

**BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI**

Appeal No. 8 of 2009

Date of decision: 15.01.2010

M/s. Subhkam Ventures (I) Private Limited
15, Onlooker Building,
14, Sir P M Road, Fort,
Mumbai – 400 001.

..... Appellant

Versus

The Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4-A, “G” Block,
Bandra Kurla Complex, Bandra (East),
Mumbai.

..... Respondent

Mr. Somasekhar Sundaresan Advocate with
Mr. Ravichandra S. Hegde and Mr. Vaibhav Ingole Advocates for the Appellant.

Mr. Kumar Desai Advocate with Ms. Daya Gupta Advocate for the Respondent.

CORAM : Justice N.K. Sodhi, Presiding Officer
Samar Ray, Member

Per : Justice N.K. Sodhi, Presiding Officer

Whether the share subscription and shareholders agreement executed by and between Subhkam Holding Private Ltd. (now taken over by the appellant), MSK Projects (India) Ltd. (hereinafter referred to as the target company) and its promoters as referred to in Schedule I to the agreement gives to the appellant ‘control’ over the target company is the short question that arises for our consideration. Facts giving rise to this appeal lie in a narrow compass and these may first be noticed.

2. M/s. Subhkam Ventures (I) Private Limited is the appellant before us. It was formerly known as M/s. Subhkam Holding Private Limited which was the entity that triggered the open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter called the takeover code). That entity has merged into the appellant and consequently all the rights and

obligations in connection with the open offer now vest in the appellant. The appellant is an “acquirer” within the meaning of the takeover code and belongs to the group “Subhkam Ventures” promoted by Rakesh S. Kathotia and Mrs. Arti R. Kathotia. Mrs. Arti Kathotia and M/s. Subhkam Securities Private Limited belonging to the same group are persons acting in concert with the appellant in the open offer to acquire shares of the target company.

3. The board of directors of the target company in their meeting held on October 20, 2007 issued and allotted 44,50,000 fully paid up equity shares of Rs.10 each on preferential basis representing 19.91 per cent of the equity share capital of the target company for cash at a price of Rs.84 per share (including premium of Rs.74 per share) aggregating to Rs.37,38,00,000/-. The appellant was allotted 40,00,000 shares representing 17.90 per cent of the post preferential issue of equity capital. This allotment was made after the shareholders of the target company passed a special resolution under Section 81(1A) of the Companies Act, 1956 in the extra-ordinary general meeting held on August 27, 2007. A share subscription and shareholders agreement was executed on October 20, 2007 between the appellant, the existing promoters of the target company and the target company and this agreement governs the investment made by the appellant. It will be referred to hereinafter as ‘the agreement’. There is a recital in the agreement that the appellant is only a financial investor in the target company and shall not be considered to be a promoter of that company and that the control and management of the target company shall continue to vest in the promoters and that the appellant shall not acquire control and management of that company for any reason whatsoever.

4. Since the acquisition of the appellant along with its existing shareholding and that of the persons acting in concert with it was in excess of 15 per cent of the voting rights in the target company, Regulation 10 of the takeover code got triggered and it made a public announcement for an open offer to acquire 45,77,572 equity shares of the target company from its public shareholders. This public announcement was made on October 24, 2007. As on the date of the public announcement, the appellant along with persons acting in concert with it held 54,23,000 equity shares of the target company representing 24.26 per

cent of its equity share capital. Regulation 18 of the takeover code requires the acquirer to file with the Securities and Exchange Board of India (for short the Board) a draft letter of offer through its merchant banker containing the required disclosures. This draft letter which is to be sent to the shareholders has to be filed with the Board within 14 days from the date of the public announcement. Accordingly, on November 2, 2007 the appellant filed with the Board the draft letter of offer under Regulation 10 of the takeover code through Collins Stewart Inga Private Limited, the merchant banker to the open offer. This draft letter of offer in accordance with the takeover code sought to acquire more than 20 per cent of the voting rights of the target company from its public shareholders at a price of Rs.84 per share. Clause 3.3.3 of the draft letter clearly mentioned that “The Acquirer is merely a financial investor and this acquisition will not result in a change in control of the Company and therefore, the Acquirer will not be in control of the management of the Target Company.” After the filing of the draft letter of offer, the Board sought further information from time to time from the merchant banker which was provided through emails and also orally at the meetings held with the Board. The appellant kept emphasizing that the acquisition by it would not lead to a change in control of the target company. By its letter dated December 5, 2007 sent through the merchant banker, the appellant clarified that it would not acquire control of the target company and further undertook that if at all control were to be acquired by it at any later stage, the appellant would comply with the takeover code and make an offer to the public shareholders under Regulation 12 at that stage. After exchange of some further correspondence between the parties, the Manager, Corporation Finance Department, Division of Corporation Restructuring of the respondent Board by his letter dated April 28, 2008 conveyed the comments of the Board under Regulation 18(2) of the takeover code. Besides general comments which are not in issue before us, the Board directed that the offer document be revised to reflect that the open offer was being made under Regulations 10 and 12 (change in control) instead of Regulation 10 only. It appears that after the filing of the draft letter of offer, the merchant banker was holding meetings with the officers of the Board from time to time trying to emphasize upon them that there was no question of making an offer under Regulation 12 of the takeover code as there was no

change in control envisaged and it was reiterated that the appellant was merely a financial investor and cannot be termed as a promoter of the target company. In one of the meetings of the representatives of the parties, clauses 5 and 9 of the agreement came to be discussed and the Board seemed to be of the view that these two clauses give ample powers to the appellant by virtue of which it could exercise control over the target company. The appellant claims and, which fact has not been disputed before us, that it agreed to amend clauses 5 and 9 suitably to allay the apprehensions of the Board. The appellant further claims that in pursuance to the said meeting, it proposed some changes in clauses 5 and 9 of the agreement and sent those changes to the Board through email on June 13 and June 24, 2008 on the request of the Board. After some further correspondence between the parties, the Board finally by its letter dated August 13, 2008, inter alia, directed the appellant to abide by the comments offered by it as per its letter dated April 28, 2008 and also by the subsequent comments offered on June 13, 2008. Feeling aggrieved by the decision of the Board, the appellant filed Appeal no. 103 of 2008 before this Tribunal which came up for hearing on October 23, 2008 and the same was allowed on the ground that the decision taken by the Board did not contain reasons for the same. The order impugned in the appeal was set aside and the case was remitted back to the Board with a direction to pass a fresh order in accordance with law after giving reasons. After remand, the Board has by its order dated December 15, 2008 reiterated its earlier decision giving detailed reasons for the same. It is against this order that the present appeal has been filed under Section 15T of the Securities and Exchange Board of India Act, 1992.

5. The case of the appellant is that by virtue of the agreement it did not acquire control over the target company and, therefore, Regulation 12 of the takeover code did not get triggered and that it rightly made the open offer only under Regulation 10. The Board, on the other hand, refers to the various clauses of the agreement and insists that the appellant acquired control over the target company and that it should mention Regulation 12 also in the letter of offer so that proper disclosures are made to the shareholders to enable them to take an informed decision. 'Control' carries with it certain responsibilities and obligations which the appellant does not want to be burdened with.

The learned counsel for the appellant contends that the appellant is a financial investor in the target company and only wants to protect its investment through the various clauses in the agreement and has no intention to take over its control.

6. From the rival stands of the parties, what we need to examine is whether Regulation 12 also got triggered when the appellant acquired 24.26 per cent equity shares of the target company pursuant to the agreement. At this stage, it would be relevant to refer to the provisions of Regulations 10 and 12 of the takeover code which are reproduced hereunder for facility of reference:

“Acquisition of fifteen per cent or more of the shares or voting rights of any company.

10. No acquirer shall acquire shares or voting rights which (taken together with shares or voting rights, if any, held by him or by persons acting in concert with him), entitle such acquirer to exercise fifteen per cent or more of the voting rights in a company, unless such acquirer makes a public announcement to acquire shares of such company in accordance with the regulations.

Acquisition of control over a company.

12. Irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the regulations.”

Regulation 10 applies where the acquirer by virtue of his acquisition exercises fifteen per cent or more of the voting rights in a company and Regulation 12, on the other hand, would get attracted when an acquirer acquires control over the target company irrespective of whether or not there has been any acquisition of shares or voting rights in that company. In a given case, both the Regulations may get triggered simultaneously but they could also apply independently in different sets of circumstances. The term control has been defined in Regulation 2(1)(c) of the takeover code to “include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.” This definition is an inclusive one and not exhaustive and it has two distinct and separate features: i) the right to appoint

majority of directors or, ii) the ability to control the management or policy decisions by various means referred to in the definition. This control of management or policy decisions could be by virtue of shareholding or management rights or shareholders agreement or voting agreements or in any other manner. This definition appears to be similar to the one as given in Black's Law Dictionary (Eighth Edition) at page 353 where this term has been defined as under:

“Control – The direct or indirect power to direct the management and policies of a person or entity, whether through ownership of voting securities, by contract, or otherwise; the power or authority to manage, direct, or oversee.”

Control, according to the definition, is a proactive and not a reactive power. It is a power by which an acquirer can command the target company to do what he wants it to do. Control really means creating or controlling a situation by taking the initiative. Power by which an acquirer can only prevent a company from doing what the latter wants to do is by itself not control. In that event, the acquirer is only reacting rather than taking the initiative. It is a positive power and not a negative power. In a board managed company, it is the board of directors that is in control. If an acquirer were to have power to appoint majority of directors, it is obvious that he would be in control of the company but that is not the only way to be in control. If an acquirer were to control the management or policy decisions of a company, he would be in control. This could happen by virtue of his shareholding or management rights or by reason of shareholders agreements or voting agreements or in any other manner. The test really is whether the acquirer is in the driving seat. To extend the metaphor further, the question would be whether he controls the steering, accelerator, the gears and the brakes. If the answer to these questions is in the affirmative, then alone would he be in control of the company. In other words, the question to be asked in each case would be whether the acquirer is the driving force behind the company and whether he is the one providing motion to the organization. If yes, he is in control but not otherwise. In short control means effective control.

7. In the backdrop of what we have said above, let us now examine whether the appellant, in the facts and circumstances of the present case, acquired control over the target company so as to trigger Regulation 12. The Deputy General Manager of the

respondent Board in the impugned communication has referred to various clauses of the agreement on the basis of which she has come to the conclusion that the appellant did acquire control over the target company and, therefore, directed the draft letter of offer to be revised so as to include both Regulations 10 and 12 which, according to her, triggered the takeover code. The first clause which she has referred to is clause 3.2(c) of the agreement which enables the appellant to appoint its nominee on the board of directors of the target company. We do not see how this clause can give control to the appellant. It is common ground between the parties that the board of directors of the target company consists of ten directors including the nominee of the appellant. Since the appellant has the power to nominate only one director, that nominee can, by no stretch of reasoning, exercise control over the affairs of the target company or control its board of directors. That single nominee would be in a microscopic minority and he has no veto powers. It is the admitted case of the parties that the target company is a Board managed company and the overall control of that company vests with the board of directors. The object behind such a nominee director is to enable the appellant which has made heavy investments in the target company to remain in the know of things of what is happening in the company and protect its interest in regard to the protective provisions contained in clause 9 of the agreement which shall be discussed later. After all, the appellant has made heavy investments in the target company and is interested in ensuring that the objects for which the company has been set up are not deviated from without its knowledge or consent. We are, therefore, satisfied that power with the appellant to nominate its director on the board of directors does not result in giving any control, much less effective control, over the target company. The next provision to which reference has been made by the Deputy General Manager is clause 4.1 of the agreement which deals with covenants. The target company and its promoters agreed that between the signing of the agreement and the allotment of shares to the appellant under the agreement, the target company would not change its basic contours. Clause 4.1 of the agreement is a conventional 'standstill' provision having a limited purpose of ensuring that between the signing of the agreement and the actual investment of funds into the target company, the latter shall not deviate from the basis on which the decisions to invest have been made. If there were to be any

material change during this period, the appellant could treat it as a breach of the agreement and terminate the same. It is, indeed, a transitional provision which would expire upon the investment being made by the appellant. How can such a clause demonstrate acquisition of control upon making the investment? Since this clause ceases to operate from the date of allotment of shares to the appellant, it cannot be regarded as conferring control on it. Reference has then been made to clause 7.2 of the agreement by which the appellant has power to appoint its nominee on the board of directors of the target company. We have already discussed this aspect while dealing with clause 3.2(c) and are of the view that these provisions do not confer any control. They only give a right to the appellant to participate in the governance of the target company which is quite different from control. Again, clause 7.3 of the agreement which gives a right to the investor director to be a member of any committee of the board and to vote at all meetings of such committees does not in our opinion give any control to the appellant. The object of this clause is that if what would be done at the board level is done at a committee level, the investor is kept apprised of the developments.

8. The next clause to which reference has been made is clause 7.7 of the agreement which ensures the presence of the investor director to constitute quorum for board meetings. This clause provides a quorum for a Board meeting which is three directors of which one director shall be the investor director. In a board meeting where three or more directors are present the investor director will always be in a minority and he has no veto power. This clause has to be read with clause 7.8 to which the Deputy General Manager has not made any reference. According to clause 7.8 if adequate quorum in any meeting is not present, the meeting shall be adjourned by a week at the same place and same time and in the adjourned meeting the directors then present shall constitute the quorum except that they cannot consider and vote on matters enumerated in clause 9 which deals with protective provisions. We shall presently be dealing with these provisions. Clauses 7.7 and 7.8 do not in our view vest any control in the appellant. This brings us to clause 9 of the agreement on which great emphasis was laid by the learned counsel for the respondent to contend that the provisions of this clause definitely confer controlling rights on the appellant. The Deputy General Manager in the impugned communication

has also referred to sub-clauses (a) to (o) of this clause to hold that the appellant will be in a position to influence major policy decisions of the target company by virtue of its 'affirmative vote'. She also holds that the appellant would be having veto rights on crucial matters pertaining to policy decisions which would confer control. In order to understand the implication of this clause, it is necessary to refer to its text which reads as under :

“9. PROTECTIVE PROVISIONS:

The parties hereby agree that until such time as the Investor equity shareholding in the Company does not fall below 10% of the paid equity share capital of the Company, the affirmative vote of the Investor Director shall be required in a meeting of the Board (or any committee thereof) in respect of any of the following matters:

- (a) any amendment of the Memorandum and/or Articles of the Company;
- (b) any consolidation, subdivision or alteration of any rights attached to any share capital of the Company or any of its subsidiaries, any capital calls on shareholders;
- (c) any redemption, retirement, purchase or other acquisition by the Company of any Shares of the Company;
- (d) approval of the Annual Business Plan and any deviation, revisions therefrom;
- (e) the sale or disposition by the Company of any its assets, except for sales of assets:
 - (i) which are in the ordinary course of business; or
 - (ii) if outside the ordinary course of business, which, during any Fiscal year of the Company, have a fair market value of less than Rupees One Crore only;
- (f) the making of any loan or advance by the Company to any Shareholder or any third party, or the entry by the Company into any guaranty, indemnity, or surety contract or any contract of a similar nature in favour of or for the benefit of any Shareholder or any third party outside the ordinary course of business, of a value in excess of Rupees Two Crores;
- (g) the acquisition by the Company through subscription, purchase or otherwise, of the securities of any other body corporate;
- (h) to create any lien or to lease, mortgage, charge, pledge, licence any assets, rights, titles, intellectual property etc. of the Company or its Subsidiaries valued in excess of 5% of the networth of the company;
- (i) the conduct by the Company of any business other than the Business and/or the acquisition of any assets not related to the Business;
- (j) any amalgamation, splitting, reorganization or consolidation of the company (or any Subsidiary thereof);

- (k) to alter the composition and strength of the Board or to delegate the authority or any of the powers of the Board to any individual or committee;
- (l) the winding up, liquidation or dissolution of the Company;
- (m) incurrence of indebtedness in the Company in excess of 5% of the networth of the Company other than as approved in the Annual Business Plan;
- (n) appointment of key officials of the Company e.g. CEO, COO, CFO, CS or of equivalent designation and the determination of their remuneration and powers;
- (o) any capital expenditures in excess of 5% of the networth other than as approved in the Annual Business Plan;
- (p) any authorization, creation, grant, issue, allotment redemption of any Shares or convertible instruments of any class, debentures or warrants, grants, options over Shares, or approval of the terms of a public issue by the Company, or approval or disapproval of any transfers thereof, except as provided under this Agreement;
- (q) filing of all offering materials to be utilized in connection with any public offering of shares of the Company;
- (r) any strategic alliance/joint venture proposal to be entered into by the Company;
- (s) approval of the annual financial statements, distribution of profits and coverage of losses of the Company and its Subsidiaries;
- (t) transactions with affiliates;
- (u) incorporation of subsidiaries, the acquisition of interests in any company or business or to acquire or sell shares, debentures, bonds or other securities/instruments in any company;
- (v) to settle, compromise or abandon any legal or arbitration proceedings, claims, actions or suits relating to the Company involving sums exceeding Rupees One Crore in respect of anyone such claim, action or suit or cumulatively exceeding Rupees One Crore in respect of claims, actions and/or suits in a Fiscal Year;"

Having carefully gone through each and every sub-clause of clause 9, we are of the view that it means what it says. The various sub-clauses are meant only to protect the interest of the acquirer (appellant) and the investment made by it. When we look to the affirmative voting rights of the appellant as ensured by this clause, it becomes more than clear that it does not want the target company to undergo any paradigm shift from its present position without the appellant's knowledge and approval. We are in agreement with the learned counsel for the appellant that the protective provisions under clause 9 are meant to ensure standards of good corporate governance and to protect the interests of the

shareholders including that of the appellant from the whims and fancies of the promoters of the target company. The list of matters provided in clauses 9(a) to 9(o) are not in the nature of day to day operational control over the business of the target company. So also, they are not in the nature of control over either the management or policy decisions of the target company. These provisions merely enable the acquirer to oppose a proposal and not carry any proposal on its bidding. For instance, if the appellant desires that a particular scheme of arrangement ought to be promulgated or that a particular acquisition of another company should be effected or that the Annual Business Plan should contain a particular strategy or that any suitable course of action ought to be adopted, the appellant has no right to have the same implemented. How then does the appellant have control over the target company? The learned counsel for the respondent laid great emphasis on clause 9(d) read with clause 15 of the agreement to contend that the affirmative vote of the investor director to the approval of the Annual Business Plan and to any modification therefrom gives a controlling right to the appellant. He also referred to clause 9(a) and emphatically urged that since no amendment to the memorandum or articles of association of the target company could be made without the affirmative vote from the appellant, it is a sure indicator of its having control over the target company. We are unable to agree with the learned counsel. It is quite usual for any corporate entity to prepare an Annual Business Plan to be implemented in the coming fiscal year and have the same approved from its board of directors before the commencement of that year. In the case before us, the target company also prepares an Annual Business Plan which lays down broad contours of the corporate activity to be implemented in the coming year which is approved by its board of directors where the appellant is in a minority. This business plan has to be rolled out in the coming fiscal year and its day to day implementation is looked after by the board of directors. If after approving the plan, the target company wants to deviate from it or make any changes therein, the same would require an affirmative vote from the appellant. We do not think that this provision gives any control to the appellant. On the contrary, it only enables the appellant to safeguard its own investment and the interests of the shareholders in general. Amendment of articles and memorandum of association of a company does not fall within the scope of its day to

day corporate activity. The mere fact that any such amendment requires an affirmative vote from the appellant is again indicative of the fact that it wants to protect its investment and that the basic structure of the company is not altered without its knowledge and approval. By no stretch of logic, can such an affirmative vote confer control over the day to day working of the company. Sh. Kumar Desai learned counsel laid great emphasis on sub-clause (n) to contend that no key officer of the target company like Chief Executive Officer, Chief Finance Officer, Company Secretary or of equivalent designation could be appointed without the affirmative vote of the appellant and this, according to him, vests significant control in the appellant. Here again, we are unable to agree with Sh. Desai. It is true that the affirmative vote of the appellant is required for the appointment of any of these key officers but even this provision does not mean that the appellant can get its candidate appointed. Affirmative vote of the investor in these matters is necessary for protecting its investment. We cannot infer from this provision that the appellant has gained control over the target company.

9. Provisions of clause 9 do impose fetters on the target company for purposes of good governance and it is conventional for financial investors to protect their investment and, indeed, the target company itself from the whims and fancies of the promoters who manage the target company. Such fetters fall far short of the existence of “control” over the target company. It must be remembered that every fetter of any nature in the hands of any person over a listed company cannot result in “control” of that person over that company. We also cannot lose sight of the fact that in the instant case even if the entire open offer is accepted and 20 per cent shares are tendered, the appellant would be far short of a simple majority that is necessary for getting an ordinary resolution passed. In these circumstances, we cannot hold that the appellant has gained control over the target company.

10. Having gone through the agreement carefully with the help of the learned counsel for the parties, we are clearly of the view that none of the clauses therein taken individually or collectively demonstrates control in the hands of the appellant. In this view of the matter, Regulation 12 does not get triggered and the Board was not justified

in making the appellant incorporate this regulation in the letter of offer. The question posed in the opening part of our order is, thus, answered in the negative.

In the result, the appeal is allowed and the impugned direction contained in the letter dated December 15, 2008 set aside with no order as to costs.

Sd/-
Justice N. K. Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

15.01.2010
ddg/-

Prepared and compared by – Devendra