The economic integration of Indian Economy with World Economy brought in its way the need for reforming various domestic laws to reflect the new realities of international business environment. The increasing complexities of globalised business environment took the concept of competition to much elevated levels. The new age competition and its effects permeated the physical boundaries of countries. Technological growth also added new dimensions to competition issues.

Accordingly, India enacted a new law on Competition in the form of Competition Act, 2002. One of the key features of the new law has been the renewed focus of mergers and amalgamation regulation (known as “Combination Regulation” in the Act). In keeping with the practical realities of globalised business trends, it has accorded specific recognition to the role of “Group of Enterprises” in the market. Under the combination regulation part of the legislation, a higher threshold limits have been prescribed for combination involving Group or members of Group.

The present study focuses on the meaning of a Group and what makes one enterprise member of Group. Accordingly, the concept of control over management and affairs of the enterprise is discussed at length, various devices of control, shareholding patterns, concept of sole and joint control etc. have been discussed at length with an aim to understand how they are relevant to determination of Group. In the process, how Government and its departments can be brought into the fold of Group by virtue of their control over various PSUs is also discussed.

The analysis in this study has been made in the light of the existing laws, court decisions, accounting standards and guidance material issued by the Institute of Chartered Accountants of India, New Delhi.

As a student of the Post Qualification course on International Trade Laws and WTO of the Institute of Chartered Accountants of India, this study has been made as a part of
practical training. I express my sincere gratitude for the support and guidance received from the Authorities of the Competition of Commission of India, New Delhi during the course of training and this study.

I am grateful to Hon’ble Shri Vinod K. Dhall, Member, Competition Commission of India, New Delhi, for accepting my request to be associated with the CCI as an intern.

I am highly grateful to my esteemed mentor Shri Amitabh Kumar, IRS, Director General, for the valued comment and guidance on nuances of key concept involved in combination regulation and keeping me appraised of international thinking on the subject. He has reviewed and commented on each chapter to make this study reflect the present thinking on the subject. But for his comments and guidance, this study would not have been possible.

I would also like to express my sincere gratitude to Shri G.R.Bhatia, Ex-Additional Director General, for his active support and advice. I am equally thankful to Shri Augustin Peter, Economic Advisor, for his invaluable guidance and encouragement. I am also grateful express my deep feelings to Shri M.M.Sharma, Additional Registrar and all other staff members of the Competition Commission of India, New Delhi, for their overwhelming support and timely co-operation in giving present shape to this dissertation.

Last but not the least I shall remain life long obliged by my patent organisation, The Institute of Chartered Accountants of India, New Delhi, who has provided me this landing platform of The Competition Commission of India. With its recommendation only, I could get this opportunity to undergo practical training and enlighten myself in this newly emerged challenging field of the Competition Law.

New Delhi
February 15, 2006

CA. Girish Pai K
Disclaimer

This dissertation has been prepared by the author in partial fulfillment of Post Qualification course on International Trade Laws and World Trade Organisation (ITL-WTO) of Institute of Chartered Accountants of India (ICAI), New Delhi. The author had undergone internship under the Internship Programme of the Competition Commission of India for this purpose. The dissertation has been prepared for academic purpose only. The views expressed herein are the personal views of the author and do not necessarily reflect the views of the Commission or ICAI in any manner.

This report is the intellectual property of Competition Commission of India and the same or any part thereof may not be used in any manner whatsoever, without express permission of the Competition Commission in writing.

Girish Pai K
February 15, 2007
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Chapter No.</th>
<th>Particulars</th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Preface</td>
<td>1</td>
</tr>
<tr>
<td>1</td>
<td>Executive Summary</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Introduction</td>
<td>7</td>
</tr>
<tr>
<td>3</td>
<td>Scope and Methodology of the Study</td>
<td>8</td>
</tr>
<tr>
<td>4</td>
<td>Economics based approach to Competition Policy</td>
<td>11</td>
</tr>
<tr>
<td>5</td>
<td>Group Vs. Standalone Enterprises</td>
<td>13</td>
</tr>
<tr>
<td>6</td>
<td>Statutory norms on Group and Control</td>
<td>14</td>
</tr>
<tr>
<td>7</td>
<td>Control – Its meaning and forms</td>
<td>17</td>
</tr>
<tr>
<td>8</td>
<td>Group and Control under other Statute and Accounting Standards</td>
<td>20</td>
</tr>
<tr>
<td>9</td>
<td>Nature of control</td>
<td>28</td>
</tr>
<tr>
<td>10</td>
<td>Shareholding pattern and aspects of control</td>
<td>32</td>
</tr>
<tr>
<td>11</td>
<td>Control over management and control over assets</td>
<td>39</td>
</tr>
<tr>
<td>12</td>
<td>Devices of Corporate Control</td>
<td>43</td>
</tr>
<tr>
<td>13</td>
<td>Matrix Approach to Shareholding Threshold</td>
<td>48</td>
</tr>
<tr>
<td>14</td>
<td>Group – Analysis of the term with reference to Combination</td>
<td>53</td>
</tr>
<tr>
<td>15</td>
<td>Joint Ventures and Combination</td>
<td>56</td>
</tr>
<tr>
<td>16</td>
<td>State Owned Enterprise and Concept of Group</td>
<td>57</td>
</tr>
<tr>
<td>17</td>
<td>Miscellaneous Issues</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td>Recommendations and Conclusion</td>
<td>63</td>
</tr>
<tr>
<td></td>
<td>Appendix</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1. Preference shares and voting rights as per Companies Act, 1956</td>
<td>67</td>
</tr>
<tr>
<td></td>
<td>2. MRTP Act and concept of “inter-connected undertakings”</td>
<td>71</td>
</tr>
<tr>
<td></td>
<td>3. Transfer of control in different scenarios</td>
<td>72</td>
</tr>
<tr>
<td></td>
<td>References</td>
<td>77</td>
</tr>
</tbody>
</table>
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

EXECUTIVE SUMMARY

A unique feature of Combination Regulation in India is that it explicitly recognizes the combination involving Group and its members. A higher threshold limit has been prescribed for notifiable combination where groups are involved. The size of enterprises or their inter-relationship is of no concern to the Commission as long as their market behaviour are not likely to cause appreciable adverse effect on competition.

In this paper, an attempt has been made to study and analyze various ways in which Groups are formed in the market. In the process, the meaning and import of the related terms such as control over assets, exercise of voting rights, and control over management have been discussed. The concepts of de facto control and de jure controls are also being discussed to ascertain how they may affect the determination of members of Group as understood in the Act. Meaning of the terms “group” and “control” in other Acts such as MRTP Act, SEBI Takeover Code, Companies Act, and pronouncements of the ICAI have been explored. Reference to the terms such as “inter-connected undertakings” and “bodies corporate under the same management” under MRTP Act have been made to understand the direct and indirect forms of control by enterprises leading to group control.

Then a discussion is made as to the pattern of shareholding in corporate world. Holdings by various types of persons such as trusts, mutual funds, insurance companies, overseas investors such as FIIs, OCBs etc. are discussed with reference to matter of exercise of control by these investors in corporate world. It is found that unlike under SEBI regulation, the intent of holdings – either for acquiring control or as a mere investment – is not relevant for combination purpose.
‘Group and Group Control’ with respect to combination in Indian
Competition Law – A Study

Further, various devices of corporate control such as multiple classes of shares,
pyramid holdings, cross-holdings, voting agreements etc. are explored to understand
how control is exercised with such devices. Matrix based approach to compute
control thresholds are found to be of use in case of pyramidal and cross holdings.

Joint ventures are kept out of the purview of the Act upon fulfilling certain criteria
prescribed in the Act. However, the study finds the need to lift the corporate veil if
joint ventures are used a vehicle to carry out competition lessening activities
including combinations.

Then applicability of concept of Group and Group control to State Owned
Enterprises (SOEs) is discussed focusing on the nature and source of control in their
case. The study finds that there is complete unity of control with State or Central
Government as the case may be and therefore concludes that all State or Central
PSUs may have to be reckoned as belonging to one group.

The paper is concluded by urging the need for a uniform approach in deciding the
group and group control and thereby the combination notification requirement.
This type of approach will protect legal certainty by requiring parties to conform to
the Act’s requirements, rather than contorting the Act.
Chapter 1
Introduction

In India, dismantling of economic barriers through globalisation has resulted and will continue to result in major corporate/business restructuring. Indian businessmen are thinking big and global and are venturing to expand their market across the globe. Accordingly various types of alliances and combinations are being forged with domestic as well as foreign economic players. These combination/alliances vary in their organizational structure, ownership, nature of funding and other economic dimension. The business world is replete with large economic players who operate as single economic entity and but have different legal entities under common control.

A group member will have to compete only with players outside its group. A member of a group can meet competition better because of access to deeper financial resource and strength of the group in other market. To that extent there is immunity from full-fledged competition for such enterprises. Membership of a group may also confer on it the ability to replicate market power of the group. Thus, there is a room for existence of and/or exercise of covert market power by such entities.

Competition lessening activities may be resorted to by an enterprise not only directly but also indirectly through the mode of group. Subsidiaries, associates, joint ventures or shell companies may be effectively employed to significantly lessen the competition in the market. Damage to the competition effected, directly or indirectly by such group players is of concern to the Commission.

The objective of promoting and sustaining competition in market may go defeated unless threats to competition, overt or covert, are identified and regulated effectively by the Commission. In this direction, concept of Group and common control is significant. Hence, the Commission should equip itself with required knowledge and resources to identify and regulate such group behaviour of the market players.
Chapter 2
Scope and Methodology of the study

Scope of the Study
The study in this paper is undertaken as partial fulfillment of the requirements of the Post Qualification course on International Trade Laws and World Trade Organisation (ITL-WTO) under the aegis of Institute of Chartered Accountants of India, New Delhi.

The scope of this paper is to analyse the meaning of group and group control with respect to combination regulation. The analysis is confined to ascertain what is control in business world, which is supposed to enjoy control; whether person who enjoys explicit control and the person exercise the real control can be the same. Then the paper goes on to find out how the concept of control brings various persons through which it flows within the fold of term ‘group’.

In the process, various devices of control have been discussed. Further, the study also discusses about computation of threshold limit when there is cross-holdings and pyramidal holdings. Shareholdings by various types of persons are also discussed as to their relevance to exercise of control and computation of threshold for determining membership of a group under combination regulation.

The study approaches the subject purely from economic point of view. The accounting and financial aspects of combination regulation is covered in this economic approach. However, the other possible effects of control such as political, social etc. are not dealt with in this study.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

Methodology of the study

Initially a study of the Competition Act, 2002 was made to understand the basic intent of the legislation and its relevance to the present globalised business environment. The need for the Act was ascertained by learning about the shortcomings of erstwhile competition law i.e. MRTP Act.

Subsequently personal discussions with the various Authorities at the Competition Commission of India, New Delhi were held. The purpose of the discussion was to ascertain exactly the expectation of the Commission from this study. During the discussion, a fair idea was obtain as to the coverage and approach to the subject.

Then, reference was made various books, working paper, articles and study materials on the subject. The subject materials compiled at this stage of study were based on the domestic law and domestic business conditions. To make the study relevant in global business environment with which India is fast integrating, reference was extended to international laws and experiences on Anti Trust. The experience and literature on the subject are much more profound in counties like US, UK, EU. Based on the learning obtained from such study, the concept of group and group control were applied to the Indian law on the subject. While doing so, the ground realities of Indian business environment were kept in mind to draw conclusions/recommendations relevant to Indian business scenario.

The resource gathering process for this paper involved reference to web sites of various International Bodies on competition law such International Competition Network (ICN), Organisation for Economic Co-operation and Development (OECD), Customer Unity and Trust Services (CUTS), National Bureau of Economic Research (NBER), Social Science Research Network (SSRN), U.S. Department of Justice (DOJ) and Federal Trade Commission, Office of Fair Trade (OFT), UK among others.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

The various books and reference material at library of the Competition Commission of India, The Institute of Chartered Accountants of India, New Delhi were also referred to for this purpose. Reference was also made to the available material from the erstwhile Anti-trust Law of our country, i.e. The Monopolies and Restrictive Trade Practices Act, 1969.

To obtain deeper conceptual understanding of certain term, case laws of various countries especially USA, South Africa and EU were studied.

The draft of the paper compiled as above was then discussed with various authorities of the Commission such as Director General, Additional Director General, Economic Advisor and Registrar. Based on their comment and additional insight, the study was revised till such time the draft paper substantially conveyed my views on the subject.
As is well known, competition policies deal with promotion and sustenance of competition in economy and to protect the interests of consumers. All these objectives are closely linked with economics as a discipline. Though trade and commerce in an economy is multidisciplinary subject, economic and financial analysis influence the major contours of government’s policy related to it. Thus, economics based approach to competition policy assumes major significance.

An economics-based approach requires a careful examination of how competition works in each particular market in order to evaluate how specific company strategies affect consumer welfare. Indeed, an economic approach achieves two complementary goals. First, it ensures that anti-competitive behaviour does not outwit legal provisions. By focusing on the effects of company actions rather than on the form that these actions may take, an economics-based approach makes it more difficult for companies to circumvent competition policy constraints by way of attempting to achieve the same end results through the use of different commercial practices. At the same time, this approach provides a more consistent treatment of practices, since any specific practice is assessed in terms of its outcome and two practices leading to the same result will therefore be subject to a comparable treatment.¹

Second, the economics-based approach guarantees that the statutory provisions do not unduly thwart pro-competitive strategies. An effects-based analysis takes fully into consideration the fact that many business practices may have different effects in different circumstances: distorting competition in some cases and promoting efficiencies and innovation in others. A competition policy approach that directly confronts this duality

¹ Discussion Paper No. 82 - An Economic Approach to Article 82 by Jordi Gual, et al. (GESY)
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

will ensure that consumers are protected (through the prevention of behaviour that harms them) while promoting overall increased productivity and growth (since firms will not be discouraged in their search for efficiency).
Chapter 4

Group Vs. Stand-alone enterprises

Close business relations between member firms, cross-ownership and control and market power generally characterize corporate groups, which are prevalent in emerging markets.

An enterprise’s behaviour in the market widely varies depending on whether it is a stand-alone entity or a member of a group. A stand-alone enterprise is required to compete with virtually all the players in a given market. However, a group-member enterprise will have to compete only with players outside its group. Further, such enterprise may not have market power on its own; but as a member of group, it may enjoy and exercise such powers. Thus, there is a room for exercise of covert market power by such entities. It may also be true that there may be competition between two members of the same group. For eg., competition between Ultra Tech Cement and Grasim Cement. But the concern of the Commission is on the competition distorting possibilities and not otherwise.

Monitoring and regulating the market behaviour of stand alone enterprise may not help much unless an attempt is made to identify the behaviour of all the enterprises in a Group and their impact on competition in the relevant market. Both unilateral and co-ordinate effects of different market practices by such group players are of equal significance for the evaluation of competition distorting effect.
Chapter 5
Statutory norms on Group and Control in the Competition Act

Section 5 of the Act defines ‘Combination’ in three different ways. They are –

a. Combination by way of Acquisition
b. Combination by way of Acquiring of control
c. Combination by way of merger and amalgamation

Reference to the term Group in relation to combination can be found in the following manner in Section 5 on combination:

Section 5 of the Act
“The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be combination of such enterprises and persons or enterprises, if –

(a) any acquisition where –

(i) ..............

(ii) the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would belong after the acquisition, jointly have or would jointly have, -

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than two billion US Dollars or turnover more than six billion US Dollars; or
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

(b) **acquiring of control** by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, if

(i) .............

(ii) the group, to which enterprise whose control has been acquired, or is being acquired, would belong after the acquisition, jointly have or would jointly have, -

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) in India and outside India, in aggregate, the assets of the value of more than two billion US dollar or turnover more than six billion US dollars; or

(c) any **merger or amalgamation** in which –

(i) .............

(ii) the group, to which the enterprise remaining after the merger or the enterprise created as a result of the amalgamation, would belong after the merger or the amalgamation, as the case may be, have or would have, -

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) in India or outside India, the asset of the value more than two billion US dollars or turnover more than six billion US dollars.”
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

Thus reference to the term ‘Group’ is found in all the three modes of combinations.

Group and Control – Meaning of the terms in the Act

The term ‘Group’ is defined in the Explanation to Section 5 of the Act to mean two or more enterprises, which, directly or indirectly, are in a position to –

(i) exercise twenty-six percent or more of the voting rights in the other enterprises; or
(ii) appoint more than fifty percent of the members of the board of directors in the other enterprise; or
(iii) control the management or affairs of the other enterprise.

‘Control’ is defined in an inclusive way to include controlling the affairs or management by –

(i) one or more enterprises, either jointly or singly, over another enterprise or group;
(ii) one or more groups, either jointly or singly over another group or enterprise.
The term “control” is defined in the Act in an inclusive way. This is because the ‘control’ is too elastic a concept to capture the same in an exhaustive definition. It is difficult to define the contours of control for the purpose of combination regulation. Definition or meaning of control in other Acts, regulation or other pronouncements of professional bodies at best has a reference value. But they cannot be absolute framework to identify what control is.

In my opinion the term control means “the ability to materially influence the policy of the firm in a manner comparable to a person, who, in ordinary commercial practice, can exercise an element of control by virtue of his stake holding.” Thus, the notion of control goes beyond shareholding, voting rights or power to appoint members of governing body. It envisages the ability to materially influence the policy of the firm irrespective of the source of such ability.

Merger policy is not confined to an assessment of control via the legal form. The Act recognizes that control is not confined to exercise through the same legal form and that a firm can be controlled by another’s economic or commercial leverage over it. The separation of the economic and political benefits of ownership is not relevant for analyzing the control aspect for group concept under the law. What is envisaged in the law is only control and who benefits from such control is not of relevance for law. The benefit can accrue to the party exercising the control or even to a third party totally out of the Group. The economic benefits of ownership include cash inflows due to ownership interest such as dividend, profits, commission etc. The political benefit of ownership can take the form of, let us say benefits attributable to keeping the competitor out of market though there is no immediate economic benefit from such action. For eg., in an acquisition through bidding process, an enterprise may structure its bid in such a manner
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

that its close competitor in relevant market is thrown out of race for acquisition though ultimately a third firm may be the successful bidder. Here the benefit of strategy to the enterprise is not an economic one but a political one of keeping the competition from existing rival under control. The Act, recognising that the traditional company law forms of control may be inadequate to capture all possible forms of control, provided for an inclusive and open definition of control in explanation to Section 5. Control is too elastic a notion to be confined to a closed list.

*De facto Vs. De jure power of control*

There is another pertinent dimension to the power of control. What is relevant for the regulation of combination – *de facto power of control* or *de jure power of control*. The expression used in Explanation (b) to Section 5 defining Group is – two or more enterprises, which are in a position to exercise, appoint or control. Actual exercise of the power to control is of significance only when the entity in question does not enjoy de jure control and its action only speaks for its power to control. Hence, both de facto and de jure powers of control are relevant for combination regulation.

Although the acquisition by one company of an equity interest in a competitor does not in itself constitute conduct of restricting competition, such an acquisition may nevertheless serve as an instrument for influencing the commercial conduct of the companies in question so as to restrict or distort competition on the market on which they carry business.

That will be true in particular where, by the acquisition of a shareholding or through subsidiary clauses in the agreement, the investing company obtains legal or *de jure* control of the commercial conduct of the other company or where the agreement provides for commercial co-operation between the companies or creates a structure likely to be used for such co-operation.
‘Group and Group Control’ with respect to combination in Indian
Competition Law – A Study

That may also be the case where the agreement gives the investing company the
possibility of reinforcing its position at a later stage and taking effective control of the
other company. Account must be taken not only of the immediate effects of the
agreement but also of its potential effects and of the possibility that the agreement may
be part of long term plan.

Every agreement must be assessed in its economic context and in particular in the light of
the situation on the relevant market. Moreover, where the companies concerned are
multinational corporations (MNCs), which carry on business on a worldwide scale, their
relationships outside the country cannot be ignored. It is necessary in particular to
consider the possibility that the agreement in question may be part of a policy of global
cooperation between the companies, which are party to it.

In *IFINT/EXOR*² (Case M 187 of EC Dec. of 2 March 1992), the Commission, in
calculating EXOR’s turnover, included the turnover of a company in which
EXOR held a 28.69 per cent interest conferring 33.29 per cent of the votes; in
doing so, the Commission took account of the fact that at a previous annual
general meeting of the company, EXOR had held 52.1 per cent of the votes
actually present or represented. In applying these rules, the Commission did not
limit itself to theoretical control (de jure) but instead looked at what has tended to
happen in practice (de facto).

Further, the term control is defined in a broad manner in the Act. This gives rise to the
need for ascertaining the meaning of control by referring to various other sources *inter-
alia* other statutes, case laws, authoritative pronouncements of expert bodies of
knowledge.

---

² European Community Law of Competition, Bellamy & Child, 5th Edition, Edited by P.M.Roth QC,
Published by Sweet & Maxwell.
Chapter 7

Group and Control under other Statutes and Accounting Standards

Group and Control under MRTP Act.

It is pertinent to note the meaning of the term Group under MRTP Act.

Section 2(ef) defines **Group** as

(i) Two or more individuals, association of individuals, firms, trusts, or bodies corporate (excluding Financial Institutions) or any combination thereof, which exercises, or is established to be in a position to exercise control, directly or indirectly, over any body corporate, firm or trust; or

(ii) Associated Persons

Explanation to the Section also recognizes the situation where a group of persons who are able to control, directly or indirectly, the policy of body corporate without having a controlling interest in that body corporate to include in the definition of Group.

Associated Persons are defined to include –

(a) in relation to a director of a body corporate –
   (i) a relative of such director and includes a firm in which such director or his relative is a partner;
   (ii) any trust of which any such director or his relative is a trustee.
   (iii) Any company of which such director, whether independently or together with his relatives, constitutes ¼ th of Board of Directors;
(iv) Any other body corporate, at the general meeting of which not less than \( \frac{1}{4} \) th of the total number of directors of such other body corporate are appointed or controlled by the director of the first mentioned body corporate or his relative, whether acting singly or jointly.

(b) in relation to the partner of a firm, means a relative of such partner and includes any other partner of such firm; and

(c) in relation to the trustee of a trust, mean other trustee of such trust.

Further under MRTP Act, the dominance test is applied through a complex test of ‘Inter-connected undertakings’ and ‘Bodies corporate under the same management’. These terminologies were tested with criteria such as exercise of ownership and/or control, shareholding limits, voting rights etc. Not only direct but also indirect control or management, shareholdings and exercise of voting rights through one or more firms, undertakings, and subsidiary-parent relationships were recognized for this purpose.

It should be noted that MRTP Act recognized the concept of group governed by structural relationships among undertakings. The tests of “inter-connected undertakings” and “bodies corporate under the same management” were aimed at identifying groups.

An analysis of the definition and meaning of the aforesaid terms is relevant in appreciating the meaning of group under the Competition Act too. The same has been discussed in Appendix 1.

The Competition Act has laid down seemingly simple tests of voting rights, directorship and control on management and control on affairs to identify enterprises belonging to a group. However, practical application of these tests, specially the third test of control requires a lot of consideration. The criteria of interconnection and same management as envisaged in the MRTP Act will be relevant even in the Competition Act.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

The application of these criteria for determining the group and its members is of much importance when the Commission has to evaluate the appreciable adverse effect on combination involving group or their members.

Group and Control under SEBI Regulation

Control is also being defined in an inclusive way in the SEBI (Substantial Acquisition of shares and Takeovers) Regulation, 1997 (referred to as SEBI Takeover Code) as below:

Section 2 (c) "control" shall 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;

Explanation (i) to this Section states that where there are two or more persons in control over the target company, the cesser of any one of such persons from such control shall not be deemed to be a change in control of management nor shall any change in the nature and quantum of control amongst them constitute change in control of management.

The explanation to Section 2(c) clearly explains situations, which do not give, rise to change in control of management. According to the said explanation such situation can arise –

   a. Where joint control over target company is terminated by way of full cessation of control by one of the parties; or
   b. There is change in the nature and quantum of control amongst the member.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

To give an example of the above situation, let us assume that A Ltd and B LTD., each holding 40% of voting rights, jointly control C LTD. Now if A Ltd or B Ltd transfer its entire holding to the other and thereby loses the power to control, the same is not treated as change in the control for SEBI Takeover Code. So is the case if there is transfer of a part of the holding by A Ltd or B Ltd.

However, for Competition Law such transaction may be of relevance in combination regulation. A Ltd. B Ltd. and C Ltd. belong to a group as far as Competition Law is concerned. The transferee company in the above example may turn out be exercising less than 26% of voting rights or appointing less than 50% of the members of the board. There may also be change in the nature or quantum of control by transferee enterprise. By virtue of above cited transaction, A Ltd. or B Ltd. may fall outside the group due to variation in shareholding consequent to transfers. This is of relevance for applying threshold limitation for combination involving these enterprises.

Disclosure of Shareholding under clause 35 of the listing agreement

The SEBI guidelines on disclosure of shareholding recognise that the shareholding pattern of Indian listed companies has undergone a remarkable change, primarily due to the entry of new categories of investors.

One of the key changes in disclosures related to the term "Promoters". The definition of "Promoters" is extremely critical as it impacts disclosures, corporate actions, regulation, research and analysis. Historically, the term "Promoter" has had the connotation of the initial entrepreneur/stakeholder and was appropriate when companies used to be family-run and takeovers/acquisitions rarely took place. This is not true anymore.

Moreover, if more than one individual has promoted a company, it is not necessary that all of them remain with the company through its life and the departing ones, therefore, have to be excluded from any future reckoning of promoters. Also, there are examples where a single entity holds the majority of the shares in a company but still does not describe itself as a "Promoter" as the company was not initially promoted by it or that the
company was subsequently acquired by it. The key issue, therefore, is not who initially promoted the company but who controls it as of date. The new disclosure did away with the term "Promoters" and replaced it with "Controlling Interest". This is what is at the center of group control in Competition Act too.

Controlling/Strategic/in-concert holding

"Controlling Interest/ Strategic Holding/In-concert Holding" refers to entities who are in control of the company, directly or indirectly, whether as a shareholder (including shareholding of 10% or more in such companies), director or otherwise" (and control is defined as "right to appoint majority of the directors or to control the management or policy decisions exer-sicisable 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 and including persons who are instrumental in the formulation or implementation of a plan or programme") or person or persons named as promoters in any document filed with SEBI, stock exchange, ROC or any other body of offer of securities to the public or existing shareholders.

The illustrative list of controlling/strategic/in-concert interest is as under.

- Holdings by founders/directors/ acquirers, which has a control element
- Holdings by persons/ bodies and by their relatives, which has a control element
- Holdings by such entities on which the "Controlling Body" has a managerial control or has a significant investment
- Holdings by such entities where the right of first refusal on shares rests with the "Controlling Body"
- Government holdings as a promoter/acquirer
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

- All holdings under FDI and also such FII holdings where the parent is related to the FDI
- Strategic stakes by private corporate bodies/individuals
- Equity held by associate/group companies (cross-holdings)
- Equity held by Employee Welfare Trusts
- All locked-in shares
- Any entity, which would not trade in the shares of the company without the advice of the entities in control
- Any shares which would not be sold in the open market in the normal course.

Interestingly, Central / State Governments and any organisation / undertaking / enterprise/ institution which is controlled by Central/State Government and holding exercising controlling interest over other enterprise is also to be disclosed under this regulation. This requirement of disclosure under SEBI regulation clearly indicates that Governments too can hold and exercise controlling interest in enterprises in corporate world. The fall out of this proposition on combination regulation is discussed in Chapter 15 of this study.

Accounting Standards on Group and Control

Accounting Standard 18 (AS 18) on Related Party Disclosure issued by the ICAI defines the term control as below:

(a) ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

(c) a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

The definition of ‘control’ lays down independent tests as above. Consequently, it is possible that an enterprise is controlled by two or more enterprises - some controlling by virtue of ownership of majority of the voting power of that enterprise and the others controlling, by virtue of an agreement or otherwise, the composition of the board of directors - so as to obtain economic benefits from its activities.

AS-21 on Consolidated Financial Statements and AS – 23 on Accounting for Investments in Associates in Consolidated Financial Statements issued by ICAI also refer to the terms group, parent company, subsidiary company and control. Both the Accounting Standards define the following terms in the similar way:

Control:

a. the ownership, directly or indirectly through subsidiary (ies), of more than one-half of the voting power of an enterprise; or

b. control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

A parent is an enterprise that has one or more subsidiaries.

A group is a parent and all its subsidiaries.

The criteria for ascertaining control used in AS -21 and AS -23 are similar to the ones used in the Act as far as concept of control is concerned. Only variance is the quantum of
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

voting rights – 26% or more in the Competition Act and more than one-half in the Accounting Standards.

However, this kind of variation in meaning of control should not be of a concern as the Act prescribes a lower threshold limit and the enterprises identified to be belonging to group by virtue of application of Accounting Standard ipso facto are covered under the Act due to lower threshold for voting rights.
Sole Control Vs. Joint Control

Control over an enterprise can be of two types, sole control and joint control. An enterprise is under sole control if party exercising such control does not require the assent of other shareholders for any meaningful decision-making. On the other hand, in the case of joint control a party enjoying joint control has to take into account the potentially different interests of the other parties concerned. Thus more than one party simultaneous exercises control over an enterprise in cases of joint control.

Further, control can be even independent of shareholding structure. A party can exercise control over another without even acquiring or holding shares in the latter. This situation can be illustrated with the following example.

“A beneficially owns more than half of the issued share capital of an enterprise. He concludes an agreement with B in order that the latter may run the business. B agrees provided that he obtains control over the appointments to the board of directors as well as of senior staff and marketing policy. In such situation A would control the firm and would fall within the ambit of Group in terms of Explanation (b)(i) to Section 5 of the Act. B would exercise control as defined in Explanation (b)(iii) to Section 5 of the Act. In short while A would have ultimate control, B would have control of a sufficient kind to bring him within the ambit of control as well as group.”

Sole Control & Joint Control – Mutually inclusive or mutually exclusive

Another pertinent issue related to control is whether there can only be one form of control at any given time. That is, we either have a sole control or joint control. This “unitary
concept” of control assumes that there can only be one controller in any enterprise at any given time.

But this type of interpretation of type of control is not mandated by the Act. The Act provides for controlling affairs or management by one or more enterprises, either jointly or singly over another enterprise or group.

The phenomenon of sole control and joint control existing simultaneously can be explained with the help of following example.

D Ltd. holds 49% voting rights in A Ltd. Other shareholders are B Ltd. and C Ltd. who individually do not hold more than 26% voting rights nor can they appoint more than 50% of the members of the board. In this situation, there exists a sole control in the hands of D Ltd if one of B Ltd. or C Ltd. is absent in any meeting. Further, both B Ltd. and C Ltd. together enjoy joint control over any policy decision independent of D Ltd. Still further, all of them together enjoy joint control over D Ltd.

However, the situation will change if there is a shareholder agreement pursuant to which any material decision in the company required assent of more than 67% of the vote of the shareholders. This could only be achieved if D Ltd. and at least one of B Ltd. or C Ltd. voted in favour of the resolution. Thus this will be a clear situation of joint control at play.

Hence, the notion of unitary concept of control is flawed and sole control and joint control is co-terminus and could play a major role in deciding who the members of a group are.

In the above example, with reference to D Ltd, A Ltd will be member of its group by virtue of shareholding and control for the purpose of combination involving D Ltd. But
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

the same is not true with reference to B Ltd. and C Ltd. in their individual capacity. A Ltd and B Ltd. will not be treated as a group for the purpose of combination involving any of these two. Same is the case with A Ltd. and C Ltd. However, if both B Ltd. and C Ltd. are party to combination, then A Ltd. will fall in the group involving B Ltd and C Ltd.

Joint control to Sole control and vice versa

Now let us presume two enterprises enjoy joint control over another. Let us also presume that this existing joint control is a CCI notified and cleared combination. Consequent upon shareholding changes, this joint control is changed to sole control. There can be another instance like above where sole control turns out to joint control due to agreement.

Now the issue is whether these kind of agreements pertaining to change in shareholdings and consequent change in control needs notification to CCI.

The answer will be yes. The reason for this is that there is a change in control within the meaning of Section 2(a) on acquisition

In ICI/Tioxide, a case where the European Commission had to evaluate the distinction between joint and sole control:

“ … because decisive influence exercised solely is substantially different to decisive influence exercised jointly, since the latter has to take into account the potentially different interests of the other party or parties concerned… By changing the quality of decisive influence exercised by ICI on Tioxide, the transaction will bring about a durable change of the structure of the concerned parties.”
Thus, a sole controller is a different controller to a joint controller. In other words, joint controllers are considered a different species of controller to one of their member elements controlling on its own. One has to be blind to the identity of the individual members of the joint control pool and see a change between two notionally different controllers.
Chapter 9
Shareholding pattern and aspects of control

It should also be noted that the definition of Group contains many terms such as voting rights, board of directors, management or affairs etc., which are not defined in the Act. Nonetheless, Section 2(z) of the Act provides that –“words and expressions used but not defined in this Act and defined in the Companies Act, 1956 shall have the same meanings respectively assigned to them in that Act.”

Therefore it is pertinent to refer to the meaning of these terms in the company law, though reference to any other statutes is not expressly barred.

Shares and voting rights

Here, shares include both preference and an equity share since the Act is silent on the type of shares. However, if we refer to the definition of Group in Explanation (b) to Section 5 of the Act, it makes reference to exercise of 26% or more of the voting rights in the other enterprise.

Preference Share Vs. Voting Rights

Preference shareholders are generally not entitled to voting rights. However, Section 87 (2)(a) of the Companies Act, 1956 expressly provides voting rights to preference shareholder in respect of matters involving resolutions placed before the company which directly the rights attached to their shares such as winding up resolution and reduction of capital of the company.

Further, Section 87(2) (b) of the Companies Act, 1956 vests voting rights in preference shareholders in the event of default by company in paying dividends on their shares. (Refer Appendix II of this paper for full text of the same)
Section 87(2) (c) provides that where the holder of any preference share has a right to vote on any resolution in accordance with the provisions of this sub-sections, his voting right on a poll, as the holder of such share, shall, subject to the provisions of section 89 and sub-section (2) of section 92, be in the same proportion as the capital paid-up in respect of the preference share bears to the total paid-up equity capital of the company.

**Minority shareholders and voting rights**

The Act while defining meaning of group recognizes the ability to control directly or indirectly. This test is the third alternative criteria, next to voting rights and power of appointment to board. This clause of the provision can be the one, which needs real debate. In this instance, ability appears not to be limited. In other words, even if the ability is slightly removed or real, for as long as the ability exists it is enough to invoke the provisions of this section. This will be the case where a minority holder/(s) may assume control.

An interesting scenario is the following one where firm Z intends to issue 25% of its shares to firm P. Prior to the intended transfer of shares to P, the shareholding in firm Z was as follows:

- A 18%
- B 21%
- C 20%
- D 17%
- E 8%
- F 16%

With the intended transfer, the shareholding in firm Z would change as follows:

- A 15%
- B 15%
- C 15%
- D 13%
- E 6%
- F 11%
- P 25%

The main argument in this scenario will be that the transfer of shares to P would not amount to the acquisition of de facto control of Z’s shareholders’ meetings and as such would not constitute control within the meaning of the Act hence no merger would be triggered.
The evaluation indicates that P has a bigger number of shares than the rest of the shareholders. Therefore it would not be inappropriate, in a sense, to say that P is a majority shareholder despite the fact that P has less than 26% shares. However the argument that can be put forward is that, since there are no voting pool agreements in place in firm Z, the voting in the meetings could go either way notwithstanding P’s bigger shareholding. This is to say that if there were to be a resolution that needed to be passed, P would not necessarily attain the majority vote on its own to pass that resolution. Ironically, if one or two shareholder(s) were to vote in support of P a resolution voted for by P could be passed. Similarly, if one or two shareholder(s) were to abstain from voting, P could still manage to get its resolution passed. In light of this it becomes a compelling argument that the ability (as indicated in the Act) seems to exist in respect of P in firm Z following the transfer of shares.

In this scenario, the voting history will not help: no general pattern had previously been followed and no pattern existed in previous activities from which an inference could be made. Previously parties were allowed to vote in any manner making it difficult to predict how things would turn out with the inclusion of P.

Accordingly P, with its greater shareholding, appeared to possess the ability to indirectly control the voting of the majority. To cap it all, since P was coming in as a new shareholder in firm Z where there was no shareholder that seemed to be vested with control over others, it was apparent that P would be acquiring de facto control in firm Z in the same way as other existing parties. Thus P would be able to exert an influence over the firm as if they had control. Therefore, it becomes clear that even if P did not satisfy shareholding test or power to appoint members to the board test the ‘ability to influence strategic commercial behaviour’ would for all intents and purposes be applicable.

In consideration of the aforesaid, the scenario will be viewed as amounting to a transfer of control within the meaning of the Act.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

In BAT and Reynolds (“the Philip Morris case”) [cases 142 & 156 / 84 of EC] the case before the Court of Justice was to decide, “whether and in what circumstances the acquisition of a minority shareholding in a competing company may constitute infringement of Article 81 and 82 of the Treaty (dealing with combinations). The court decided that infringement of combination regulation occurs when such acquisition results in acquiring of control of the competitor’s commercial conduct or if it provides for commercial cooperation between the undertakings concerned or creates a structure, which makes such commercial cooperation likely.\(^3\)

**Holdings by Employee Welfare Trusts / ESOPs**

Corporate as a part of their human resource policies often form employee welfare trusts. Shares can be issued to these trusts with beneficial ownership vesting with employees. Further, Employee Stock/Share Option Schemes (ESOPs) are also operated through these trusts.

For the purpose of combination under the Act, all holdings in the name of the Employee Welfare Trusts as also shares allotted to employees under ESOP should be considered for ‘control test’ and ‘group test’, whether such shares/stocks are presently under lock-in period or not.

However, the shares of subsidiaries and associate enterprises allotted to present employees by parent company on a preferential allotment basis and not carrying any lock-in may give rise to different situation. Under SEBI regulation on disclosure of shareholding under clause 35 of listing agreement, such holdings are treated as ‘free float’ and not as part of controlling interest. Nevertheless, when it comes to control and management of the enterprise, there may be unity of control between management and employee shareholders. Hence for the test of control and management, the aggregate

---

\(^3\) European Community Law of Competition, Bellamy & Child, 5th Edition, Edited by P.M.Roth QC, Published by Sweet & Maxwell.
holdings of all the employees may have to be considered depending on the facts and circumstances of the case.

**Holdings by Banks / Financial Institutions/FIIs/Venture Capital Funds**

Section 6(4) of the Act excludes share subscription or financing facility or any acquisition by public financial institution, for institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement. Section 6(5) envisages notification to the Commission of details of acquisition including the details of control and the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be. Under SEBI too, shares held by banks (scheduled, co-operative, rural, private, foreign etc.) and financial institutions, SEBI registered FIIs and SEBI registered venture capital funds as a portfolio investment are treated as free float holdings for disclosure.

In my opinion, the exemption given above shall apply only to the circumstances under which the control flows to the concerned banks, public financial institution, FIIs and venture capital fund due to consequences of default arising out of loan or investment agreement. The further transfer of control by these institutions to third party should not enjoy such immunity, as the role of these institutions during such circumstances will no more be of financier/investor.

However, whether changed role of these institutions will trigger consideration of group and group control for any future disposal of these impounded stakes by these financiers? No, they do not. Other enterprises financed by these institutions or their investments other enterprises still continue to enjoy the immunity granted under Section 6 (4) of the Act.

Further, in the extreme case of two or more unrelated enterprises defaulting the loan or investment agreement at the same point of time and case of disposal of such impounded
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

stakes in one or more than one arises, whether the consideration of group and group control trigger. In my opinion, such circumstances may not give rise to group and group control as the initial acquisition of control and subsequent transfer of control by these financiers is under a totally different circumstance than the normal transfer of control in corporate world.

However, a word of caution is to analyse each transaction of transfer of control in its proper background and then apply the provisions of the Act. For this reason, the legislature has cast responsibility of notification of transfer of control on such financiers, though such transfers of control are outside the purview of combination regulation under the Act.

**Holdings by Insurance Companies/Mutual Funds/Private Equity Funds**
Shares held by IRDA approved Insurance companies, SEBI registered Mutual Funds as portfolio investment is treated as free float holdings under SEBI regulation on disclosure of shareholdings pursuant to clause 35 of listing agreement.

Under competition law too, these holdings shall be given the same treatment for combination regulation purpose.

**Overseas holdings**
Holdings by following overseas parties are order of the present day globalised business environment.

- Foreign individuals (including FDI)
- Foreign corporate bodies (including FDI)
- Non-resident Indian individual
- Non Resident Indian Corporate Bodies, and
- Overseas corporate bodies as defined under SEBI guidelines
Holdings by these entities are classified as ‘controlling/strategic/in-concert holdings’ and ‘free float’ under SEBI guidelines on clause 35 of listing agreement depending upon facts and circumstances of each case.

For combination regulation too, the same considerations hold good for determination of control and management and accordingly consideration group control.

**Global Depository Receipts (GDRs), American Depository Receipts (ADRs) and American Depository Shares (ADSs).**

All underlying shares of GDRs, ADRs and ADSs or any other foreign depository receipts with controlling interest may have to be reckoned for the purpose of test of control and management and accordingly consideration of group control.
Chapter 10
Control over management and control over assets

CONTROL OVER MANAGEMENT.

Explanation (a) to Section 5 of the Act states that Control includes controlling the affairs or management of the other enterprise. The term controlling the affairs or management is neither defined in the Act nor in the Companies Act, 1956. However, we can refer to the following case law on these terms, which was decided under Income Tax Act, 1961.4

Control and management

Whether two or more lines of business can be regarded as the same or as different businesses, does not depend upon the special methods prescribed by the income-tax authority for computation of taxable income. It depends upon the nature of the business, the nature of organisation, management, source of capital, fund utilised, method of book keeping and a host of other related circumstances. That a business can be carried on after the closure of the other is not the decisive factor. It is dependent on the inter-connection, inter-lacking, inter-dependence and unity apparent from the existence of common management, common business organization, common administration, common fund and common place of business. It is not necessary that all these ingredients must be present. One or other of the ingredients may be absent, but it is the totality of the materials, which will determine the factor. It is the overall approach by the company with regard to the different lines of business that would clinch the issue. But the fact remains that the majority of these ingredients must be present in order to arrive at a conclusion of inter-connection, inter-lacing and inter-dependence. Keeping of separate accounts for each line of business would not be a determining factor. Absence of one or two ingredients would not stand in the way. When there are sufficient materials to show that there is oneness and that the tax is being assessed for the assessee for a considerable period of time as one assessee comprising of several lines of business, then it would be an over-whelming

‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

evidence to hold in favour of the assessee about the oneness of the business. It is the unity of control and not the nature of the different lines of business, which is the concluding factor - *Jayshree Tea & Industries Ltd. v. CIT* [2005] 272 ITR 193/143 Taxman 143 (Cal.).

**Power to appoint members of the Board of Directors**

The power to appoint member of the Board of Directors in the other enterprise can be better understood by referring to Section 4 of the Companies Act, 1956 on meaning of ‘Holding Company’ and ‘Subsidiary Company’. The said section talks of *controlling the composition of Board of Directors, which* is akin to the power to appoint members to the Board.

Section 4(2) of the Companies Act, 1956 states that –

“the composition of a company's Board of directors shall be deemed to be controlled by another company if, but only if, that other company by the exercise of some power exercisable by it at its discretion without the consent or concurrence of any other person, can appoint or remove the holders of all or a majority of the directorships; but for the purposes of this provision that other company shall be deemed to have power to appoint to a directorship with respect to which any of the following conditions is satisfied, that is to say-

(a) that a person cannot be appointed thereto without the exercise in his favour by that other company of such a power as aforesaid;
(b) that a person's appointment thereto follows necessarily from his appointment as director, or manager of, or to any other office or employment in, that other company; or
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

(c) that the directorship is held by an individual nominated by that other company or a subsidiary thereof.”

CONTROL OVER ASSETS OF AN ENTERPRISE

In control over assets of an enterprise, the crux of the matter lies in two terms – control and assets. Regarding the term control, the discussion made in the section ‘control over management’ is equally relevant here.

However, regarding the term ‘assets’, the meaning of the term is left undefined in the Act. Hence, we have to understand the same by referring to the Generally Accepted Accounting Practices (GAAP) prevalent in the relevant market, i.e. by referring to Indian GAAP in case of combination involving group enterprises within India or International GAAP in case combination involves group enterprises with cross border presence.

Again these assets can be tangible and intangible. Tangible assets do not pose many problems when it comes to identifying and valuing for combination regulation purpose. That is not the case when it intangible assets are involved.

In a globalised market, the intangible assets in the form of patents, copyrights, GIs, trademarks, industrial designs etc., constitute significant portfolio of assets of global companies. However, most of these assets are self-generated meaning they get generated by an automatic process of enterprises’ conscious effort to develop and market their goods and services by adopting best standards of quality of goods and services in the relevant market. Thus valuation of intangible assets gives rise to difficulties when it comes to combination regulation matters.

Assets as criteria of control are significant in situations where enterprises in the relevant market rely primarily on utilization of such assets to compete in the market. Enterprises engaged in production, distribution and trading of similar or identical or substitutable goods could be tested for combination regulation with this benchmark.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

However, enterprises involved in rendering of services often stand on a different footing when it comes to control of assets. Such enterprises may own or control significantly lower value of assets. Nonetheless, they may, as a group, command substantial part of the turnover in the relevant market for a particular service. In such cases asset test fails and turnover test prevails in applying combination regulations.

**Beneficiary of control and concept of group**

The Act mentions only ability to exercise control. Both *de jure* and *de facto* control are covered without distinction. Based on the concept of control over management and affairs of the enterprise together with voting power threshold and board control threshold the determination of membership of a group is determined in combination regulation. However, the Act does not concern itself with the benefits attached with such control. The benefits, both economical and political, of control can accrue to the party exercising it or to a third party totally out of group on which the party exercising control may not have control. Thus, an enterprise cannot be brought into the fold of group only as a beneficiary of power of control unless it is demonstrated that such third party has the ability to exercise such power.

To illustrate, let us assume A Ltd. is holding more than 26% of voting rights in or controls the composition of board of directors of B Ltd. C Ltd. is totally different company unrelated to A Ltd. and B Ltd. However, the exercise of control by A Ltd. over B Ltd. may benefit C Ltd. strategically in its business development and this fact may be obvious in the market.

Now whether C Ltd. can be brought into the folds of Group of A Ltd. and B Ltd. is a moot point. Even though it may sound logical to answer in affirmative, it cannot be a member of the group since the Act is blind to the benefit of control criteria for group membership in combination regulation.
Chapter 11

Devices of Corporate Control

As is known, exercise of control, voting rights and right to appoint Board members are the determinants of a group structure. Collectively these can be termed as devices of corporate control. Paradoxically the nuances of group and group control in the mergers and takeovers (combinations) can be best understood from the study of literatures relating to anti-takeovers (barriers to takeovers).

These literatures classify barriers to takeover into structural barriers and technical barriers. The former reflects existing conditions in economic environment including circumstances such as the ownership concentration in families and small groups, the influence of large banks and limited role of stock exchanges in corporate financing.

Technical barriers are part of the corporate governance structure, as they are erected by statutes and by the companies’ memorandum and articles of association, which may specify legal rules and allocate powers between various interested parties (shareholders, management and labour). Techniques such as pyramidal groups, cross-shareholdings and the issuance of non-voting shares, not only contribute to the separation of ownership and control, but also protect management and the controlling shareholders from the risk of unfriendly takeovers.

Franks and Mayer (2001) identify four types of corporate control: large shareholders, complex ownership patterns, bank control in widely held companies, and blocks of shares. These devices of control fall in one of the technical or structural barriers to takeover. A brief description of devices of corporate control is attempted below to help appreciate the conceptual understanding and how they affect the determination of group for combination purpose.
1. Multiple share classes:

These are also known as shares with differential voting rights in India. Section 86(a) (ii) of the Companies Act, 1956 contains provisions for issue of such shares. Accordingly, the Central Government has notified ‘Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. Clause 2(1)(a) of the Rules states that the differential voting rights includes rights as to dividend or voting.

Thus, companies can issue shares with different voting rights that confer a percentage of votes that are disproportionate to cash flow rights and/or voting rights on other classes of equity. Traditionally companies issued shares with no or lower voting rights to allow a controlling shareholder to maintain control while issuing equity that they did not subscribe.

For combination regulation, shares with differing voting rights should be identified separately and treated appropriately. The varying right could also mean shares with no voting rights. There can be shares with only dividend rights and no voting rights. Further, the Rules provides that shares with differing voting rights can be as high as 25% of the total share capital issued. This is a significant limit and may alter the control structure substantially. The financial resources tapped by the corporate through these types of shares do not necessarily dilute the control in favour of subscribers. Hence, these facts should be borne in mind while computing the degree of voting rights and accordingly the test control should be applied.

2. Golden Shares

Golden shares are another related mechanism. These are minority shareholdings retained by governments in privatized companies, which have a special control rights including exclusive rights attached to a single share to appoint board members and veto certain management decisions such as asset sales. Adolff (2002) extends the definition of “golden shares” to all devices employed
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

governments to retain special control rights over privatized enterprises. These include limits on shareholdings of ‘foreigners’ and approval of shareholders over a defined threshold.\(^5\)

These share give rise to the case of de facto control and accordingly to be treated for determination of control and identification of groups for combination regulation.

3. Pyramids:

These are a form of corporate control structure whereby a company holds shares in another company, which in turn holds shares in another one. Control of the corporation at the top of the pyramid combines with the stakes all the way down for outright control of chain. Dividends, transfer pricing and management fees (often used for tax purpose) employed to funnel cash up the control chain.\(^6\)

Collectively these are “tunneling” devices, inter-company dealings whose terms benefit the controlling shareholder at the top of the pyramid. (Johnson et al, 2000)\(^7\).

4. Cross Shareholdings:

This is a planned capital structure whereby two companies buy stakes in each and other, senior managers/owners sit on each other’s board and vote their shares together defensively. Combination may result in these cross holdings being unwound. In these cases, identifying the members of the group is a straightforward exercise.


5. Voting agreements.

Voting agreements are the simplest defensive measure. They are entered into by two or more shareholders, each holding insufficient shares to secure effective or voting control, and provide that the parties’ joint holdings are to be voted as a block and cannot be sold separately. It is usually specified that decisions as to the sale of the shares, which are subject to the agreement, or the exercise of their voting rights, are to be made unanimously (with arbitration in the event of a conflict) or perhaps by the majority of the shareholders in number or in value of the shares contributed.

These types of voting agreements are private arrangements of some shareholders and beyond the purview of company’s record. But they directly affect the control and management of the company in question. The only way to identify this type of control is by analyzing the past history of voting at the company meetings. There can be voluntary disclosure of such agreements by the shareholders as a part of competition compliance programme. These agreements too can help determine the members of the group for combination purpose.

6. Embedded Defenses:

There are also company/industry specific devices. These have been defined as “Embedded Defences” by Arlen and Talley (2003) and include change of control provisions in leases, licenses, joint ventures, employment contracts and debt instruments as well as issuance of preferred stock with put options. Generally these embedded defenses are structured as anti-takeover measures. Nevertheless, they do affect the determination of control structure and thus group control for combination regulation.

---

7. Poison pills and other unilateral changes in top-level control rights

Poison pills are securities issued by vote of the board of directors and, unlike some takeover defenses, do not require shareholder ratification. A basic perspective on the corporate governance problem and the importance of top-level control rights is useful in analyzing the effects of poison pills. Manager and boards of directors are the agents of shareholders, who are the principals in the contracts effected through the corporate charter.

Depending on the circumstances, it can be desirable for a principal to delegate a wide range of decision rights to the agent. In no event is it sensible for the principal to delegate the ultimate control rights to the agent. Control rights are the rights to hire, fire, and set the compensation of the agent. If the control rights were delegated to the agent, the agent would effectively own the decision rights (without right of sale) and use them in his own interests.9

Poison pills allow the board to unilaterally reallocate to itself some of the top-level control rights of stockholders—the right to remove the board and management in certain control transactions. These securities take a variety of forms, but all have the characteristic that they change the rights of shareholders on the occurrence of a control event such as a tender offer, acquisition of a large block of stock or voting rights, or addition to such a block, by a party not approved by the board of directors. One common form gives target shareholders the right to buy stock of the bidder at a large discount from market value, typically 50%, as a condition for completion of the merger.

---

Complex corporate structures as discussed in the previous chapter render application of control test increasingly difficult.

We may resort to matrix methodology of computation of shareholders’ integrated ownership proposed by Flath (1992)\textsuperscript{10}, Hoshi and Ito (1991)\textsuperscript{11}. Integrated ownership is the sum of all direct and indirect shareholding participation. Its determination is useful for consolidation (accounting perspective) as well as corporate governance concerns.

**A. Direct and Integrated ownership model**

Direct ownership is a simple case of direct holdings in another enterprise. They give rise to both right to vote and right over cash flows. Indirect ownership does not give rise to additional cash-flow rights. For this reason, it is sometimes called control.

The computation of integrated ownership is not obvious because the simple sum of direct and indirect participations suffers from a double counting problem. Indeed, when adding up all levels of ownership, the same shares are considered at each ownership level.

This approach eliminates the double counting. Indeed, the total holdings are the same for direct (matrix 1) and integrated (matrix 2) ownerships. The difference lies in the allocation of the ownership pieces to the company's shareholders. Integration takes away the cash-flow rights from the intermediate firms and attributes them to the corresponding ultimate shareholders in due proportions.


‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

Direct holding approach

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>40</td>
</tr>
<tr>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>60</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>40</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>50</td>
</tr>
<tr>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>90</td>
</tr>
</tbody>
</table>

Integrated holding approach

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>40</td>
</tr>
<tr>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>60</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>40</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>50</td>
</tr>
<tr>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>90</td>
</tr>
</tbody>
</table>

Figure 1

Figure 2

Fig. 1 and 2 illustrate the matrix algebra on a set of 5 firms counting 3 ultimate shareholders. Fig. 1 gives the original situation corresponding to matrix $A$. The direct cash-flow rights of firm 4 in firm 5 (50% in matrix 1) lead to indirect ownership of firms 2 and 3 in firm 5 (respectively, 30% and 20%, in matrix 2), as shown in Fig. 2. Thus, the shares of the intermediate corporation, firm 4, are reallocated to its ultimate shareholders.

B. The majority control model

This model envisages effective control and full control. *Effective control* is defined with reference to the majority threshold. A shareholder having more than 50% of the voting rights of a company is said to hold its *full control*, i.e., 100% of effective control. This rule is consistent with the Bebchuk et al. (1999)12 view that 50% of voting rights are necessary for formal control in pyramidal structures. However, the debate on this issue is

---

linked to the observed ownership concentration, which typically exhibits a large variability in time and space. But, even in an environment of dispersed ownership, partial control is always open to challenge through takeovers, for instance. Furthermore, even if the 50% threshold may look too conservative for several situations, it is the smallest threshold that cannot lead to theoretical inconsistencies such as a full control exerted by two different shareholders.

Several papers consider that a shareholder controls a company with only 20% of the voting rights, a level suggested by La Porta et al. (1999)\textsuperscript{13}. According to these authors, the threshold can even be lowered to 10% when the ownership is more dispersed, like in Anglo-Saxon countries. Analysing Asian countries, Claessens et al. (2000)\textsuperscript{14} follow the arguments by La Porta et al. (1999) to justify their choice of the 20% and 10% thresholds. They, nevertheless, agree that this limit may vary according to the country legislation.

Bennedsen et al. (2003)\textsuperscript{15} examine the distribution of ownership and the implied allocation of control in small closely held companies, where control is generally very concentrated. They state that, although an ownership stake of 25% might bring ultimate control when the rest of the ownership distribution is much dispersed, such a stake brings almost no control in closely held companies, where a shareholder can reach 55% of the votes. This argument is not only applicable to small firms. Indeed, many European listed companies display an ownership concentration similar to the one of closely held corporations (ECGN, 2001)\textsuperscript{16}.

\textsuperscript{13} La Porta, R., F. Lopez-de-Silanes and A. Shleifer, 1999, "Corporate ownership around the world", \textit{Journal of Finance}, 54(2), 471-517.


\textsuperscript{15} Bennedsen, M., M. Fosgerau, and K. Nielsen, 2003, "The Strategic choice of control allocation ownership distribution in closely held corporations", working paper, Copenhagen Business School.

\textsuperscript{16} ECGN (European Corporate Governance Network), 2001, \textit{The Control of Corporate Europe}, F. Barca and M. Becht Eds, Oxford University Press, Oxford.
Actually, the threshold of 20%, for instance, follows from an empirical rule of thumb that might be relevant for specific countries and specific periods of time, but has no specific formal justification. In case of concentrated ownership, it cannot hold. On the opposite, the 50% voting power threshold benefits from the legal enforcement in corporate strategic. By nature, it allows \textit{a priori} at most one controlling shareholder per company. Moreover, the majority rule rationalizes the actual existence of shares larger than 50%. Indeed, if full control were possible at a lower level, why would a rational shareholder hold 50% of the voting rights in a single company and, consequently, loose potential gains from diversification? Stylized facts on European data (ECGN, 2001) confirm that the median largest voting block in listed companies’ lies above 50% in Austria, Belgium, Germany and Italy (but under 10% in the US and the UK).

Effective control is obtained by applying the \textit{majoritization rule} to the matrix of voting rights, namely, matrix $B$. A voting share of greater than 50% is turning into absolute control (100%), meaning that firm holds full control over the other firm. Moreover, since the other shareholders of the other firm are expropriated from control, their effective control over firm is set equal to zero. This definition of effective control formalizes the expropriation faced by the minority shareholders, largely documented in the literature (Shleifer and Vishny\textsuperscript{17}, 1995; Zingales, 1994\textsuperscript{18}, La Porta et al., 1999).

Following the example provided by Fig. 1, Fig. 3 exhibits the effects of applying the majoritization rule to matrix 1, leading to matrix 3 of effective control. Firms 1 and 3 are expropriated from their shares of control, respectively, over firm 5 and firm 4. Fig. 4


‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

illustrates the computation of matrix 4 of indirect control. It appears that firm 2 controls firm 5 through firm 4. The elimination of the arrow linking firm 4 to firm 5 is a consequence of the no double counting principle, attributing to the ultimate shareholder, here firm 2, the whole control exerted by its branches.

<table>
<thead>
<tr>
<th>Majority control approach</th>
<th>Majority control approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

Matrix 3

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Matrix 4

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>3</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Figure 3

Figure 4
Chapter 13
Group – Analysis of the term with reference to Combination

The Act refers to the term group in relation to combination of three types – acquisition, acquiring of control and mergers and amalgamation. Let us analyse each of the above separately.

Acquisition:

Acquisition is defined in Section 2(a) of the Act to mean acquiring or agreeing to acquire, directly or indirectly –

(i) shares, voting rights or assets of any enterprise; or
(ii) control over management or control over assets of any enterprise.

However, though acquisition or agreement to acquire shares, voting rights, assets, control over management or control of assets may mean acquisition, such acquisition will fall within the ambit of notifiable combination only when it satisfies the quantitative threshold limits prescribed in Section 5 of the Act. Even if such acquisition meets the criteria of combination, what is required under the law is a voluntary notification thereof. Law does not prohibit such acquisition. Rule of *Per Se Illegality* has been done away with. *Rule of Reason* principle has been adopted by government in merger control. Thus dominance is not of a concern to government in as much as abuse of dominance is.

Acquiring of control

The second type of combination referred to in the Act is acquiring of control. Here the law talks of acquiring of control by person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production,
distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service.

The plain reading of this section leads to conclude that if the acquirer doesn’t have under his direct or indirect control another enterprise in the same line of business, it is outside the combination regulation prescribed under Section 5 of the Act. That means an enterprise has to be part of a group in order to be covered under acquiring of control route to combination.

However, a careful reading of provision of Section 5(a) and 5(b) of the Act gives different interpretation. Though Section 5(b) talks of acquiring control by an enterprise already having under its control another enterprise in the same line of business, Section 5(a) encompasses acquisition of another enterprise engaged in unrelated line of business by a standalone enterprise or by an enterprise belonging to a group (acquirer). Since quantitative threshold limits being same in both types of combination, only the test of combination shifts from acquiring of control mode to acquisition mode.

Whether an operation gives rise to an acquisition of control depends on a number of legal and/or factual elements. The acquisition of property rights, control over management and voting rights are important but are not the only elements involved; purely economic relationships may also play a decisive role. Therefore, in exceptional circumstances, a situation of economic dependence may lead to control on a de facto basis, where, for example, very important long term supply agreement or credits provided by suppliers or customers, coupled with structural links, confer decisive influence.

Control is nevertheless normally acquired by persons or enterprises, which are the holders of the right or are entitled to rights conferring the control. There may also be exceptional situations where the formal holder of a controlling interest differs from the person or enterprise having in fact the real power to exercise the rights resulting from this interest. This may be the case, for example, where an enterprise uses the parent-
subsidiary route to control or when power is exercised through a chain of enterprises within the group. The evidence need to establish this type of indirect control may include factors such as the source of financing or family links.

We can classify the acquiring control in different scenarios in the following ways. They are only indicative classification and do not purport to be a complete list.

1. Acquisition of sole control

   1.1 Acquisition of sole control of the whole company
   1.2 Acquisition of sole control of part of a company
   1.3 Acquisition of sole control after reduction or enlargement of the target company
   1.4 Acquisition of sole control through a subsidiary of a group

2. Acquisition of joint control

   2.1 Acquisition of joint control of a newly-created company
   2.2 Acquisition of joint control of a pre-existing company
   2.3 Acquisition of joint control with a view to immediate partition of assets

3. Any other change in the composition of shareholding.
4. “Demergers” and the break up of companies
5. Management buy-outs

These scenarios involving transfer of control have been discussed in Appendix 3
Joint venture stands on a different footing as far as competition law is concerned. Proviso to Section 3(3) gives exemption to agreements entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services.

In transactions where a joint venture acquires control of another enterprise, the question arises whether or not, from the point of view of the acquiring party, the joint venture should be regarded as a single enterprise or whether each of its parent companies should individually be regarded as enterprises concerned. In other words, the issue is whether or not to “lift the corporate veil” of the intermediate enterprise (the vehicle).

In principle, the enterprise concerned is the direct participant in the acquisition of control. However, there may be circumstances where companies set up “shell” companies, which have little or no turnover or assets of their own, or use an existing joint venture that is operating on a different market from that of the target company in order to carry out the acquisition on behalf of the parent companies.

Section 5 of the Act on combination uses the term “enterprise” and “person”. Joint venture is covered by the definition of person as “an association of persons or body of individuals, whether incorporated or not, in India or outside India”. Hence, the combination transactions involving joint ventures fall within the ambit of Section 5 of the Act. The ‘shell approach’ to combination through joint venture will be within the purview of combination regulation.

For the purpose of computation of threshold limits, the value of the assets and turnover recognised in its separate financial statements and consequently in the consolidated financial statements of parents in compliance with AS-27 – Financial Reporting of Interest in Joint Ventures will have to be reckoned.
State Owned Enterprises (SOEs) and Concept of Group

Public Sector Undertakings (PSUs) are popularly known as State Owned Enterprises (SOEs) in competition literature worldwide. SOEs are owned by governments rather than by private investors. SOEs compete directly with private, profit-maximising enterprises in many important markets. For example, government postal organization often offers overnight mail and package shipping services in direct competition with private delivery companies. Many public hospitals and educational institutions also directly compete with private players. Production and distribution by public enterprises is particularly widespread in India. SOEs are typically instructed to pursue goals other than profit maximization and therefore, one might suspect that SOEs would act less aggressively towards their competitors than would private, profit-maximizing firms. However, in reality SOEs may have stronger incentives than profit-maximising private firms to pursue activities that disadvantage competitors.\(^{19}\)

When it comes to combinations in Competition Law, all SOEs, Central and State, stand on a different footing vis-à-vis private players. The characteristics, control and management of public sector undertakings are as below.\(^{20}\)

**Shareholding:**

Constitution of India has designated the President as Head of the Republic of India and the Governor as Head of the state. All executive actions of the Government shall be expressed to be taken in the name of President/Governor as the case may be. Hence, share capital contributions by the Central/State Government are issued to the President/Governor of the concerned State Government, by designation.

---

19 For more information on this, refer Competition Law for SOEs by David E M Sappington & J Georgy Sidak, Anti-trust Law Journal Vol. 71

20 “Audit Reports in Public Sector” (CPED:5:2004:47) published by CPE committee of ICAI, New Delhi
Consolidated Fund:

All the receipts due to the Government shall be remitted into Government Account and such account is called Consolidated Fund of India or Consolidated Fund of the concerned State. All payments (investments/expenditure/donations etc.) from such Consolidated Fund shall be made only after approval from the parliament/concerned State Legislative, through budgetary demands.

Legislative oversight and control:

Parliament and State Legislature mainly formulate broad policy framework and the guidelines, in their respective jurisdiction. SOEs are subjected to review and oversight. Section 619A of the Companies Act provides for tabling of the annual reports, including the financial statements and the auditor’s reports in the Houses of Parliament in case of Central SOEs and respective State Legislature in case of State SOEs.

Review of the working:

Committees of Parliament such Committee on Public Sector Undertakings (COPU), Consultative committee of the respective administrative departments also have powers to review and monitor the workings of PSUs. These reviews cover the performance of the PSUs in general and the financial discipline in particular. Further, Government of India, since 1992, initiated target setting through Memorandum of Understanding between the Chief Executive of the PSUs with concerned Administrative Department. These targets cover various areas such as production, input-output norms, infrastructure utilization, profitability and other financial parameters.

Investment in SOEs:

Fund based assistance such as equity participation, long term loans, advances, grants/subsidies, soft loans, channeling of world bank loans/assistance are made by Government after due approval of parliament or concerned state legislature, as the case may be. Further, non-fund based
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

assistance such as providing sovereign guarantees, infrastructure and other facilities, tax exemptions/concessions etc. are made by government.

Thus there is a complete unity of control in all SOEs. By virtue of this, all SOEs, Central and State, may have to be regarded as belonging to one single group for the purpose of regulation of combination under Competition Law. This may redefine the competition in Indian market in which SOEs play a larger role, directly and indirectly. Combination regulation would assume greater importance with SOEs coming into the fold of group. Sheer size of PSUs, both Central PSUs and State PSUs would result in them crossing the bright lines of threshold prescribed in combination regulation. Hence, they may have to notify any transfer of control or acquisition of control and mergers and amalgamation with the Commission.
Identifying turnover of Groups

When an enterprise concerned in a combination within the meaning of Section 5 of the Act belongs to a group, the turnover of the group as whole is to be taken into account in order to determine whether the thresholds are met. The aim is again to capture the total volume of the economic resources that are being combined through the operation.

The Act does not define the concept of group in abstract terms but focuses on criteria of voting rights, power to appoint members to the board and control of management or affairs as the yardstick to determine which of the companies that have some direct or indirect links with enterprise in question should be regarded as part of its group.

This means that turnover of the company directly involved in the transaction should include its subsidiaries, its parent companies, the other subsidiaries of its parent companies, subsidiaries and parent of its own subsidiaries and any other enterprise jointly controlled by two or more of the companies belonging to the group. A graphic example is as follows.
A. The Enterprise concerned
B. Its subsidiaries and their own subsidiaries i.e. B1 and B2
C. Its parent companies and their own parent companies i.e. C1 and C2
D. Other subsidiaries of the parent companies of the enterprise concerned
E. Companies jointly controlled by two or more companies of the group

Some important points relating to above described group in combination regulation while computing threshold limit are as under:

1. As long as the test of control is fulfilled, the whole turnover or assets of the subsidiary in question will be taken into account regardless of the actual shareholding of the controlling company. In the example, the whole turnover of the three subsidiaries (called B) of the enterprise concerned, A, will be included.

2. When any of the companies identified as belonging to the group also controls others, these should also be incorporated into the calculation of threshold. In the example, one of the subsidiaries of A (called B) has in turn its own subsidiaries B1 and B2.

3. When two or more companies jointly control the undertaking concerned (A) in the senses that the agreement of each and all of them is needed in order to manage the affairs of the enterprise, the turnover or assets of all of them
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

should be included. In the example, the two parent companies (C) of the enterprise concerned (A) would be taken into account as well as their own parent companies (C1 in the example).

4. Any intra-group turnover should be subtracted from the turnover of the group.

The internal turnover or intra-group turnover

The combination regulation provisions in the Act uses turnover as one of the criteria to identify notifiable combination. However, the Act is silent on the internal turnover or intra-group turnover in the case of group companies. However, Accounting Standard 26 issued by Institute of Chartered Accountants of India on Consolidation of Financial Statements requires that intra-group turnover has to be eliminated for the purpose of reporting consolidated result. Thus, the aggregate turnover of a group shall not include the sale of products or the provision of services between any of the enterprise in the Group. The aim is to exclude the proceeds of business dealings within a group so as to take account of the real economic weight of each entity and the group as a whole. Thus, the amount of turnover to be taken into account for threshold computation in the case of group is only the turnover effected by the group as a whole with the outside parties.
Chapter 17
Recommendations and Conclusion

Recommendations:

1. **Minority shareholding and control.**
   The thresholds regarding voting rights and power to appoint directors on the Board are only bright lines. As discussed in this paper depending on the facts of each case, the acquisition of a minority shareholding in an enterprise may confer “joint control” or even “sole control” within the meaning of combination regulation in the Act. In such case the acquisition gives rise to a “combination”.

2. **Change in quality of control – Sole control to Joint Control and vice versa. – Cases of multiple notifications**
   The extant power relationship might have been even notified to and approved by CCI. As discussed in this paper, a mere change in quality of control may trigger notification obligation. Such change may involve transfer of control among the enterprises belonging to the same group. In such cases, triggering of an obligation to notify when the bright lines of voting rights or power to appoint members of the board makes sense. The fact that there may be cases where the journey across the bright line is very brief does not negate the rationality of policy. So cases of multiple notification of transfer of controls are possible and real.

3. **State Owned Enterprises (SOEs or PSUs) and Group**
   In a mixed economy like ours, public sector undertakings play a major role in market. SOEs compete directly with private, profit-maximising enterprises in many important markets. These SOEs are under the control of ministries of the government. For example, oil PSUs like IOC, BPCL etc. are under the control of Ministry of Petroleum and Natural Gas. Apart from the common shareholding, there will legislative oversight and control over these SOEs. The committees will monitor their
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

performance. The “enterprise” in the Act is defined to include “a department of government. Now in identifying whether a particular PSU belong to a group, the other PSUs under the same Ministry will be treated as member of the Group by virtue of common control by Ministry. Further, all the PSUs may be considered as a group since government is the common controller in all these PSUs. Same will be the case of state owned PSUs.

4. **Group companies and relevant market**

Section 6(1) of the Act provides that combinations which cause or likely to cause an appreciable adverse effect on competition within relevant market in India shall be void. Section 6(2) provides that parties to the combination or proposed combination can voluntarily notify the same to Commission.

In terms of Section 5 of the Act, to identify groups, only those enterprises competing in the relevant product markets or relevant geographic markets and belonging to a group are to be considered. Other enterprises in that Group in different product and geographic market shall not be considered.

5. **Joint Ventures**

As discussed in the above paras, joint ventures are covered within the ambit of merger regulation. Whether they are directly involved in combination as acquirer or as target, they will be treated as member of a group. Hence, to calculate the threshold limit for notification, the value of assets and turnover recognized in its separate financial statements and consequently in its consolidated financial statements in compliance with AS 27 – Financial Reporting of Interests in Joint Ventures will have to be reckoned.

6. **Control, benefits of control and member of group**

The Act mentions only about ability to exercise control. Both *de jure* and *de facto* control are covered without distinction. Based on the concept of control over
management and affairs of the enterprise together with voting power threshold and board control threshold the determination of membership of a group is determined in combination regulation. However, the Act does not concern itself with the benefits attached with such control. The benefits, both economical and political, of control can accrue to the party exercising it or to a third party totally out of group on which the party exercising control may not have control. Thus, an enterprise cannot be brought into the fold of group only as a beneficiary of power of control unless it is demonstrated that such third party has the ability to exercise such power.

Conclusion

The Act has provided broad guidelines for identifying the concept of control and consequent formation of group among related enterprises. The criteria of “group” provided in Explanation (b) to Section 5 of the Act are only “bright lines”. When enterprises cross that line, they must notify, albeit that they have not traveled very far in crossing it (border lines cases).

When interpreting legislation, one must consider whether the legislation will be effective. Thus, the bright lines set out in the Act are for all to know – both the enterprises and the Commission. This approach of legislature is to give some kind of certainty in combination cases. Thus for this reason the Act has adopted the approach of recognising instances of control; not just in a legalistic sense, but also as a concept that acknowledges economic and commercial reality as well.

In the globalised business environment there is a need to ensure that reorganizations, alliances or combinations do not result in lasting appreciable adverse impact on competition in the market. Hence, Competition policy designed by the country shall have powers of effective control over combinations from the point of view of their effect on the structure of competition in the market.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

It is urged therefore, to adopt a conservative yet uniform approach that protected legal certainty by requiring the parties to conform to the Act’s requirements, rather than contorting the Act to fit with the creative ways which parties devise to structure their transactions.
Appendix 1

MRTP Act and concept of ‘inter-connected undertakings’

As per Section 2 (g) of the MRTP Act, “inter-connected undertakings” mean two or more undertakings, which are inter-connected with each other in any of the following manner, namely

i. One owns or control the other

ii. Where the undertakings are owned by firms, if such firms have one or more common partners

A,B,C, D,E & F are partners in more than one firm and are called common partners

Comment: ABC & Co., BCD & Co., DEF & Co, AEF & Co, and XYZ Ltd. are inter-connected

iii. Where the undertakings are owned by bodies corporate, -

a. if one body corporate manages the other body corporate, or
b. if one body corporate is a subsidiary of the other body corporate, or
c. if the bodies corporate are under the same management, or
d. if one body corporate exercises control over the other in any other manner.

Comment: ABC Ltd., DEF Ltd., GHI Ltd., JKL Ltd., MNO Ltd., and XYZ Ltd. are inter-connected.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

iv. Where one undertaking is owned by a body corporate and the other is owned by a firm, if one or more partners of the firm,-

a. hold, directly or indirectly, not less than fifty percent of the shares, whether preference or equity, of the body corporate, or
b. exercises control, directly or indirectly, whether as director or otherwise, over the body corporate.

![Diagram]

**Comment** ABC Ltd., DEF Ltd., MNO Ltd. and XYZ & Co. will be inter-connected.

v. one enterprise is owned by a body corporate and the other is owned by a firm having bodies corporate as its partners, if such body corporates are under the same management

![Diagram]

**Comment** P Ltd., Q Ltd., ABC Ltd., and R are inter-connected.
vi. Enterprises are owned or controlled by the same person or by the same group.

Comment: Alpha group and its constituents, X Ltd., Y Ltd. and Z Ltd. are interconnected.

vii. One enterprise is connected with the other directly or through any number of enterprise which are inter-connected within the meaning of one or more foregoing sub-clauses.

The test of “bodies corporate under the same management” uses the following criteria –

c. Common or joint control over other undertaking.
d. Control over other undertaking through group mechanism.
e. Members of two independent group exercising control over a common undertaking.
f. Common manager and / or managing director
g. Equity shareholding of not less than one-fourth in one undertaking by a body corporate.
h. Controlling the composition at least one-fourth of the board of other undertaking.
i. Equity shareholding of not less than one-fourth by director and / or his relatives.
j. Common directors constituting not less than one-fourth of members of board of the other undertaking.
k. Common individuals or individuals belonging to group and holding not less than one-fourth of equity shares in two undertakings.
‘Group and Group Control’ with respect to combination in Indian Competition Law – A Study

1. Body corporate or bodies corporate belonging to a group holding not less than one-fourth of the equity shares in two undertakings either directly or through their subsidiaries.

m. Same individual or same body corporate exercising or controlling not less than one-fourth of total voting powers in two undertakings, directly or indirectly.

n. Exercise or control of voting powers to the same extent and in the same manner as described in (k) above but by individual or bodies corporate belonging to group, directly or indirectly.

o. Directors accustomed to act in accordance with the directions or instructions of director of another undertaking.
Appendix 2

Preference shares and voting rights as per Companies Act, 1956

As per Section 87(2) (b) of the Companies Act, 1956, every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, be entitled to vote on every resolution placed before the company at any meeting, if the dividend due on such capital or any part of such dividend has remained unpaid –

(ii) in the case of cumulative preference shares, in respect of an aggregate period of not less than two years preceding the date of commencement of the meeting; and

(iii) in the case of non-cumulative preference shares, either in respect of a period of not less than two years ending with the expiry of the financial year immediately preceding the commencement of the meeting or in respect of an aggregate period of not less than three years comprised in the six years ending with the expiry of the financial year aforesaid.

Explanation to this Section provides that for the purposes of this clause, dividend shall be deemed to be due on preference shares in respect of any period, whether a dividend has been declared by the company on such shares for such period or not. –

(a) on the last day specified for the payment of such dividend for such period, in the articles or other instrument executed by the company in that behalf; or

(b) in case no day is so specified, on the day immediately following such period.

Section 87(2) (c) provides that where the holder of any preference share has a right to vote on any resolution in accordance with the provisions of this sub-sections, his voting right on a poll, as the holder of such share, shall, subject to the provisions of section 89 and sub-section (2) of section 92, be in the same proportion as the capital paid-up in respect of the preference share bears to the total paid-up equity capital of the company.
Appendix 3

Transfer of control in different scenarios

1. Sole Control – Different scenarios

1. Acquisition of sole control of the whole company.

This is the most straightforward case of acquisition of control. In this case an enterprise belonging to a group will acquire another enterprise not belonging to its group.

Here, while calculating the threshold limits specified in Section 5 of the Act, no need to take into account the turnover or assets of the group to which target company belonged prior to combination. Only the post transaction limits of assets and turnover of the acquirer group is relevant.

2. Acquisition of sole control of part of a company

In this case, sole control is acquired of a part of an enterprise. Here the concept of ‘parts’ is to be understood as one or more separate legal entities (such as subsidiaries), internal sub-divisions within the seller (such as an unit or division), or specific asset which in themselves constitute a business (e.g., in certain cases brands and licenses) to which market turnover can be clearly attributed.

In this case, only the turnover and assets attributable to such part needs to be reckoned for computing quantitative thresholds.
3. Acquisition of sole control after reduction or enlargement of the target company

In this case, the commission shall base its findings on the configuration of enterprises as on the date of event triggering the obligation to notify combination as stipulated in Section 6(2) of the Act.

Thus if the target enterprise has divested an entity or closed a business prior to the date of event triggering notification or where such a divestment or closure is a pre-condition of combination, then assets and turnover of such divested entity or closed business shall be ignored for threshold limit calculation. Conversely, if the target company has acquired an entity prior to the date of event triggering notification of combination, then turnover and assets of the latter are to be added for threshold limit calculation.

4. Acquisition of sole control through a subsidiary of a group

When the target company is acquired by a group through one of its subsidiaries, turnover and assets of the group as a whole after acquisition is relevant for threshold limit computation. However, regarding actual notification, this can be made by the concerned subsidiary or its parent company.

2. Joint Control – Different scenarios

1. Acquisition of joint control of newly created company

In this case, joint control is acquired of a new enterprise. Obviously the new enterprises may not have any turnover. But it can have assets, which are transferred to it by the parties to joint control. However, a moot point is to
which group the newly created enterprise belongs after acquisition. Because based on this decision only the group turnover or assets are reckoned for computing threshold limits. This will be a practical situation if the parties to joint control fail the three tests of ‘Group’ as defined in Explanation (b) to Section 5 of the Act.

2. Acquisition of joint control of a pre-existing company

Here, the joint control is acquired by two or more enterprises, which may or may not belong to the same group. If the joint control is acquired by enterprises belonging to the same group, then it will be a straightforward case for combination regulation.

However, if joint control is acquired by two or more enterprises belonging to two or more groups, then the structure of holding becomes complicated. Further, there is a need to identify to which group/(s) the acquired enterprise will belong in order to club the group assets or group turnover for threshold test prescribed in Section 5 of the Act. Since more than one group is involved in this case, turnover and assets of more than one group may have to be considered in clubbing.

For instance, suppose A Ltd., B Ltd., and C Ltd, together acquire joint control over Z Ltd. Further, A Ltd. B Ltd., and C Ltd., themselves belong to 3 different groups. Now the issue is to which group Z Ltd., will belong after acquisition.
3. **Acquisition of joint control with a view to immediate partition of assets**

Where several enterprises come together solely for the purpose of acquiring another company and agree to divide up the acquired assets according to pre-existing plan immediately upon completion of the transaction, there is no effective concentration of economic power between the acquirers and the target company since the assets acquired are jointly held and controlled for only a “legal instant”.

3. **Any other changes in the composition of shareholding**

In the case where following changes in the shareholding, one or more shareholders acquire control, the operation may constitute a notifiable combination under the Act on the basis of change in the quality of control.

Irrespective of whether the number of shareholders decreases, increases or remains the same subsequent to the operation, this acquisition of control can take any of the following forms:

(a) entry of one or more new shareholders (change from sole to joint control, or situation of joint control both before and after the operation).

(b) acquisition of controlling interest by one or more minority shareholders (change from sole to joint control, or situation of joint control both before and after the operation).

(c) substitution of one or more shareholders (situation of joint control both before and after the operation).

In all these situations, there may be combination by way of acquisition of control in terms of the provisions of the Act.
4. **Demerger.**

When two enterprises merge and then subsequently demerge or breakup and in particular assets are split between the “demerging” parties in a configuration different from the original, there will be more than one acquisition of control. For e.g., A Ltd. and B Ltd., merge and then subsequently demerge with a new asset configuration. There will be acquisition by A Ltd. of various assets (which may previously have been owned by itself and by B Ltd. and jointly acquired by the entity resulting from merger) with similar asset acquisition pattern by B Ltd. Breakup of companies in this way is asymmetrical. But nonetheless control over assets is being altered.

5. **Management buy-outs**

An acquisition of control of a company by its own managers is also an acquisition by individuals and what has been said here is therefore applicable here. However, the management of the company may pool its interest through a “vehicle company”, so that it acts with a single voice and also to facilitate decision-making. Further, with or without a vehicle company, the management may also look for investors in order to finance the operation. Very often, the rights granted to these investors according to their shareholding may be such that control within the meaning of the Act will be conferred upon them.
References:

1. The Competition Act, 2002 (Bare Act)
3. MRTP Act, 1969 (Bare Act)
6. Companies Act, 1956 (Bare Act)
7. SEBI (Substantial Acquisition of shares and Takeovers) Regulation, 1997
15. South African Competition Commission website – www.compcom.co.za