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The Indian antitrust regulator fines parties for gun jumping (Zuari Fertilisers and Chemicals and Zuari Agro Chemicals)

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The Competition Act, 2002 ("**Act**") read with the attendant Combination Regulations provide for a mandatory notification of the transaction to the Competition Commission of India ("**CCI**") provided that threshold limits provided under the Act are met ("**combination**"). The Act provides for a suspensory regime i.e. the parties cannot consummate a combination (for which CCI approval is required) without obtaining the approval of CCI. Further, a strict time frame is also given (30 days from the trigger date) for notification, failing which penalties can be levied under Section 43 A of the Act. The penalty exposure for non notification of a combination or consummation of the combination without obtaining the approval of the CCI is huge and exposes the parties to a penalty which may be upto 1% of the assets and turnover of the combination. As such, the CCI has used this power increasingly to levy fines under Section 43 A of the Act.

In a recent case, the CCI had received a merger notification from Zuari Fertilisers and Chemicals Limited ("ZFCL") and Zuari Agro Chemicals Limited ("ZACL") (collectively referred to as the Acquirers) pertaining to a shareholders agreement dated 12th May 2014 [1], entered into between the Acquirers, and the UB group comprising United Breweries (Holdings) Limited, Kingfisher Finvest India Limited and McDowell Holdings Limited for an acquisition of upto 3,08,13,939 equity shares of Mangalore Chemicals and Fertilizers Limited (MCFL) (representing additional 26 per cent stake in MCFL), as per the relevant provisions of SEBI Takeover regulation. CCI held that during the continuation of the tranche agreements, transactions approx. 16.43% in the equity share capital of MCFL was consummated prior to giving notice under sub-section (2) of Section 6 of the Act. CCI held that the parties had not provided adequate evidence to the effect that Acquisition was solely as an investment to qualify the exemption under Entry 1, Schedule 1 of the Combinations Regulation [2]. Furthermore, the CCI relied on a television interview of the head of the Acquirer's company interview that the Acquirers and the then-Chairman of MCFL and promoter of UB group, i.e. Mr. Mallya wanted to operate MCFL as joint venture between Zuari and UB group which affirmed the intent of the parties to consummate the transaction to some extent. However, the final penalty

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amount was reduced as the Acquirers had disclosed the information regarding the mode and timeline of the Acquisition, and given the quantum of the turnover of the combination, CCI deemed fit to impose a penalty of Rs. 3 crores [3].

Furthermore, in relation to the same transaction [4], CCI did not provide an exemption to the a part of the acquisition between the parties despite parties' plea that the acquired shares were in an escrow account maintained with the escrow agent and the parties were not exercising any beneficial interest, including voting rights. CCI clarified that the Act and the 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, was held to be untenable under the law. The implication of the decision remains that merely keeping the shares in an escrow account after consummation of certain part of the transaction would not rectify the violation of Section 6(2) of the Act in the first place [5].

It is interesting to note that this is not the first time wherein the CCI has imposed a penalty on parties for gun jumping.

Way forward

Based on the above decisional practice of the CCI, it is imperative that enterprises willing to invest in India are aware of the best practices to ensure that they are in compliance with the Combination Regulations. The practices that have to be kept in mind include the following:

(a) **Mandatory notification**: The primary issue which has to be kept in mind by the companies is when to notify a combination. The Act provides for a fixed time frame (30 days from the trigger date) within which the combination has to be filed with the CCI for approval. Non- filing of combination within the stipulated time frame attract penalties from the CCI, even though the transaction in itself is cleared by the CCI. Further, the CCI is now looking into "substance over form" i.e. if an ultimate effect of a transaction is as a result of multiple transaction, the CCI looks into the substance of the transaction and is penalizing parties if the transaction has been structured in such a manner to avoid notification. Therefore, the parties must be cautious and must undertake the following activities:

• Trigger event and by when the transaction needs to be notified to the CCI.

• In case of a global transaction, the transaction may need to be notified to the CCI even when the deal has no local nexus to India.

• Does the transaction amounts to acquisition of control by the investor. Past decisional practices of the CCI shows that even a minority investment coupled with veto rights constitute control and hence, such transaction requires notification to the CCI.

• Even if the parties have no overlaps, such transaction may also require notification to the CCI. It may be a technical filing which will be expeditiously cleared by the CCI, but such clearance is required.

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• Parties must exercise due diligence in analyzing whether their transaction does fall within the exception provided under the Act and Combination Regulations.

(b) **Gun jumping**: As mentioned above, the Act provides for a suspensory regime i.e. the parties cannot consummate a combination (for which CCI approval is required) without obtaining the approval of CCI. The CCI has, in the past, levied a penalty on parties who have taken steps to consummate the transaction prior to obtaining approval of the CCI.

There are certain practical issues, which are at play, which needs to be kept in mind. Generally, certain standstill obligations will be put in place by the investor to ensure that the target company and its promoters do not indulge in certain practices (during the period between signing and closing of the transaction) to protect the interest of the investor during the interim period. However, the investor must be cautious not to indulge in certain activities during the standstill period which is viewed by the authorities as integration steps, and hence indulging in "gun jumping". In considering pre-closing integration activities and standstill obligations, the parties should be aware that Act and the outlook of the CCI is an important factor to avoid huge financial exposure. Certain good practices are mentioned below which may be followed by the parties to ensure that they do not violate the "gun jumping" rules. However, these "good practices" are not exhaustive:

• **Deal documentation**: It is in the commercial interest of the investor to seek protection of its investment value i.e. the business of the target company must not change during the period between signing and closing. Therefore, the right of the investor to veto decisions of the target company which are outside the ordinary course of business may be legitimate. Contra, if the investor seeks to control the target's ordinary course of business, it will be viewed as gun jumping. What is construed as ordinary course of business will be a question of fact!

• **Gun jumping guidelines**: Clear and unambiguous gun jumping guidance must be in place for those involved in integration as to what can and cannot be done. The said guidelines have to be customized to sector and market realities. Transition planning (how to conduct the business post the approval without implementing) is permissible and such transition planning must be done with appropriate legal guidance. The parties to the transaction should limit the information sharing to such minimum extent which is required to prepare the parties for post approval integration process. Commercially sensitive information (pricing, cost pattern, list of top customers) must not be shared. A practical way of sharing commercial sensitive information, if required, is to use a "clean team" where the personnel identified for receiving such commercial information must be clearly identified to carry out the applicable due diligence activity and such personnel must be different from the actual personnel involved in the operations both pre and post closing period. Such clean teams agreement must be carefully worded to avoid enterprise liability and also personal liability of those involved in information sharing.

[1] Please refer to the order passed under Section 43 A of the Act by the Competition Commission of India in the notice given under Section 6(2) of the Act given by Zuari Fertilizers and Chemicals Limited and Zuari Agro Chemicals Limited (C-2014/06/181) available at http://www.cci.gov.in/May2011/Order...

[2] Exemption under Entry 1 Schedule I states that any acquisition of shares or voting rights, solely as an investment or in the ordinary course of business, which does not entitle the acquirer to

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exercise more than 25% or more of the shares or voting rights of the target company and not leading to acquisition of control by acquirer will not require a merger notification.

[3] Combination Registration No. C-2014/06/181, decided on 10 February 2015, Para 9-12

[4] Please refer to the order passed under Section 43 A of the Act by the Competition Commission of India in the notice given under Section 6(2) of the Act given by SCM Soilfert Limited (C-2014/05/175) available at http://www.cci.gov.in/May2011/Order...

[5] Combination Registration No. C-2014/05/175 decided on 10 February 2015, Paragraph 10.1

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