Info Byte

APEX COURT RULING ON NON-COMPETE FEES SETTING ASIDE SAT ORDER ON NON-COMPETE FEES UNDER THE ERSWHILE SEBI TAKEOVER CODE 1997

The Supreme Court passed an order setting aside the Securities Appellate Tribunal (***SAT***) decision [and order of SEBI] on payment of "non-compete" fee under the erstwhile SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (***SEBI Takeover Regulations***).

Background and Facts

- On 29 March 2011, the appellants (IP Holding Asia Singapore and others) entered into a share purchase agreement with Bangur Group [20 entities] to acquire 53.46% of the share capital of the target company viz: Andhra Pradesh Paper Mills Limited for a price of INR 523 per share aggregating INR 1,111.9 Crore.

- Additionally, the parties also entered into an exclusivity agreement to maintain exclusive negotiations with one another during stipulated period. Exclusivity fee for such an agreement was INR 21.20 per share.

- The parties also enter into a "non-compete and business waiver" agreement, in terms of which the appellants agreed to pay an amount of about INR 277.95 Crore to Bangur Group for refraining from competing with the business of the target company either on their own behalf or through their affiliates for a period of three years.

- The appellants accordingly made an open offer to the public shareholders of the target company representing 21.54% of the voting capital at a price of INR 544.20 [INR 523 + INR 21.20] in accordance with the provisions of the SEBI Takeover Regulations.

- Upon filing the draft letter of offer (***DLOF***) with SEBI and after various correspondence between them, SEBI while issuing its comments/observations on the DLOF directed that, the offer price be increased to INR 674.93 per share inclusive of the non-compete fee being paid to Bangur Group.

SEBI's reasoning for adding the non-compete fee to the offer price was as follows

According to SEBI, the non-compete fee was in fact a part of the negotiated price per share payable by the appellants to Bangur Group and hence should be added to the offer price to the public shareholders. Of the twenty promoter entities comprising Bangur Group, only five were eligible to receive the non-compete fee. Of the remaining fifteen, two individuals were not eligible to receive the non-compete fee, since they did not have any experience or expertise in the area of operation of the target company and hence not capable of offering any competition to the appellants. According to SEBI, the payment was made merely because they were shareholders. The remaining thirteen entities were also not eligible to receive non-compete fee because they did not even have in their object clause, the business of pulp and paper manufacturing. Since the exclusivity fee was being paid to Bangur Group and also to the public shareholders, even the non-compete fee should be paid to the public shareholders. Above all, the merchant banker was unable to give sufficient justification for payment of non-compete fee.

Supreme Court Decision

While allowing the appeal and setting aside the directions and orders passed by SEBI and SAT, Supreme Court considered the facts and held If the non-compete fee is less than 25% of the offer price, the jurisdiction of SEBI would be exercisable only in an extremely rare case and only if SEBI was in a position to ex facie conclude that the transaction involving the takeover was not bona fide. Ordinarily, when there is a gap of 25% between the consideration paid to the selling promoters and non-compete fee, SEBI ought not to conduct an inquiry. SEBI can certainly delve further into the matter, if it appears that the difference between the offer price and non-compete fee is less than 25% but is nevertheless a disguise or a camouflage to reducing the cost of acquisition. According to the Supreme Court, no such conclusion is apparent, nor was it canvassed or pointed out from the share purchase agreement and the non-compete agreement .It is the perception of the appellants that is more important, while deciding to pay non-compete fee to the selling promoters.

Conclusion

Non-compete fee is paid to the selling promoters so that they do not re-enter the business and pose threat to the target company under the control of new promoter. Under the erstwhile SEBI Takeover Regulations, payment by an acquirer to the

selling shareholders towards non-compete was always a vexed one. The tolerance limit of 25% on non-compete fee was brought in as a measure of curbing the practice where the acquirer passes on a significantly large portion of the consideration to the outgoing promoter in the form of non-compete fee and only a token amount is shown as negotiated price for acquisition of shares under the agreement. Under the present SEBI Takeover Regulations, 2011, after much debate and discussion by Achuthan Committee, any form inclusive of all ancillary and collateral agreements forms part of the negotiated price and the same is now considered as one of the parameters for fixing the offer price, if such price is higher than other prescribed parameters. *Although SEBI is mandated to protect the interest of all investors and can question the payment of a non-compete fee or for that matter, even has the ability to intervene and question the merits of the decision taken by the parties involved in a transaction, following are some of the key takeaways from the Supreme Court ruling:*

(a) commercial decisions of the parties should be respected, unless there are good reasons not to do so;

(b) it is imperative to give sufficient elbow room to commercial entities for entering into a business transaction and host of considerations go into business relations; and

(c) threat perception cannot be decided on the basis of hindsight, but must be left to the commercial wisdom of the players on the field.

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