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A COMPARATIVE ANALYSIS OF TAKEOVER LAWS: INDIA & HONG KONG

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Abstract

While there is extensive study on takeover regimes of developed economies with advanced capital markets, a comparative analysis of takeover regimes among Asian economies that do not essentially share similarities with the West is limited. The present study attempts to fill this gap. Through this paper, the author aims to study takeover regimes in the leading Asian economies of India and Hong Kong in a comparative context and bring to light points of convergence and divergence. The critical areas considered for comparison are mandatory bid rules, pricing guidelines, rules for competitive bidding and the concept of control. The approach adopted is doctrinal research. The research method adopted throughout the paper can be categorised as descriptive, comparative and analytical. The paper seeks to aid the existing literature concerning comparative takeover regulation.

Keywords: Asia, India, Hong Kong, Takeover, Control, Open Offer, Trigger Point, Acquisition

Introduction

Growing globalisation has had a manifold impact on individuals, organisations and the world economy.[2] Increased competition, changing business models, privatisation, foreign direct investment and trade liberalisation have led to the wave of mergers and acquisitions, joint ventures and takeovers. Though broad reasons for the emergence of takeovers are similar, the national regulatory responses have differed across jurisdictions. Takeover regulation does not develop in void; the method by which a country determines the regulatory framework for

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[1]LLM, National Institute of Securities Markets.

[2]Okoro Blessing, Ogochukwu Nebo and Okoro Victoria Ikodia, *The Impact of Globalisation on the World Economy in the Global Market and Production*, 13 IJAAER 105 (2017).

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corporate acquisitions explains a great deal about how a corporation functions within the country and how the broader process is viewed. While the United Kingdom (**U.K.**) and the United States (**U.S.**) have an established system of takeover regimes owing to highly developed capital markets, it is a relatively newer concept in Asian jurisdictions. Although several jurisdictions in Asia have modelled their takeover laws on the U.K.. City Code on Takeovers and Mergers (**U.K. City Code**), pertinent differences subsist among Asian countries due to domestic factors and market structures. These factors eventually influenced and shaped the takeover laws. The existing literature widely focuses on the variances in the takeover laws worldwide vis-à-vis the U.K. and U.S. However, analysing differences in regimes within the Asian jurisdictions has not been undertaken extensively. The present paper aims to illuminate the trajectory of takeover laws of Asian giants, i.e. India and Hong Kong, and provide an analytical framework to explain the divergence in the approach of these countries in ways that protect significant interests within each market's national corporate governance system. Based on this, the author delves into the prospect of reforms in the Indian takeover laws.

This paper centres on the two jurisdictions for several reasons. The countries under study share common interests in trade expansion and rapid development and have been powerful drivers of the global economy. On January 23, 2024, India overtook Hong Kong in terms of stock market capitalisation as the combined value of shares listed on the Indian stock exchanges amounted to $4.33 trillion vis-à-vis $4.29 trillion market capitalisation of Hong Kong.[3] This makes India the fourth largest stock market globally. Both the jurisdictions under study are based on the standard law system despite drawing heavily from the U.K. The City Code and the takeover laws of India and Hong Kong are laced with certain distinct features. In the context of India's developing[4] economy, the nature of takeover regulation mandates an approach with greater emphasis on mandatory bids and disclosure of substantial shareholding. Hong Kong, on the other hand, has fewer rigid regulations.

The principal analysis in this paper pertains to four critical areas of takeover laws: (1) mandatory bid rule (**MBR**), (2) pricing guidelines, (3) rules for competitive bidders, and (4) concept of

[3]Available at https://www.bloomberg.com/news/articles/2024-01-23/india-overtakes-hong-kong-as-world-s-fourth-largest-stock-market (Last visited January 25, 2024).

[4]See ibef.org/economy/foreign-direct-investment.aspx (Last visited October 23, 2023).

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control. The differences in critical concepts between the jurisdictions strike at the foundation of this paper.

Statement of the Problem

There is an extensive body of theoretical and empirical study on the developed economies of the U.K. and the U.S., which have advanced capital markets, concerning whether their experiences of takeover law are suitable for other countries (especially in Europe), considering the differences in their legal traditions. However, a comparative analysis of takeover regimes, particularly among Asian economies that do not necessarily find similarities with the West, is scarce. A limited comparative study of the Indian legal framework for takeover regulations has been undertaken vis-à-vis other leading economies in the sub-continent. The present study attempts to fill this gap. Through this paper, the author aims to examine takeover regimes in the leading Asian economies of India and Hong Kong and demonstrate the similarities and differences. Based on the understanding that the jurisdictions have adopted different ways to regulate takeovers, the paper makes a comparative analysis of laws in the critical areas of MBR, pricing guidelines, rules for competitive bidding and the concept of control.

Research Questions

The following pertinent questions concerning the two countries shall be dealt with through the course of this paper:

- What is the nature of the existing market structure?
- What is the threshold prescribed for triggering an open offer, and what is the role of market structure as a determining factor of MBR?
- What are the prescribed pricing guidelines?
- What are the prescribed rules for competitive bidding?
- What method is adopted to determine 'control' over a target company during a takeover, i.e. qualitative, quantitative or mixed, and rationale for the same?

Objectives

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The study's main objective is to make a comparative analysis of critical areas in the takeover regulations of India and Hong Kong, ascertain the similarities and differences and look into the potential for reforms in the Indian takeover regime. The specific objectives are:

- To demonstrate how the nature of market structure impacts the regulations.
- To examine the rationale for diverging trigger points for invoking mandatory open offers and the role of market structure in determining the thresholds.
- To study the guidelines for pricing.
- To examine the rules for competitive bidding.
- To examine the varied approaches undertaken to establish what constitutes 'control'.
- To explore the need for changes in the Indian takeover laws.

Scope & Limitations of Study

This paper is an effort to examine the substantive and regulatory framework of takeover laws in India and Hong Kong. The study examines the key concepts in each jurisdiction leading to the formulation of takeover laws and makes a comparative analysis. The author relies on the information on respective statutes available in the public domain in the online mode and other internet sources. Due to the nature of the study, the comparison is incomplete.

Research Methodology

The present study is founded on doctrinal research. The research method adopted throughout the paper can be categorised as descriptive, comparative and analytical.

- **Research Tools**

The literature review constitutes primary and secondary sources. The primary sources relied on include statutes and case laws of the jurisdictions under study. Secondary sources are comprised of books, journals, and relevant internet sources.

- **General Method of Analysis**

The present study uses a deductive approach to analyse the research questions and accomplish the research objectives. Logical deductions are drawn from the compilation of all the primary and secondary sources of the present study.

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- **Mode of Citation**

Throughout the paper, the researcher has followed the *Bluebook: A Uniform System of Citation: 20th Edition.*

Chapter 1: Overview of 'Takeover'

The change in the policy of liberalisation and globalisation in the 1990s resulted in the growth of the Indian economy at an increased pace. The opening of the economy led to a highly competitive business environment. This stimulated corporate restructuring through strategies and tools, including mergers and takeovers. In the backdrop of the then-present environment, exercising the powers conferred under Section 30 of the Securities and Exchange Board of India (**SEBI**) Act, SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1994 was enacted. Subsequently, the regulations have changed to keep in sync with the changing environment and demands of the corporate sector. SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997, substituted the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1994. In September 2009, SEBI, under the chairmanship of Mr. C Achuthan, constituted the Takeover Regulations Advisory Committee (TRAC). The Committee resolved to examine the SEBI (SAST) Regulations, 1997, and make necessary changes. In June 2010, the TRAC Report recommended far-reaching changes in significant areas such as trigger points for open offers, offer size, the applicability of exemptions from open offer obligations, calculation of offer prices, and competing offers. The report forms the foundation of the regulations in their present form, i.e., SEBI (SAST) Regulations, 2011 (**Takeover Code**) superseding the SEBI (SAST) Regulations, 1997.

'Takeover' is when one company, i.e., the acquirer, acquires a controlling stake in another company, known as the target company. The Takeover Code governs any direct or indirect acquisition of shares or voting rights in a target company or direct or indirect acquisition of control over a target company. For India's mergers and acquisitions landscape and the realm of capital markets, the Takeover Code has been a breakthrough advancement. The broad objective of the Takeover Code is to provide a legal framework for facilitating takeover activities fairly and transparently. The primary goal is to protect investors' rights and safeguard their investments. This is achieved by providing the public shareholders with an opportunity to exit

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their investment in the target company when a substantial acquisition of shares in or takeover of the target company takes place on terms that are not inferior to the terms on which substantial shareholders make.

Chapter 2: Market Structure & Regulatory Framework

Public takeovers and mergers in India are broadly regulated through the Companies Act of 2013 and applicable Rules, Takeover Code, SEBI (SCRA), 1956, Competition Act, 2002, and Foreign Exchange Management Act, 1999. The Takeover Code is the principal enactment which regulates the takeovers of listed companies in India. It is administered by SEBI, which was established as a statutory authority under the SEBI Act of 1992. In Hong Kong, The Code on Takeovers and Mergers and Share Repurchases, 2005 (**the H.K. Code**) is the primary legislation governing public takeovers. The administration function is bestowed upon the Executive Director of the Corporate Finance Division of the Securities and Futures Commission (**SFC**)—the U.K. City Code forms the foundation of the H.K. Code. The applicability of the H.K. Code extends to takeovers and mergers of companies with a listing of equity securities in Hong Kong and unlisted public companies. In the case of the latter, the SFC determines the applicability.

Most public companies' ownership is highly concentrated in India[5]and Hong Kong.[6] Families mainly control them. It is due to this reason that there is usually no separation of ownership and management. This puts the families at the helm in a position to appoint and remove directors without the outside support of shareholders.

Chapter 3: Mandatory Bid Rule Threshold

'Mandatory bid' or 'mandatory open offer' denotes the exit opportunity given by the acquirer and persons acting in concert (**PAC**) to the public to dilute their shareholding in the target company in case of a change in control of the target company.[7]

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[5]Available at https://www.samco.in/technology/pledge_monitor (Last visited November 10, 2023).
[6]Zhilan Chen, Leung Cheung, Aris Stouraitis& Anita Wong, *Ownership concentration, firm performance, and dividend policy in Hong Kong*, 4 PBFJ 431 (2005).
[7]Clause 3(1), The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

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In India, the Takeover Code stipulates specific situations which mandate the acquirer to make a mandatory open offer to the existing shareholders of the target company for an acquisition of a minimum of 26% of the target company's shares. The trigger points for making mandatory open offers are explained as follows:

- Initial Trigger

If an acquirer acquires shares or voting rights in a target company, which, in addition to shares or voting rights held by such acquirer prior to such acquisition (along with the PACs), entitles them to exercise voting rights of 25% or more in the target company.[8]

- Creeping Acquisition

An acquirer who (along with PACs) holds shares or voting rights of 25% or more but less than the maximum threshold of non-public shareholding in a target company is mandated to make a mandatory open offer on the gross acquisition if more than 5% of the shares or voting rights of such target company is acquired in a single financial year.[9] In such a case, minimum offer size is 10% of the total shares of the target company. The acquirer gradually applies a strategy to acquire the shares or voting rights without triggering an open offer.

- Control Trigger

Irrespective of the extent of shares or voting rights held in the target company, any acquirer who acquires, directly or indirectly, control over a target company is required to make a mandatory open offer.

- Indirect Acquisition

Any acquirer who acquires control over a target company, directly or indirectly, must make a mandatory open offer.[10] This is irrespective of the extent of shares or voting rights held in the target company.

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[8] Ibid.

[9] Clause 3(2), The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

[10] Clause 5(1), The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

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Under the laws of Hong Kong, the acquirer must make a mandatory open offer to every class of equity share capital and any class of voting non-equity share capital of the company. In the case of the former category, it is irrespective of whether the shares carry voting rights. The H.K. Code observes the following circumstances[11]:

- Initial Trigger

An acquirer (along with groups of PACs) who acquires voting rights equating to 30% or more in the target company.

- Creeping Acquisition

An acquirer (along with groups of PACs) holds voting rights of a minimum of 30% but is at most 50% in the target company, which further acquires voting rights, increasing shareholding to more than 2% from its lowest percentage holding in the previous 12 months.

- Indirect Acquisition

An acquirer (along with groups of PACs) who acquires statutory control of a company which is not the target company and, after that, indirectly acquires 30% or more of the voting rights in a latter company to which the H.K. Code applies.

Chapter 4: Pricing Guidelines

The Indian law incorporates the principle of the 'best price rule' when it comes to the offer price payable under a mandatory open offer. In this respect, the Takeover Code classifies companies into two categories, i.e. (a) companies with frequently traded shares and (b) companies with infrequently traded shares. Different parameters are specified.[12]

Broadly, in the case of direct acquisition, the lower limit of the offer price needs to be the highest of the following:

· the negotiated price;

[11]Rule 26.1, The Code on Takeovers and Mergers, 2005.

[12]Clause 8(2), The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

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· the volume weighted average price paid or payable by the Acquirer/PACs during the 52 weeks immediately preceding the date of the open offer;
· the highest price paid by the Acquirer/ PACs for any acquisition during the 26 weeks immediately preceding the date of the open offer;

If the shares are frequently traded:
· the volume-weighted average market price during the 60 trading days immediately preceding the date of the tender offer;

If the shares are infrequently traded:
· The fair price is resolved by considering the parameters customary for valuing company shares, such as book value and comparable trading multiples.

As per the H.K. Code, the mandatory open offer must be the minimum of the highest price paid by the acquirer (or PACs) for shares with voting rights.[13] The acquisition period under consideration is during the offer period and the immediate six months preceding its commencement. Express consent of the Executive would be required if the highest price is not to be taken as the offer price.

Chapter 5: Rules for Competitive Bidding

The Takeover Code permits a competing offer within 15 business days of the original mandatory open offer. Beyond the said period, a competing offer cannot be made until the expiry of the initial offer. Consequently, time is of the essence. The law requires that the competing and initial offers be treated at par. The target company must tender equal information disclosure to both the acquirers.
Notwithstanding the failure of a competing offer, the person remains a shareholder in the target company. The offer size in a competing offer has to be at least equal to the size of the original offer. As per the H.K. Code, a competing offer carries no additional conditions other than those necessary to implement such an offer. In case of failure of a competing offer, the person is

[13]Rule 26.3 (a), The Code on Takeovers and Mergers, 2005.

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prohibited from selling the shares acquired to the bid winner. Like the Indian position, such a person remains a shareholder in the target company, even if the competing offer has failed.

Chapter 6: Definition of 'Control'

'Control' is a crucial takeover concept. It is widely defined under the Takeover Code. It includes (a) the right to appoint a majority of the directors of the target company or (b) to control the management or policy decisions of the target company, whether individually or with PACs. Such rights may be acquired directly or indirectly. The manner of accrual of such rights needs to be more consistent. It may be by way of shareholding management rights, shareholders' agreements, or any other manner.[14] Control encompasses *de facto* and *de jure* Control. SEBI determines whether a change in control has occurred by evaluating each case individually. This power is vested in SEBI as India follows a mixed approach of qualitative and quantitative models to define control. It is subjectively ascertained whether an acquirer is in a position to exercise control over the management or policy decisions of the target company by exercising contractual rights or otherwise as required under the Code. The H.K. Code demarcates control as a holding or aggregate holding of 30% or more voting rights in a company. In effect, change in control or *de facto* control is not considered.

Chapter 7: Analysis

The trigger point threshold for mandating an open offer is higher in Hong Kong vis-à-vis India. Hong Kong, being a developed market, has a trigger point of 30%. However, the same cannot be modelled yet in India owing to the developing nature of the market. The primary rationale for pegging the threshold for control at 25% is to forbid the acquirers from gaining powers to block a resolution without incurring the obligation of making an open offer.[15]

About pricing guidelines in the case of an open offer, in the Indian context, allowing the option of average market price during the 60 trading days immediately preceding the date of the tender offer as one of the considerations may motivate the target company to manipulate the price in its

[14] Clause 2 (1)(e), SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
[15] As per Companies Act, 2013, the passing of a special resolution requires a minimum of 75% shareholding.

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favour. Such a situation will not arise in the Hong Kong market as all the pricing options/alternatives are based on actual payment by the acquirer. On the positive side, the Takeover Code considers volume-weighted prices more reflective of the market price. Having guidelines for the pricing of illiquid stocks is an India-specific requirement. Such a situation may not arise in the Hong Kong market owing to global transactions on its stock exchange, ensuring high liquidity. About competing offers, since an upper limit of the period is not mentioned in the H.K. Code, it may be assumed that the same can be made before the expiry of the initial offer. The Indian position is specific in this context. The period is short, i.e. 15 days, favouring the initial bidder.

In terms of defining 'control', while India operates in pursuit of fact-based determination of control by following a combined model of quantitative and qualitative measures, Hong Kong follows the concept of purely *de jure* control, wherein a quantitative threshold is established, and any acquisition exceeding such a threshold would attract open offer obligations. India follows a more holistic approach to determining change in control by ensuring that the acquirers do not circumvent the numeric threshold by devising strategic transactions. Powers are vested in SEBI to assess the same on a case-to-case basis. However, on the downside, India's subjective definition of control creates ambiguity. The judicial interpretation of the same has been unequivocal. In the case of *Subhkam Ventures v. SEBI,*[16] SEBI held that protective covenant/positive control is tantamount to gaining control. On appeal[17], the Hon'ble Securities Appellate Tribunal (**SAT**) categorised control as positive and Negative Control. It was held that the latter, wherein an acquirer is only in a position to block a company from doing what it wants to do, will not constitute control. An appeal was filed against the decision before the Hon'ble Supreme Court; however, due to certain developments in the case, the Hon'ble Supreme Court could not deliberate upon it further. A similar position was taken in the case of *Kamat Hotel v. SEBI.*[18] When an issue as to whether veto rights to protect the minority interests constitutes control came up for consideration, the Hon'ble SAT concluded in negative.[19] In *Re: Jet Airways*

[16]Civil Appeal No. 3371 of 2010.
[17]Subhkam Ventures (I) (P.) Ltd. v. SEBI [2010] 99 SCL 159 (SAT).
[18]Order No. WTM/GM/EFD/DRAIII/20/MAR/2017 dated March 31, 2017.
[19]Rhodia SA v. SEBI [2001] 34 SCL 597 (SAT).

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Limited,[20] the issue was whether 24% shares allotted to Etihad Airways amounts to control over management and policy decisions of Jet Airways. SEBI opined that the same did not result in a change in control. It was reasoned that Etihad Airways did not hold any positive or blocking rights at the board or general meetings, casting vote rights or pre-emptive rights owing to the transfer of shares. This decision holds significance in operating as a touchstone while making investment transactions in listed companies. Exercising control in day-to-day management vis-à-vis significant corporate transactions is different. While the former may indicate the presence of control, influence in the latter case usually subsists in protecting the minority interests of investors. Preserving the distinction is of utmost importance.

Chapter 8: Conclusion

Globally, the primary aim of takeover regulations is to offer an exit opportunity to the minority shareholders of a target company in case of a change in shareholding or control of the company in the manner required under the law. The idea is to protect the shareholders' investment and ensure transparency and fairness. The requirement of a mandatory offer is based on the broad spectrum that if there is a change in the control of a company, a general open offer to all other shareholders is mandated to allow them an opportunity to exit at the best bid. There is an interplay of certain key concepts in the takeover activities. This paper compared select critical concepts in the takeover regimes of two significant Asian markets, India and Hong Kong, despite basing their takeover laws on the U.K. City Code, the author observed specific differences. While both jurisdictions are characterised by concentrated ownership in public companies, Hong Kong has a higher threshold for mandatory bids than India, which aligns with global practice. This is due to the more advanced character of the Hong Kong markets vis-à-vis India. While India harmonised the qualitative and quantitative factors to determine 'control', Hong Kong adopted a pure numeric threshold. Specific other differences were also noted. While no straight-jacket formula exists, each jurisdiction has devised its strategy. Given the existing stage of development, market needs, and shareholders' interests, the thresholds of the H.K. Code cannot be imported into the Takeover Code yet.

[20]Order No. WTM/RKA/CFD-DCR/17/2014 dated May 8, 2014.

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