BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 28 of 2008

Date of decision: 8.7.2008

Cementrum IB. V. …… Appellant

Versus

1. Securities and Exchange Board of India
2. Ambit Corporate Finance Pvt. Ltd. …... Respondents

Mr. Janak Dwarkadas Senior Advocate with Mr. Somasekhar Sundaresan and Mr. Zerick Dastoor Advocates for the Appellant.
Mr. J. J. Bhatt, Senior Advocate with Dr. Poornima Advani, Mr. Haihangrang E.H. Newme and Mr. Vithal Mahajan Advocates for Respondent No.1
Mr. Sagar Divekar Advocate for Respondent no.2.

Coram: Justice N.K. Sodhi, Presiding Officer
Arun Bhargava, Member
Utpal Bhattacharya, Member

Per: Utpal Bhattacharya, Member

Under challenge in this appeal is the order passed by the wholetime member of the Securities and Exchange Board of India (the Board for short) on 14.1.2008 directing the appellant, who is the acquirer of Mysore Cements Ltd., the target company, to pay the public shareholders of the latter Rs.72.50 per equity share instead of Rs.58 per equity share that has been paid and also interest for the delay in the payment of the differential.

2. The sequence of events leading to this appeal may be briefly narrated before considering the merits of the case. On 18.7.2006, a tripartite share subscription and share purchase agreement (SSSPA) was executed among the appellant, the target company and certain promoters of the target company belonging to the S.K. Birla Group (hereinafter referred to as promoter sellers). In terms of this agreement, the appellant agreed to purchase from the promoter sellers equity shares amounting to 8.48 per cent of the paid up equity share capital of the target company. The agreement also provided for infusion of funds by the appellant into the target company by way of preferential allotment of equity shares. Consequent on the purchase and preferential allotment of equity shares, the shareholding of the appellant in the target company would be 50.57 per cent triggering the

Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (Takeover Code, for short). Accordingly, the appellant alongwith its holding company Heidelberg Cement A.G. of Germany, acting in concert, made a public announcement dated 22.7.2006 of an open offer to acquire shares held by the public shareholders in accordance with regulations 10 and 12 of the Takeover Code. In the public offer, the offer price was Rs.58 per share as negotiated by the acquirer with the promoter sellers and was the highest among the prices worked out in accordance with the different parameters specified in regulation 20(4) of the Takeover Code. In addition to the offer price, the acquirer agreed to pay Rs.14.50 per equity share as non-compete consideration to the promoter sellers. On 4.8.2006 the appellant filed with the Board the draft letter of offer to be issued to the public shareholders in terms of the Takeover Code. In the month of August 2006 itself the target company made the preferential allotment of shares to the acquirer as stipulated in the SSSPA. In September 2006, the Board passed on to the appellant two shareholder complaints, both claiming that the payment of non- compete fee by the appellant was nothing but a ploy to pay a higher price to the promoter sellers and that the open offer should be enhanced from Rs.58 per equity share to Rs.72.50 per equity share. On 30.11.2006 the Board sent its comments on the draft letter of offer of the appellant to respondent no.2 which included the following paragraph:

> " Justification of Offer Price
> In the facts of the instant case, the payment of non compete fee to the selling promoters does not appear to be justified and thus you are advised to revise the offer price after including the payment of non compete fee (per share) in the negotiated price (per share), as the negotiated price is highest among all the parameters under Regulation 20. Accordingly, suitably carry out the consequential changes in the letter of offer".

Being aggrieved by this direction of the Board, the appellant filed an appeal before this Tribunal. This Tribunal in its interim order of 13.12.2006 allowed the appellant to go ahead with the acquisition in accordance with the letter of offer but directed it to furnish a bank guarantee for the amount of difference between the price offered by the appellant and the price enhanced by respondent no.1 before the letter of offer was issued. It was further directed that in case the appeal failed, the appellant should pay to the shareholders who had

tendered their shares, in addition to the differential in price, interest on the differential at the rate of six per cent per annum from the date when the differential became due till the date of payment. This appeal was finally disposed of by this Tribunal on 19.11.2007 with the following words:

> " Without going into the merits of any of the issues raised in the appeal, we set aside the direction of the Board requiring the appellant to add the non-compete fee per share in the negotiated price per share and to carry out consequential changes in the letter of offer on the ground that it contains no reasons. We further direct the Board to pass a fresh order giving reasons after affording an opportunity of hearing to the appellant. Let the needful be done within eight weeks from the date of receipt of a copy of this order. The bank guarantee furnished by the appellant in pursuance to our interim order dated August 31, 2007 shall continue to remain operative for a period of four weeks after the passing of the fresh order by the Board unless it comes to the conclusion that it is not necessary to include the non-compete fee in the negotiated price per share. In that event, the bank guarantee shall stand discharged. In any case, the bank guarantee shall remain operative till February 28, 2008".

In pursuance of the aforementioned direction of this Tribunal, the Board allowed the appellant a personal hearing on 30.11.2007 and sought written submissions from the appellant regarding the justification for the non-compete fee paid by the appellant on or before 8.1.2008 which the appellant did. Thereafter the Board passed the impugned order dated 14.1.2008.

3. The learned counsel for the appellant began his arguments by contending that the appellant had been prejudiced during the hearing on 30.11.2007 since the Board had not issued any show cause notice to it and it was unaware of the specific issue(s) to address at the hearing. We, however, do not agree that there was any such prejudice since in the impugned order, the whole time member of the Board has considered and rejected this contention of the appellant and proceeded to record detailed reasons for his order. The learned senior counsel also argued that there was a lack of consistency in the orders passed by the Board regarding non-compete fee in as much as just about three weeks after passing the impugned order, the Board took a completely contrary view in the similar case of acquisition of LANXESS ABS Limited by INEOS ABS (Jersey) Limited in which the Board held that the payment of non-compete fee was justified. We do not, however,

consider it necessary to go into this aspect before considering the substantive arguments on the merits of the appeal before us.

4. Before taking us through the impugned order, the learned senior counsel made the general point that non-compete fee is a perfectly justified payment whose legitimacy is recognized even under the Contract Act provided that the restraint on competition is within reasonable limits. Moreover, regulation 20(8) of the Takeover Code clearly permits such payment up to 25 per cent of the offer price and should the payment exceed 25 per cent, the same regulation requires the excess to be added to the offer price. Thus, according to the learned senior counsel, there is really little scope for the regulator to go into the justification for the non-compete fee once the Takeover Code has been adhered to. Referring to the impugned order, the learned senior counsel identified two main reasons on which the order is based. The first was that in September 2004, the target company had been referred to BIFR as a sick company and this clearly showed that the promoters of the target company who were controlling it, did not possess the business acumen required to compete with the acquirers and were therefore not entitled to any non-compete fee. The second reason was that the promoter sellers included a charitable and an educational organisation and such organisations, according to the whole time member, can hardly be deserving of any non-compete fee. Against these arguments, the learned senior counsel for the appellant contended that there are usually multiple reasons behind a company becoming sick and these are quite often beyond the control of the management. In any case, the fact that a company has fallen sick can not ipso facto lead to the conclusion that the management or the promoters of the company are incompetent. This apart, whether the target company is managed competently or otherwise is not relevant in adjudging the ability of the promoter sellers to create and/or support a rival business organisation. As has been acknowledged in the impugned order itself, the promoter sellers “are connected to a very established industrial family” and their industrial connection, their knowledge of the target company’s operations and their relatively easy access to market information are enough for them to start a competing venture. For this purpose, it would not matter if the promoter seller is a charitable or educational organization. Even the charitable and

educational organizations among the promoter sellers have been as much involved in the business of the target company as the other promoter sellers and for as long as the others. Considering that they belong to the same group, these organizations would be as capable as the others of generating competition. The learned senior counsel of the appellant also pointed out that the non-compete provision in the SSSPA binds not only the promoter sellers of the target company but their affiliates as well so as to protect the target company from competition from the entire S. K. Birla group. This would be clear from a perusal of the text of article 14.1 of the SSSPA which is reproduced below:

> " 14.1 Each of the Sellers undertakes and covenants that, during the period commencing from the Second Closing Date and ending on the expiry of 5 (five) years thereafter, such Seller will not, and shall ensure that the Affiliates of such Seller shall not, directly or indirectly:
>
> (a) participate in as an investor, manager, consultant or in any other capacity in any business which is similar to or competes with the Business;
>
> (b) interfere with, tender for, canvass, solicit or endeavour to entice away from the Company the business of any person who was, to their knowledge, a customer, client or agent of or supplier to; and/or
>
> (c) supply any product, carry out or undertake or provide any service which is the same as or similar to those with which the Company provides;
>
> *provided however* that nothing contained in this Article 14.1 shall prohibit investment by the Sellers and their Affiliates in the aggregate of upto five percent (5%) of the outstanding shares of capital stock of any corporation listed on a recognized securities exchange or publicly traded in the over-the-counter market."

5. The learned senior counsel for the respondent Board argued that non-compete fee is payable only to those who are capable of competing and not otherwise. The promoter sellers of the target company were only shareholders and not taking any active part in the business and could not therefore be expected to compete with the target company. According to him it was also incongruous to have a non-compete agreement with certain erstwhile promoters when two members of the promoter group namely Shri S. K. Birla and Shri Siddharth Birla continued to hold shares and be on the board of directors of the target company. Coming to the question of the Board's orders on the subject of non-compete fee

being inconsistent with one another, the learned senior counsel pointed out that the Board's order in the case of LANXESS ABS was on a different footing since the promoter of the target company in that case was an acknowledged technical expert and had been engaged in actually running the business for a long time. Countering the argument of the learned senior counsel of the appellant that the Board should not concern itself with the non-compete fee if the Takeover Code has not been violated, the learned senior counsel for the Board placed before us several judicial interpretations of the expression "regulate" in order to establish that it would be within the Board's power to examine and decide on the question of correctness and/or admissibility of non-compete fee even when it does not exceed 25 per cent of the offer price.

6. We have carefully considered the arguments of the learned senior counsel on both sides and the material on record. Our view is that the question of non-compete fee- whether it should be paid and if so, how much- is primarily a matter to be decided by the acquirer and the target company in the facts and circumstances of each case. The only restraint placed by the Takeover Code on the matter is that the quantum of the fee can not exceed 25 per cent of the offer price vide regulation 20(8) which is reproduced below:

> " Any payment made to the persons other than the target company in respect of non compete agreement in excess of twenty five per cent, of the offer price arrived at under sub-regulations (4) or (5) or (6) shall be added to the offer price."

Non-compete agreements permit certain payments to be made to substantial shareholders which are not offered to the public shareholders. This is, therefore, liable to be misused to pass on extra value to substantial shareholders to the detriment of public shareholders. Justice Bhagwati Committee, pursuant to whose recommendations regulation 20(8) was introduced in the Takeover Code, had the following observation to make in this regard:

> " On non-compete payment the Committee noted that there is a need to address the situation specially where the acquirer passes on a significantly large portion of the consideration to the out going 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. The Committee felt that in such cases the offer price does not truly reflect the actual consideration paid and this could be used as a ploy for reducing the cost of acquisition through public offer."

The recommendation made by Justice Bhagwati Committee in this regard was as follows:

> " Any payment in respect of non-compete agreement in excess of 25% of consideration paid to persons other than the target company shall be deemed to form part of the consideration paid for acquisition of shares and should be factored in for the purpose of reckoning offer price."

The mischief of excessive non-compete fee is sought to be curbed through the Takeover Code by limiting the quantum of non-compete fee. The question whether further scrutiny into the justification for such fee in any given case can be undertaken by the Board has been raised in this appeal. It is not necessary nor are we inclined to attempt a general response to that question. In the facts and circumstances of the case before us, we are in agreement with the basic argument of the learned senior counsel for the appellant that the promoter sellers being members of the S.K. Birla group and having had a long association with the company, were definitely in a position to create competition for the target company. Moreover, since the non-compete clause in the SSSPA binds all affiliates of the promoter sellers, meaning the whole of S.K. Birla Group, not to compete with the target company, the acquirer was entirely justified in negotiating non-compete fee with the promoter sellers.

7. In this view of the matter, we have no hesitation in allowing the appeal and setting aside the impugned order which we hereby do with no order as to costs.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Arun Bhargava
Member

Sd/-
Utpal Bhattacharya
Member

8.7.2008
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