

Draft Rules for Combinations/ Merger Regulation in India

The Ministry of Corporate Affairs (MCA) has published a series of draft rules and opened these up for public consultation till April 10, 2024:

1. The Draft CCI (De Minimis) Rules, 2024 (**Draft De Minimis Rules**);
2. The Draft CCI (Exempted Combinations) Rules, 2024 (**Draft Exempted Combinations Rules**); and
3. The Draft CCI (Green Channel) Rules, 2024 (**Draft Green Channel Rules**).

While the changes seem to codify existing practices, the scope of many existing exemptions may stand constricted, especially the exemption related to minority acquisitions.

A. Proposed change to ‘materiality thresholds’ for overlap assessment:

- ▮ The overlap assessment is key to presenting the parties’ arguments on the potential impact of a transaction. It is also the basis for availing the Green Channel (automatic acknowledgement) route for obtaining clearance from the Competition Commission of India (CCI).
- ▮ Which entities of the acquirer group/ target group are to be considered for the overlap assessment? The answer is currently available in the CCI’s Notes to Form I, where entities that meet the materiality thresholds are referred to as “affiliates”.

- ▮ The scope of these thresholds will change, and they will also become relevant to the applicability of the current Item 1 exemption in Schedule I to the Combinations Regulations.¹
- ▮ Here is a tabular representation of the changes in the definition of an “affiliate”:

Present definition of an affiliate	Proposed definition of an affiliate ²
Currently, an entity is considered to be an affiliate of another enterprise if the said enterprise has: 1. direct or indirect shareholding of 10% or more; or 2. a right or ability to exercise any right that is not available to an ordinary shareholder; or 3. a right or ability to nominate a director or observer.	Per the proposed definition, an entity will be an affiliate of another enterprise if the said enterprise has: 1. 10% or more of the shareholding or voting rights ; or 2. a right or ability to access commercially sensitive information (CSI) ; or 3. a right or ability to have a representation on the board of directors either as a director or an observer.

¹ CCI (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011
² Explanation (b), Rule 3 of the Draft Green Channel Rules and Explanation 2, Schedule to the Draft Exempted Combinations Rules

Impact

- ▮ **Emphasis on information rights:** Applying materiality thresholds to determine overlaps between the acquirer's and the target's businesses will now include a determination of information rights as opposed to "special rights" that the party to the combination has in other companies. This is arguably a broader threshold because information rights are not presently strictly considered for this purpose, per market practice. In recent times, however, the CCI has started to emphasize on information rights during informal consultations.
- ▮ **What is CSI?** It is unclear what the CCI intends to include within the umbrella of CSI. An illustrative list of such information, at least in the FAQs that the CCI routinely publishes, would be helpful. Investors routinely seek basic information on the financials and operations of companies that they are invested in to protect the viability of their investment. It is also common knowledge that investors would not likely be able to influence the affairs of the investee company or generally impact competition dynamics in the market based on this information.
- ▮ The proposed change directly impacts (i) the availability of the Green Channel (*see below*); and (ii) the exemption for minority investments (Item I of Schedule I to the existing Combinations Regulations) (refer point B on this page).
- ▮ **Availability of the Green Channel:** The proposed change directly impacts the availability of the Green Channel route. The Green Channel is applicable where there are **no** horizontal/ vertical/ complementary overlaps. For ruling out overlaps, business activities of "affiliates" (i.e., entities which meet materiality thresholds) of the acquirer group are mapped against the target and its downstream affiliates.
- ▮ The inclusion of access to CSI (instead of all special rights) in the materiality thresholds, could broaden the scope of "affiliates" since investors often have access to at least some information for tracking the financial health of the investee company. A wider ambit of "affiliates" would make the overlap assessment process more time consuming and could limit the number of cases where the Green Channel route is available.

B. Exemption for Minority Acquisitions (Item 1 of Schedule I to the Combinations Regulations):

The Draft Exempted Combinations Rules split the concept of minority acquisitions into two – "ordinary course of business" and "solely as an investment" – explaining these concepts narrowly and limiting the scope of the exemption that has been available (in some form or the other) since June 2011.

1. Acquisition of shares/ voting rights in the ordinary course of business (OCB)

The OCB exemption will apply to only a **limited category** of acquisition of shares or voting rights:

1. **Acquisition of unsubscribed shares by underwriters:** provided the acquirer holds less than 25% shares or voting rights post the transaction;
2. **Acquisition of shares by stockbrokers:** provided the acquirer holds less than 25% shares or voting rights post the transaction;
3. **Acquisition of shares by mutual funds:** provided the acquirer holds less than 10% shares or voting rights post the transaction.

Impact

- ▮ CCI's decisional practice has already limited the scope of the OCB exemption to purchases of securities intended at benefitting only from the price movement of such securities (without any right or ability to participate in decision making, access CSI, or influence strategic business decisions).
 - ▮ The proposed definition in the Draft Exempted Combinations Rules will restrict the scope of the exemption further and prevent most minority investors from relying on the exemption. The exemption will only be available to underwriters, stockbrokers, and mutual funds, subject to certain conditions.
- ### 2. Acquisitions of shares/ voting rights made solely as an investment (SOI) & upto 24.99%:
- ▮ Minority acquisitions made solely as an investment will be subject to two thresholds: (i) acquisition of less than 10% shares or voting rights and (ii) acquisition of shares or voting rights between 10-24.99%.

- ▮ The 10-24.99% threshold will be subject to another condition – there must be no overlaps between the acquirer group (including affiliates, as explained in point A on page 1) and the target (including affiliates).
- ▮ Both these thresholds and the specific conditions in which they will apply are discussed below:

	Proposed conditions for the SOI Exemption
Acquisition of less than 10% shares or voting rights	<p>Exempt if:</p> <ol style="list-style-type: none"> 1. There is no acquisition of control over the target; and 2. The acquirer does <u>not</u> gain a right or ability to: <ol style="list-style-type: none"> a. have board representation (a director or observer); or b. access CSI
Acquisition of shares or voting rights between 10-24.99%	<p>Exempt if:</p> <ol style="list-style-type: none"> 1. There is no acquisition of control over the target; 2. The acquirer does not gain a right or ability to: <ol style="list-style-type: none"> a. have board representation (a director or observer); or b. access CSI and 3. The acquirer group (including affiliates) does not have any horizontal or vertical or complementary overlaps with the target group (including affiliates).



- ▮ Acquisitions in the 10-24.99% range by sector investors or acquirers holding investments in companies that have horizontal, vertical or complementary overlaps with the target may need to be notified (assuming materiality thresholds are met – refer point A on page 1) even if there are no control rights, no board seats, and no access to CSI.

- ▮ **Observer rights cast in stone:** The Draft Exempted Combinations Rules specifically list, as a condition to the SOI exemption, that the acquirer must not have the right or ability to appoint either a director or an observer. This is in line with recent CCI trends.

3. Exemption for additional acquisition of shares/ voting rights below 25%:

- ▮ Currently, Items 1A and 2 of the Combinations Regulations (covering acquisitions of additional shares or voting rights by an existing investor) apply to acquisitions where the existing investor has 25% or more shareholding/ voting rights.
- ▮ The Draft Exempted Combinations Rules clarify that additional acquisitions by existing minority investors (holding less than 25% shares/ voting rights) would be exempt if the conditions below are satisfied.

Impact

- ▮ The standard of access to ‘special rights’ in the current Combinations Regulations is proposed to be replaced by the access to CSI standard.

Condition 1	The acquirer must continue to hold less than 25% in the target post the additional acquisition		
Condition 2	There must be no acquisition of control		
Condition 3	Scenario A There are overlaps	Scenario B No overlaps	Scenario C There are overlaps and the acquirer's shareholding will become 10% or more because of the additional acquisition
	The incremental acquisition must not exceed 5%	No cap on the incremental acquisition (provided the acquirer continues to hold less than 25%)	The exemption will not be available

Impact

- ⌞ Existing investors would be able to increase their shareholding/ voting rights percentage all the way up to 24.99% without triggering a CCI notification requirement, as long as: (i) there are no overlaps; and (ii) there is no acquisition of control rights.
- ⌞ However, for sector investors, who have overlapping investments, the exemption will allow an incremental acquisition of less than 5% (subject to a maximum cap of 25% and provided no control rights are acquired).
- ⌞ A further restriction that has been proposed is that if an investor (with overlapping investments) trips the 10% mark because of the additional acquisition, the exemption will not be available.

For example: An investor with overlapping investments may avail the exemption if its shareholding increases from 5% to 9%, provided no control rights are acquired. However, if the shareholding increases from 9% to 13%, the exemption will not be available.

C. Exemption for Minority Acquisitions (Item 1 of Schedule I to the Combinations Regulations):

Exemptions prescribed for certain types of acquisitions will not apply if there is a “**change in control**” because of the acquisition. These are:

- (a) Additional acquisition of shares/ voting rights by an existing investor between 25% to 49.99%

Impact

This is a codification of practice. e.g., if an acquirer holds 30% and acquires an additional 2%, which results in the acquisition of certain rights it did not previously have (such as the right to appoint an observer/ director, or additional veto rights), then the acquirer may have to seek CCI approval.

- (b) Acquisition of shares or voting rights, where the existing investor continues to hold 50% or more shares or voting rights, both prior to and post the transaction.

Impact

The present Combinations Regulations stipulate that acquisitions where the acquirer already has more than 50% shares or voting rights prior to the transaction are exempt if there is **no transfer from joint to sole control**. The Draft Exempted Combinations Rules lower this threshold, and state that the exemption will not be available if there is **any change** in control.

D. Exemption for Demergers

- ⌞ Presently, no specific exemption is available for demergers, and these are treated as acquisitions for the purpose of applying the Schedule I exemptions. For instance, a demerger may be exempted if it meets the criteria for the intra-group acquisition exemption (Item 8 of Schedule I to the Combination Regulations).

- ▮ The Draft Exempted Combinations Rules now incorporate a specific provision, exempting demergers where the resulting company issues shares to the demerged company (or its shareholders) **in proportion to their existing shareholding in the demerged company.**

Impact

- ▮ This provision will benefit demergers involving mirror shareholdings and internal restructurings (by way of demergers), which may not presently meet the strict criteria stipulated in the Item 8 exemption (covering intra-group acquisitions).

E. Intra-group acquisitions, mergers and amalgamations

1. No specific exemption for intra-group acquisition of shares/ voting rights

The Draft Exempted Combinations Rules do **not** provide for specific exemptions for **intra-group** acquisition of **shares and voting rights.**

Impact

- ▮ This means that going forward, intra-group acquisition of shares/ voting rights may be exempt only if they fall under Item 5 of the Draft Exempted Combinations Rules. The proposed Item 5 exempts acquisitions where:
 - the acquirer/ its group entities already have 50% or more shares or voting rights; and
 - there is **no** change in control.

2. Exemption for intra-group mergers and amalgamations and asset acquisitions

- ▮ Intra-group: (i) mergers and amalgamations and (ii) asset acquisitions, will be exempt provided there is **no change in control.**

Impact

- ▮ At present, intra-group mergers and amalgamations are exempt if there is **no transfer from joint to sole control.** This will now be replaced with the “no change in control” standard.
- ▮ Currently, the exemption also requires that more than 50% shares or voting rights of the merging/ amalgamating parties must be held by the same group. This 50% threshold is proposed to be deleted and all intra-group mergers/ amalgamations will be exempt if there is no change in control.

F. De Minimis Rules

- ▮ The De Minimis Rules make no notable change and list the increased thresholds (pursuant to notification issued by the MCA on March 7, 2024) for availing the de minimis/ small target exemption.
- ▮ The increased thresholds are tabulated below.

	Old threshold	New threshold (basis notification dated March 7, 2024)
Asset threshold	INR 350 crore	INR 450 crore
Turnover threshold	INR 1,000 crore	INR 1,250 crore

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