the requirement for notification under the relevant provisions of the Act. The intention to acquire 26.8 per cent stake subsequently cannot be attributed to paint the First Acquisition as anything other than an acquisition of shares made solely as an investment. The Commission cannot impute the intention of SCM, developed and acted upon in 2014, to a transaction that took place at a different point of time, without any basis and contrary to its own legal standards.

8. With respect to the submissions of the Acquirers, as discussed in paragraph 7 above, it is observed that:

8.1. The Acquirers contended that the First Acquisition was not notifiable as it was exempted from notification under Item 1 of Schedule I read with Regulation, 4 of the Combination Regulations. From a perusal of Item 1 of Schedule I to the Combination Regulations, it is amply clear that Item 1 read with Regulation, 4 of the Combination Regulations deems acquisitions as normally not notifiable provided that the proposed acquisition of shares or voting rights does not entitle the acquirer to hold 25 per cent or more of total shares or voting rights, directly or

indirectly, in the target enterprise and does not lead to a change of control and is made (i) solely as an investment, or (ii) is in the ordinary course of business.

8.2. It is observed that the categories of combinations listed in Schedule I to the Combination Regulations must be interpreted in light of the Commission's objectives (listed in Section 18 of the Act) and the intent of Schedule I (expressed in Regulation, 4 of the Combination Regulations). This means that the categories of combinations listed in Schedule I as normally not notifiable ought not to include combinations which envisage or are likely to cause a change in control or are of the nature of strategic combinations including those between competing enterprises or enterprises active in vertical markets.

8.3. In the instant case, the Acquirers have contended that the First Acquisition was made 'solely as an investment'. In this regard, it is observed that the phrase 'solely as an investment' indicates 'passive investment' as against a 'strategic investment'. Therefore, to qualify for Item 1 of Schedule I to the Combination Regulations, an acquisition must not have been made with an intention of participating in the formulation, determination or direction of the basic business decisions of the target or likely to cause or result in the same. Such participation by the acquirer in the business decisions of the target enterprise may be through various means including by means of voting rights, agreements, representation on the board of the target or its affiliate companies, affirmative/veto rights in the target, etc.

8.4. In the instant case, as stated above, it is noted that the First Acquisition was made by the Acquirers on a single day, i.e. on 3rd July 2013, through a number of block and bulk deals on the BSE. In this regard, it is noted that majority of the shares, amounting to 19.9 per cent of the shares of MCFL, were acquired through block deals. Further, as stated earlier, pursuant to First Acquisition, DFPCL had filed a press release with the BSE and the NSE. In its press release dated 3rd July 2013, DFPCL had stated that "given DFPCL's considerable strengths in the fertilizer business", the purchase of 2,89,91,150 equity shares amounting to 24.46 per cent of the share capital of MCFL was a "very strategic and a good fit with the company's [DFPCL's] business". The press release further stated that "DFPCL looks forward to working closely with MCFL to enhance long term value for the shareholders of both companies."

8.5. As stated above, the Acquirers in this regard, have contended that the First Acquisition would not help it benefit in any way other than in terms of earning dividends. It is observed that on a

dividend yield basis, the acquisition of shares by the Acquirers in MCFL, if it was made only for the sake of earning dividends does not seem to be a sound investment, since as per the information available in public domain, for the financial year 2012-13, MCFL declared a dividend of only 12 per cent on face value of INR 10/- (i.e. INR 1.2 per share),[1] which, on absolute terms comes to less than 2 per cent (approx.) as the average price per share acquired was more than INR 60.

8.6. Further, it has been observed that as per the media reports, the Acquirers and the Zuari group[2] have been in a takeover bid for MCFL since April 2013. In April 2013, Zuari group purchased shares amounting to 16.43 per cent of MCFL's share capital. Soon thereafter, the Acquirers made the First Acquisition. Further, the Acquirers have not provided any evidence to support their claim that there was no

8.7. In view of the foregoing, it is evident that the First Acquisition was not made solely as investment or in ordinary course of business and should have been notified in terms of sub-section (2) of Section 6 of the Act and therefore the Acquirers on account of their failure in this regard are considered to be liable for penalty under Section 43A of the Act.

B. Second Acquisition

9. The Acquirers in their reply dated 1st September 2014 have contended the following with respect to Second Acquisition:

9.1. The Second Acquisition was duly notified to the Commission and has not yet been consummated. As per the Acquirers, the shares acquired, representing 0.8 per cent stake in MCFL, were kept in an escrow account maintained with their escrow agent and depository participant. The Acquirers also entered into an escrow agreement in this regard. The contentions of the Acquirers with respect to Second Acquisition may be summarised as follows.

9.2. In order to ensure compliance with the requirement under Section 6(2A) of the Act but at the same time exercising their right to acquire such numbers of MCFL securities that would have helped them to make the Open Offer, the Acquirers resorted to the only means possible for ensuring that the Second Acquisition is not consummated. The Acquirers through SCM entered into an escrow agreement, whereby the shares acquired were credited into a specifically designated escrow account, which was to be maintained till approval of the acquisition by the Commission. The escrow agreement, inter alia, provides that SCM shall not exercise its legal and beneficial rights accruing upon the acquisition of shares by way of the Second Acquisition, till such time the shares

are held in the escrow account.

9.3. The definition of the term “share” under Section 2(v) of the Act refers to “shares in the share capital of a company carrying voting rights”. This means that so long as an acquirer of shares is unable to exercise its voting rights, the mere transfer of shares from one owner to another cannot be viewed as consummation of a transaction for acquisition of shares.

9.4. The Second Acquisition was not consummated and it was to be consummated only upon fulfilment of all the conditions specified in the escrow agreement, including receipt of approval from the Commission.

10. With respect to the submissions of the Acquirers, it is observed that:

10.1. As already stated above, the Second Acquisition is part of the Proposed Combination. The decision to keep the acquired shares in an escrow account maintained with the escrow agent and to not exercise any beneficial interest, including voting rights, with respect to the Second Acquisition was that of the Acquirers and not due to any statutory requirement in this regard. Further, the Act and Combination Regulations do not exempt a situation wherein a buyer acquires shares but decides not to exercise legal/beneficial rights in them, from the purview of the provisions of the Act in general, and Section 43A of the Act, in particular. Therefore, the Acquirers' contention that the Second Acquisition was not consummated, as the shares were kept in an escrow account and they were not entitled to exercise any legal or beneficial rights over them till approvals of regulatory bodies are obtained, is not tenable under the law.

10.2. With regard to the Acquirers' claim that the shares acquired through the Second Acquisition were not “shares” within the meaning of the Act, it is observed that as per Section 2(v) of the Act, “shares” includes shares in the share capital of a company carrying voting rights[3]. In this regard, it is not disputed by the Acquirers that the shares constituting the Second Acquisition carry voting rights with them. Therefore, despite the subsequent decision of the Acquirers to not exercise voting

10.3. It is further observed that in terms of sub-regulation (1) of Regulation, 3 of the Takeover Regulations, it is mandatory to initiate an open offer if an acquirer has acquired 25 per cent or more stake in a listed company. However, there is nothing in the Takeover Regulations to suggest that an open offer cannot be initiated without breaching the 25 per cent threshold. Sub-regulation (1) of Regulation, 3 of the Takeover Regulations reads

as follows:

> "No acquirer shall acquire shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, entitle them to exercise twenty-five per cent or more of the voting rights in such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations."

10.4. The FAQs released by the Securities and Exchange Board of India provide clarification in this regard.[4] As per the FAQs, "any person with or without holding any shares in a target company, can make an offer to acquire shares of a listed company subject to minimum offer size of 26 per cent". The foregoing suggests that acquisition of 0.8 per cent (i.e. Second Acquisition) was not sine qua non for initiating the Open Offer.

10.5. Further, the Acquirers have consummated the Second Acquisition twenty-nine (29) days prior to giving the notice in terms of sub-section (2) of Section 6 of the Act, thereby contravening the provisions of Section 6(2) of the Act.

11. In terms of Section 43A of the Act, if any person or enterprise fails to give notice under sub-section (2) of Section 6 of the Act, the Commission shall impose on such person or enterprise a penalty which may extend to one per cent of the total turnover or the assets, whichever is higher, of such a combination. However, considering the fact that the Acquirers disclosed the requisite information, and given the quantum of turnover of the Proposed Combination, the Commission considered it appropriate to impose a nominal penalty of INR Two Crores (INR 2,00,00,000 only) on the Acquirers. The Acquirers shall pay the penalty within sixty (60) days from the date of receipt of this order.

12. The Secretary is directed to communicate to the Acquirers accordingly.

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[1] Source http://www.moneycontrol.com/company-facts/mangalorechemicalsfertilisers/dividends/MCF01#MCF01.

[2] The Zuari group, now known as Adventz group, is headed by Mr. Saroj Poddar. It has interests in fertilizer sector through its various group companies including Paradeep Phosphates Ltd., Zuari Agro Chemicals Limited and Zuari Fertilisers Limited. intention on their part to gain control over MCFL, either immediate or long term. Infact, the Acquirers themselves stated in the Reply that they had considered the possibility of a partnership with MCFL or its shareholders in the future. In this regard, it is noted that the Acquirers and MCFL are engaged in similar businesses.

[3] Section 2(v) of the Act reads as follows:

> ""shares" means shares in the share capital of a company carrying voting rights and includes—
>
> (i) any security which entitles the holder to receive shares with voting rights;
>
> (ii) stock except where a distinction between stock and share is expressed or implied." rights associated with such shares, the acquired shares being part of the Proposed Combination, were "shares" within the meaning of the Act. Further, as stated above, non-exercise of voting rights for a limited period of time with respect to the Second Acquisition is a self-imposed contractual obligation taken upon by the Acquirers.

[4] Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1399625542441.pdf.