M&A LAB

BHARTI – MTN DEAL (Part – II) Dissected

Dissected by – *Team M&A*

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PROLOGUE

In our M&A Lab titled '*BHARTI-MTN: Ringing The Bell From Asia To Africa*' dated June 5, 2009 ("**M&A Lab – Part I**"), we had attempted to anatomize the strategic merger of MTN Group Limited ("**MTN**") and Bharti Airtel Limited ("**Bharti Airtel**")[1] (the "**Proposed Transaction**") from a commercial, legal, regulatory and tax perspective.

We had then referred to MTN as the "*Runaway Bride*" and concluded the Lab with an interesting question - "Will the African lady say 'I do', to its Indian suitor"? Approximately four months hence, MTN reaffirms its tag of '*Runaway Bride*' as the proposed merger has been called off by both the global telecom players for the second time in two years. This time, though, the break-off saga is slightly different from the last instance as the collapse this time is an upshot of the dissent that came from the '*Father of the Bride*', Government of South Africa, even though MTN and its shareholders had consented to the union.

The USD 24 billion deal to build a transcontinental telecom behemoth was publicly called off by Mr. Phuthuma Nhleko, CEO of MTN and Mr. Sunil Bharti Mittal, Chairman and MD of Bharti Airtel on September 30, 2009, the last day of the twice extended exclusivity period.

In the M&A Lab – Part I, we had assured a sequel by dissecting the Proposed Transaction post its consummation; however, since the negotiations have been called off, we present this Part II of the M&A Lab making a deeper probe into the failure of the Proposed Transaction. As always, we seek to analyze the reasons for the demise of this multibillion dollar dream of Bharti Airtel and MTN, which this time are not just legal, regulatory and commercial but also political.

BACKGROUND

For the sake of continuity we provide '**Table A**' which encompasses the history of events between both the Companies as provided in the M&A Lab – Part I and then '**Table B**' shall capsulate the chronology of events following thereon till the failure of the negotiations.

Table A

Date	Events
May 5, 2008	Bharti Airtel announces that it has entered into exploratory discussions with the MTN Group.
May 6, 2008	Bharti Airtel denies media reports that it has put an offer on the table for acquiring MTN.
May 16, 2008	Both Parties reach an in-principle agreement and a term sheet was initiated

[1] MTN and Bharti Airtel shall be hereinafter referred to as the "**Companies**" or "**Parties**".

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Date	Events
	between the two Parties.
May 21, 2008	The agreed term sheet is presented to the MTN Board of directors.
May 24, 2008	Bharti Airtel withdraws from the talks, following the MTN board presenting a completely different structure to Bharti Airtel. Bharti Airtel sees this new proposal as a convoluted way of getting indirect control of the proposed combined entity, which would have made Bharti Airtel a subsidiary of MTN.
May 26, 2008	Reliance Communications ("**RCom**") enters into exclusive merger discussions with MTN.
July 19, 2008	RCom and MTN formally end talks.
May 25, 2009	Bharti Airtel makes a media statement announcing that it has entered into talks with MTN for a strategic merger with exclusivity period till July 31, 2009.

Table B

Date	Events
June 16, 2009	Ministry of Corporate Affairs issued a circular clarifying that the GDR holders should not be considered as members of the issuing company.
June 22, 2009	Securities and Exchange Board of India ("**SEBI**"), through its informal guidance ("**Informal Guidance**"), exempted MTN and its shareholders from making an open offer for acquiring 36% economic interest in Bharti Airtel through Global Depository Receipts ("**GDRs**").
July 30, 2009	Companies mutually agree to extend the exclusivity period to August 31, 2009.
Mid August 2009	South African Government's Treasury proposes dual listing ("**Dual Listing**") of the Companies in India and South Africa, respectively.
August 28, 2009	Securities Appellate Tribunal ("**SAT**") dismissed the appeal by Mr. Deepak Mehra, a shareholder of Bharti Airtel, that challenged the SEBI Informal Guidance exempting South Africa's MTN from making an open offer to Bharti Airtel's shareholders for acquisition of GDRs.
August 30, 2009	Companies mutually agree to extend the exclusivity period to September 30, 2009.
September 15, 2009	The Finance Ministry of India rejected the proposal by the South African Government to allow the immediate Dual Listing; however, there was no formal clarification sought from the concerned authorities in India for the Dual Listing.
September 22, 2009	SEBI decided in its board meeting to amend the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("**Takeover Code**") to include provision on trigger of open offer obligations on acquisition of ADRs and GDRs with voting rights.
September 24, 2009	Delegation of the South African Government met the Indian regulators to seek

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Date	Events
	clarity on the Proposed Transaction and possibility of Dual Listing.
September 30, 2009	The Proposed Transaction called off for the second time in two years on the expiry of the exclusivity period.

COMMERCIAL CONSIDERATIONS

- **Was the 'strategic merger' the first step to a full merger of MTN into Bharti Airtel? Did it have an impact on the failure of the Proposed Transaction?**

The beginning contained the end, though inexplicitly. The media statement issued by Bharti Airtel on May 25, 2009 carried the seeds of this controversy which were later nourished and reaped by the South African Government.

The media statement reads "*The broader strategic objective would be to achieve a full merger of MTN and Bharti as soon as it is practicable to create a leading emerging market telecom operator which today would have combined revenues of over USD 20 billion and a combined customer base of over 200 million.*"[2]

The commercial motive of Bharti Airtel was to use the 'strategic merger' whereby Bharti Airtel would acquire 49% in MTN and MTN and its shareholders would acquire 36% economic interest in Bharti Airtel as the first step to the full merger which was to follow. It appears that the idea of Dual Listing was not envisaged by Bharti Airtel when the 'strategic merger' was announced. If Dual Listing was part of their initial scheme then they would have sought the opinion of Indian regulators in advance as they did with the issue relating to open offer under the Takeover Code for acquisition of GDRs by MTN and its shareholders.

The strategy of Bharti Airtel was to control MTN pursuant to the strategic merger which the South African Government did not find very appealing. The strategic merger required the exchange control approval of the National Treasury ("**Treasury**") of South African Government as a precursor to the inflow and outflow of money.[3] The application for the same was forwarded to the Treasury by the South African Reserve Bank and while processing the application the Treasury made the approval conditional upon the Companies agreeing on a DLC structure with Bharti Airtel listed in India and MTN listed in South Africa. The Treasury on September 11, 2009 categorically ruled out approval for the 'strategic merger' if Dual Listing was not allowed and if MTN did not remain domiciled in South Africa forever.[4] It is to be believed

[2] www.bharti.com/136.html?&tx_ttnews%5Btt_news%5D=319&tx_ttnews%5BbackPid%5D=116&cHash=e775e69e38

[3] Lesley Stones, SOUTH AFRICA: MTN-BHARTI DEAL IS ANOTHER STEP CLOSER, September 3, 2009 http://allafrica.com/stories/200909030106.html

[4] Siddharth Zarabi, WHY DUAL LISTING PROMPTED BHARTI-MTN TO CALL OFF DEAL? October 2, 2009 www.livemint.com/2009/10/01221612/Why-dual-listing-prompted-Bhar.html

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that the idea of Dual Listing was not Indian but came from the South African end. This draws validity from the fact that South Africa has previous experience with Dual Listed Companies ("**DLC**") structures while the concept is still alien to India.

❖ **Why was the South African Government adamant about the DLC structure?**

A conventional merger of companies could be effected only at the expense of the identity of one of the companies. In cases where two companies are of similar size, the managements of the companies may both wish to avoid losing the identity and existence of their respective companies. It is interesting to note that the demand for maintaining the identity of MTN came initially from the Government of South Africa and it was promoted by MTN subsequently. The Government of South Africa made the deal conditional upon the Parties agreeing for Dual listing of both the Companies and MTN remaining domiciled in South Africa. Dual Listing was perceived as a possible solution to overcome the deadlock as both the Companies relented to shed their identities.

Economic Nationalism: The Government of South Africa gave precedence to economic nationalism over the corporate benefits of the multibillion dollar Proposed Transaction.[5] The South African Government did not want the ownership of MTN to fall into foreign hands and insisted on the company remaining domiciled in South Africa. It was of utmost importance for the Government of South Africa to ensure that MTN maintained its identity as the leading South African telecom company.

MTN CEO Mr. Phuthuma Nhleko went on record stating "*it is a big and complex transaction and the company has to ensure that it continues to grow from its South African base and does not lose its DNA*".[6]

MTN is viewed locally as a national champion, having launched in 1994 as South Africa emerged from apartheid with the election of Nelson Mandela. It also is the last South African-owned telecom company after the U.K.'s Vodafone Group PLC bought control of Vodacom Group Limited, the second largest mobile company in South Africa. The South African Government handled the deal with abundant caution and objected to losing the leading mobile company in the country after losing the second largest company already. The Government expressed its discomfort in allowing capital movement out of South Africa and their protectionist approach turned out to be the deal breaker.

Mr. Siphiwe Nyanda, South African Minister for Communications, said "*we need to keep the family silver at home". "It's important MTN retains its character as a South African company*."[7] The intention of the South African Government could not have been clarified in better terms. The Treasury suggested DLC as a possible solution for maintaining the identity of both the Companies by listing Bharti Airtel and MTN in

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[5] Nasreen Seria and Nicky Smith, MTN-BHARTI MERGER VETO MAY SIGNAL BIGGER ZUMA ROLE (UPDATE2), October 2, 2009 www.bloomberg.com/apps/news?pid=20601116&sid=a7D2aiceWTeQ

[6] SOUTH AFRICAN MOBILE GIANT MTN FACES 'IDENTITY CRISIS' IN BHARTI DEAL, October 7, 2009 http://story.africaleader.com/index.php/ct/9/cid/371b1b8643d479c1/id/536898/cs/1/

[7] Robb M. Stewart, SOUTH AFRICA'S GOVT SET TO SCRUTINIZE MTN-BHARTI September 15, 2009 http://online.wsj.com/article/BT-CO-20090915-703850.html

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India and South Africa. South Africa is very comfortable with DLC which is very evident from the number of DLCs already existing in the country but it is still a mirage for India Inc.

Though the apparent reason for the failure of the deal may be legal or regulatory concerns, the motive was evidently political.

- **Were the MTN shareholders content with the proposed merger of the global telecom giants?**

A global corporate merger of the size and consequence of Bharti Airtel – MTN, spanning two continents would definitely have to keep its commercials intact to see the light of the day especially when the deal has a flawed history to haunt. On May 25, 2009 when Bharti Airtel released the media statement elucidating the structure of the Proposed Transaction the consideration of MTN and its shareholders were decided as USD 13 billion and it was broken into USD 7 billion in cash USD 6 billion worth of stock. The shareholders of MTN were quick to register their objection to the valuation by Bharti Airtel and demanded a better consideration for selling their stake in MTN to Bharti Airtel. The 'strategic merger' of Bharti Airtel and MTN was one of equals and the shareholders were not ready to compromise on anything that diminished the value of their shares. The shareholders were very vocal in their demand for enhancing the cash component of the deal and expressed their discontent in being dumped with the GDRs of Bharti Airtel. The deal required the approval of at least two third shareholders of MTN and the news reports even predicted the possibility of the deal failing to garner adequate support from the shareholders.

It is at this critical juncture Bharti Airtel proposed a last minute 'sweetener' to appease the shareholders on MTN. Bharti increased the cash component of its offer for a 49% stake in MTN to USD 10 billion from a proposed USD 7 billion with USD 4 billion in stock for a total increased package of USD 14 billion.[8] The last minute sweetener managed to silence the shareholders but could not gather an overwhelming support from them. If Bharti Airtel had to make an offer to MTN which it could not have refused commercially then the fate of the deal might have been different. When the shareholders themselves were not too happy with the deal, the South African Government had no reason to approve the Transaction and witness the country losing its leading telecom company to a foreign owner.

- **Did the fluctuation in the South African Rand impact the Proposed Transaction?**

With enough happening, the Proposed Transaction had to face rough weather constantly and on top of that, the rising South African currency was only aggravating their problems. Appreciation of 'rand' against dollar by around 6% during the pendency of the Proposed Transaction had increased the cash component that Bharti Airtel had to pay to MTN shareholders. If the Transaction had materialized then Bharti Airtel would have to pay at least USD 413 million more than what was decided initially. In May, 2009 Bharti Airtel had decided to make cash payment of 86 ZAR[9] for every MTN share. The total dollar outgo at that time came to around USD 6.94 billion. With the ZAR appreciating against the dollar, this total amount shot by around USD 413 million to around USD 7.38 billion. According to the original deal,

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[8] The change in amounts due to currency fluctuations are not taken into consideration.

[9] ZAR refers to the South African Rand.

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Bharti Airtel was supposed to get USD 2.9 billion in cash from MTN but due to the rupee depreciation against the dollar the amount went up by USD 72 million. This increase would have been over and above the sweeteners which Bharti Airtel had to offer to MTN shareholders for the deal to go through. This only adds to the perception that beneath the peripheral layer of legal and political symptoms the deal always suffered from a core commercial ailment which could not be cured by Bharti Airtel and MTN on time.

POLITICAL CONSIDERATIONS

❖ South African perspective

The South African Government objected to the proposed merger of Bharti Airtel with MTN as they did not want the company to lose its African identity and existence. What is surprising is the fact that, a year ago, the same Government had allowed Vodacom Group Limited, a mobile venture that had been owned equally by South Africa's Telkom SA Ltd. and Vodafone Group PLC to be fully acquired by the UK company. Why did the Government compromise on the African identity and character of Vodacom? The question becomes all the more striking in the light of the fact that Congress of South African Trade Unions (COSATU) had protested against the deal through South African communication regulator, Independent Communications Authority of South Africa (ICASA).[10] The justification that is advanced and promoted by the South African Government is that they have become all the more watchful after the Vodacom deal and since they have already lost one of their major players they do not want more companies to lose their African identity. Unlike Vodacom, MTN is closer to the Government because the largest shareholder of MTN is the Public Investment Corporation ("**PIC**") which is South African Government's pension fund manager. PIC has around 21% stake in MTN and has to be a key reason for the protectionist attitude of the South African Government towards Bharti Airtel – MTN deal unlike the Vodafone Vodacom deal.[11]

❖ Indian perspective

Mr. Sunil Mittal had left no stone unturned for the success of the Proposed Transaction. The Indian Prime Minister and the Finance Minister expressed their support for the deal in public and went the extra mile to discuss it with his South African counterpart "*as far as MTN issue is concerned, I mentioned it to Zuma. I sincerely hope that this deal would go through and there will be no discrimination against it*".[12] The attitude of Indian authorities towards the deal looked promising from the very beginning and it was further affirmed when SEBI exempted MTN from the open offer obligation under the Takeover Code for the proposed acquisition of GDRs through the Informal Guidance dated June 22, 2009.

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[10] www.moneycontrol.com/news/business/sa-labour-union-against-bharti-mtn-deal-sources_416222.html

[11] www.reuters.com/article/innovationNewsTechMediaTelco/idUSTRE5515B220090602

[12] http://economictimes.indiatimes.com/Features/PM-strongly-backs-Bhartis-efforts-to-acquire-stakes-in-MTN/articleshow/5059758.cms

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However surprisingly, on September 22, 2009 SEBI decided to amend the Takeover Code to remove the blanket exemption on acquisition of ADRs and GDRs from open offer obligation and clarified that any acquisition of ADRs and GDRs with voting rights would trigger the open offer obligation. It was a lethal blow to the deal and beyond all comprehension as SEBI had already delivered a contrary Informal Guidance to Bharti Airtel. The timing of this move by SEBI appears to cast serious doubts on the stand of the Indian Government in relation to the deal.

LEGAL AND REGULATORY CONSIDERATIONS

- **What is DLC and its relevance in the Proposed Transaction? What were the demands of the South African Government?**

The climax would have been tragic but Bharti Airtel and MTN have definitely left India Inc. wondering and pondering about the possibility of DLC structure. Even though the idea is new to Indian corporate legal paradigm, it actually dates back to 1907 when the oldest DLC, Royal Dutch / Shell was implemented. Royal Dutch was incorporated in Netherlands while Shell was incorporated in the UK.[13] However it is interesting to note that the DLC structure which is as old as 1907 has not received an overwhelming response from the global corporate world. DLC structures remain quite unusual in the international context, with only a few in exceptions in the major countries today.

DLC is a very flexible structure which flows in form of an agreement between the companies. The indispensible characteristics are that the companies should retain their existence and identity with separate shareholders and registries; they should remain listed on the respective stock exchanges in their respective jurisdictions, they should pool their resources and share their profits. The companies are free to add features of their choice and convenience to this basic structure without exceeding the limits of law. This freedom differentiates one DLC structure from the other and averts uniformity.

Proposed Structure

In the Proposed Transaction, it seems that the South African Government insisted on a DLC model as against the Cross Listing model (refer box below to understand the difference between Dual Listing and Cross Listing).

DLC – A DLC structure comprises series of contractual arrangements between two listed entities, to achieve economic substance of a traditional merger without the companies forgoing separate identities, separate shareholders and stock exchange listings.

Cross Listing – Cross listing is general listing of a company in more than one stock exchange. In this case, shares listed in all stock exchanges belong to the same company.

[13] Royal Dutch / Shell has converted itself into a conventional merger in 2005 and thus the DLC structure is not in existence anymore.

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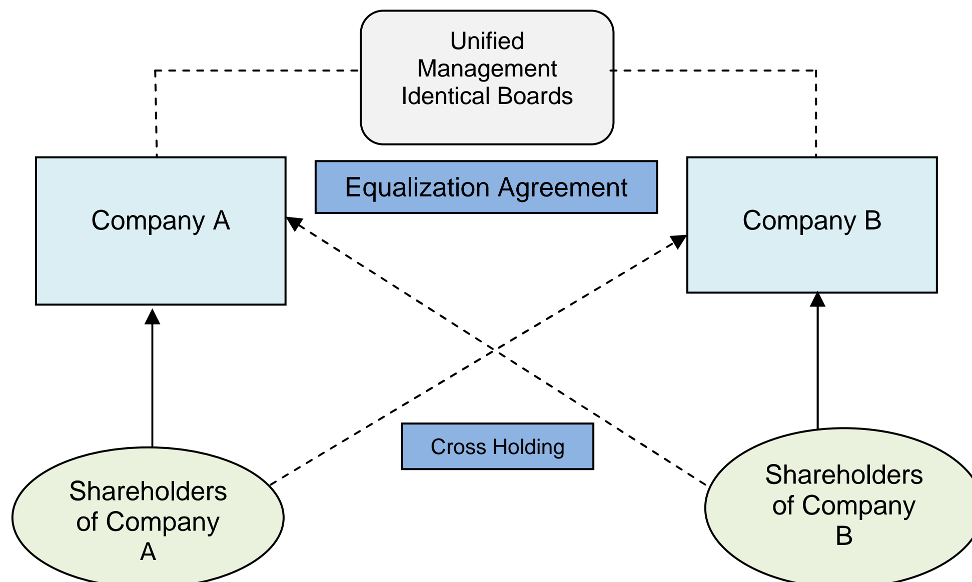
Contrary to the media perception in India, which seems to envisage Cross Listing of the Companies on both the bourses, we believe that the proposed DLC structure did not contemplate Cross Listing of companies. In simplest terms it can be described as a structure wherein Bharti Airtel would continue its listing in India and MTN would remain listed on Johannesburg Stock Exchange (**"JSE"**). Post DLC, the shareholders of MTN would hold shares of MTN and Bharti Airtel and shareholders of Bharti Airtel would hold shares of Bharti Airtel and MTN. By way of equalization agreement ("**Equalization Agreement**"), the shareholding of the shareholders of both the Companies would be equalized in a predetermined ratio. Also, the shareholders of Bharti Airtel and MTN would hold stake in both the Companies in the equalization ratio.

Illustration: 'X' is a Bharti Airtel shareholder and 'Y' is a shareholder of MTN prior to the merger. Pursuant to the merger, 'X' and 'Y' will hold shares of both Bharti Airtel and MTN in the ratio determined under the Equalization Agreement and each of these shares remain listed in their respective jurisdictions.

So in essence, (i) both the companies would retain their identities (ii) both the entities continue to remain listed on their respective stock exchanges (iii) shareholders of each company hold proportionate shareholding in the other company as well thus creating a notional entity by the name Bharti MTN group with consolidated accounts and management.

The motive behind the demand seems to be that the South African Government wanted to ensure liquidity and market for MTN and its shareholders. The structure as demanded would have enabled MTN shareholders to transact on both the Indian and the South African bourses.



❖ **Which are the common DLC Models?**

Equalization agreement: One form of DLC structure involves contractual arrangements to share the cash flows from each other's assets. Both the companies remain listed on stock exchanges of their respective jurisdictions. The Equalization Agreement entered into between the companies, determines the legal and

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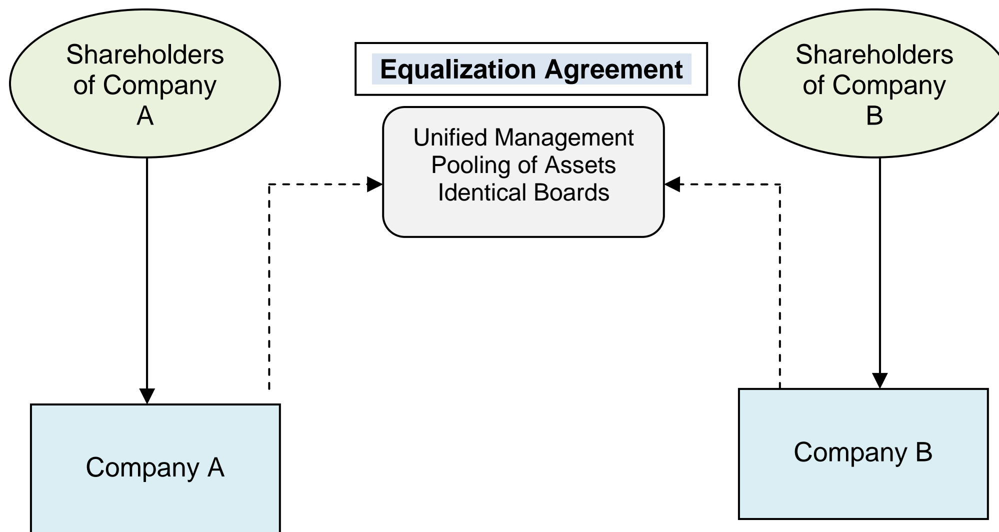
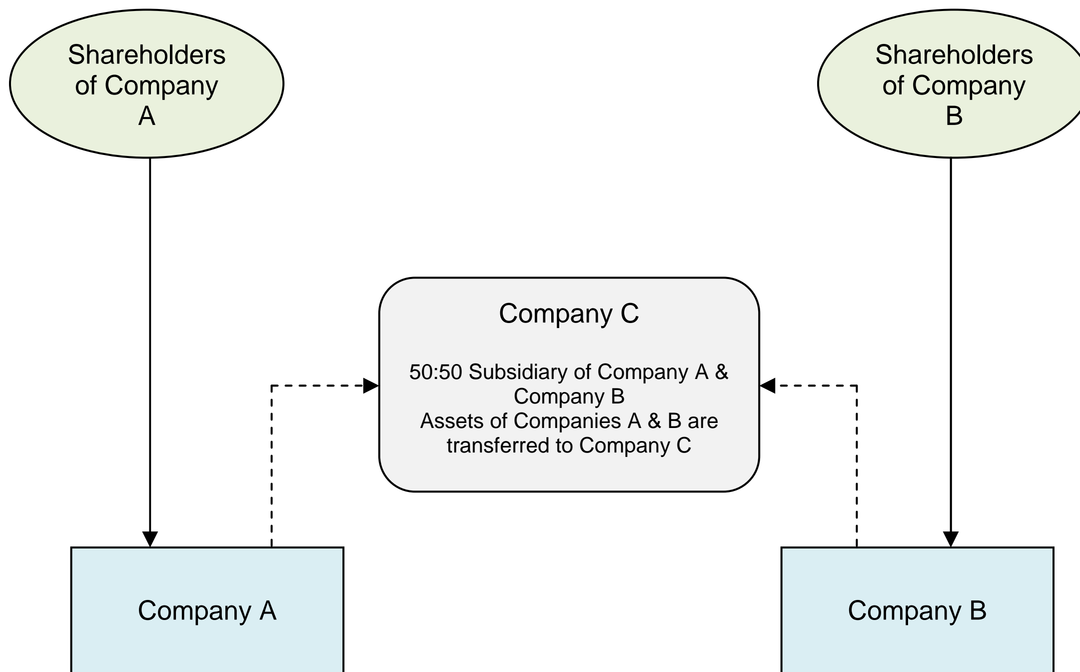
economic rights between the shareholders and facilitates achievement of desired economic integration. It is comparable to a unified charter document which lines out the guiding principles for all governance matters right from functioning of board and shareholders' rights till the termination of DLC.



Holding company: This form of DLC involves the two companies transferring their assets to one or more jointly owned companies. The jointly owned company(s) then passes dividends back to the main companies, which distribute them according to a predetermined ratio.



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❖ Which are the existing DLCs globally?

Following is the list of all the DLCs existing worldwide with the break-up of the jurisdictions where the companies have been listed and the model opted:

Dual Listed Companies					
Sr. No.	**Company**	**Country**	**Listing**[14]	**Year**	**Model**
1.	Unilever PLC	UK	LSE	1930	Equalization Agreement
	Unilever NV	Netherlands	AEX		
2	Reed Elsevier PLC	UK	LSE	1993	Holding Company
	Reed Elsevier NV	Netherlands	AEX		
3.	Rio Tinto PLC	UK	LSE	1995	Equalization Agreement
	Rio Tinto Ltd	Australia	ASX		
4.	BHP Billiton PLC	UK	LSE	2001	Equalization Agreement
	BHP Billiton Ltd	Australia	ASX		
5.	Investec PLC	UK	LSE	2002	Equalization Agreement
	Investec Ltd	South Africa	JSE		
6.	P&O Princess Cruises PLC	UK	LSE	2003	Equalization Agreement
	Carnival Corporation	US	NYSE		
7.	Mondi PLC	UK	LSE	2007	Equalization Agreement
	Mondi Ltd	South Africa	JSE		

❖ What are the merits and demerits of the DLC structure?

South African Government's persistence on compulsory Dual Listing of Bharti Airtel and MTN could not be accepted by the Indian Government. This equation gains justification from the fact that South Africa already has allowed cross border DLCs while India has not yet opened its doors for such structures.

In light of the fact that Dual Listing proved to be the hurdle which the Proposed Transaction could not surpass, we analyze the merits and demerits of DLC structures. The merits are:

- *First step to merger*: Experts suggest that DLC can be used as a good momentary step before going for a full fledged merger, especially when political conditions and shareholder's hesitation may not warrant an immediate merger. This would give shareholders of both companies time to get acquainted with each other before possible unification.[15] Six of the major DLCs later converted their structure to a more convenient conventional merger structure. More importantly, unlike mergers, a DLC arrangement may be terminated anytime. So the DLC structure offers a

[14] We have taken into consideration only the primary listings of the companies.

[15] R Vaidhyanadhan Iyer and Vedant Shukla, DUAL LISTED M&AS: LIVE-IN STATUS IN CORPORATE WORLD, The Economic Times, December 17, 2008

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two way mechanism, move ahead and effect a complete merger or go back to terminate the entire scheme.

- *Tax benefits*: DLC structure may minimize capital gains tax obligations that would result from a conventional merger since the model does not involve issuance of additional shares or share swap. The structure helps in reducing cross-border dividend payments to shareholders whereby the home-bias and differences in national tax systems may be avoided. Similarly, accounting regimes may favour a DLC over a conventional merger or acquisition, if the latter would require recognizing and amortizing goodwill that results from the merger. Effectively, DLC arrangement enables the companies to pool in their assets, share infrastructure, expand business and operations to new territories, but at the same time avoid drawbacks of a traditional cross-border merger.

- *Retaining identities of the companies*: A conventional merger or takeover happens at the expense of the identity of the merging/taken over company. Most cross-border mergers require various forms of official/regulatory approval from the governments of the respective countries and the process involved often proves to be a nightmare for the companies. The DLC structure offers relief as the existence of each company in each market is preserved which may be the best way of ensuring the required approvals. In cases where the two companies are of similar size, the managements of the companies may wish to avoid the appearance of having been taken over.

- *Operational issues*: The existing contractual arrangements of the companies may cause various types of rights to be triggered (e.g. options in debt contracts and rights of other companies involved in joint ventures) in the event of a takeover or conventional merger. However, these consequences may be avoided if the merger occurs in the form of a DLC arrangement.

- *Perceptions of better access to capital markets*: Since local investors are already familiar with their respective companies, management may believe that the merged company will have better access to capital markets if it maintains listings in each market.

- *Concerns over 'flow-back'*: In a conventional merger with a stock swap, the merged company will have to choose one country for its domicile and primary listing and the shareholders from the other country will receive equity in a company domiciled in a foreign market. The merged company will now be a larger company and will see a higher weight in the share market index of its country of domicile, but it will disappear from the index in the other market. A DLC may be chosen if it is anticipated that a merger would result in selling pressure in one market exceeding increased new investor interest in the other market.[16]

However, the fact that most cross-border mergers do not take the form of a DLC and that some companies have decided to unify their DLC structures implies that there are also possible disadvantages to DLCs.

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[16] Supra no:1

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These may include:

- *Complexity of operations*: The contractual arrangements of DLCs provide procedures for the treatment of the interests of the shareholders of both companies in the cases of capital raisings, asset sales and other events. Nonetheless, the existence of two sets of shareholders may at times constrain the flexibility of management and the full benefits of a more conventional merger may not in practice be realised.

- *Regulatory issues*: The ongoing operations of the separate companies means that the DLC must satisfy the accounting and regulatory frameworks of two countries. This is likely to be costly, and possibly constrain the ability of management to maximise the joint value of the two companies.

- *Liquidity, transparency and shareholder value issues*: In practice, the existence of two separate companies may result in less liquidity than would result if there was a single larger company. In addition, investors may view the DLC structure as somewhat complex and less transparent than a conventional single company. Hence they may value the two parts of the company less highly than they would a single larger company.

- **Why couldn't India accept the DLC structure proposed by the South African Government?**

Mr. Sunil Mittal, MD and Chairman of Bharti Airtel, had left no stone unturned for the success of the Proposed Transaction. He personally met the Hon'ble Prime Minister of India Dr. Manmohan Singh and the Finance Minister Mr. Pranab Mukherjee seeking support for the deal which they very conveniently extended. Little did they know that his demand mandated a plethora of amendments to the corporate law and exchange control regime of the country. To effectively implement the DLC structure, the Companies Act, 1956 would require significant changes to facilitate accounting disclosures, prospectus disclosures, financial formats, common board and common shareholder meetings as well as defining the implications of dissolution of one of the DLCs. Securities laws would also require changes to the listing requirements and prospectus disclosures and exchange control regulations may need to be amended vis à vis trading of dual listed stock. A DLC cannot become a reality in India without incorporating the above mentioned amendments into our legal system.

- **What is Capital Account Convertibility ("CAC") and how is it linked to the demise of the Proposed Transaction?**

Experts opine that the lack of full CAC in India is the most critical cause for the failure of the Proposed Transaction. The most fundamental amendment for implementing DLC would be to permit full CAC under the Foreign Exchange Management Act, 1999 ("**FEMA**"). Full CAC is a basic requirement for implementing a DLC structure as transfer of capital and assets between the companies in the DLC would be crucial. CAC refers to the abolition of all limitations and restrictions with respect to the movement of capital from India to different countries across the globe. It permits transfer of capital assets from residents to non-residents without any obstruction. It also allows the people and companies not only to convert rupee to the other currency, but also free cross-border movement of currencies, without the interventions of the law.

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As of today, FEMA does not permit CAC for residents and this proved to be the real deal breaker for Bharti Airtel – MTN. Convertibility of capital for non-residents has been a basic tenet of India's foreign investment policy all along, subject of course to fairly cumbersome administrative procedures. It is only residents both individuals as well as corporates who continue to be subject to capital controls. However, as part of the liberalisation process the government has over the years been relaxing these controls.

In August 1994, the Indian economy adopted the present form of Current Account Convertibility, compelled by the Article No. VII of International Monetary Fund (IMF), Articles of Agreement. Current Account Convertibility allows free inflows and outflows for all purposes other than for capital purposes such as investments and loans.

❖ **What are the concerns attached to CAC?**

CAC is widely regarded as one of the hallmarks of a developed economy. In a bid to attract foreign investment, many developing countries went in for CAC in the 1980s not realising that free mobility of capital leaves countries open to both sudden and huge inflows as well as outflows, both of which can be potentially destabilising. More important, that unless there are institutions, particularly financial institutions, capable of dealing with such huge flows, countries may not be able to cope as was demonstrated by the East Asian crisis of the late nineties. Following the East Asian crisis, even the most ardent votaries of CAC in the World Bank and the IMF realised that the dangers of going in for CAC without adequate preparation could be catastrophic. Since then the collective wisdom has been to move slowly but cautiously towards CAC with priority being accorded to fiscal consolidation and financial sector reform above all else.[17]

In India, the Tarapore committee had laid down a three-year road-map ending 1999-2000 for CAC. It also cautioned that this time-frame could be expedited or delayed depending on the success achieved in establishing certain pre-conditions — primarily fiscal consolidation, strengthening of the financial system and a low rate of inflation. With the exception of the last, the other two pre-conditions have not yet been achieved. It is evident that India has been slow in achieving CAC but the regulators claim that it has been steady. Indian regulators including the Reserve Bank of India ("**RBI**") do not want to commit any mistake by rushing into CAC. In the light of the Proposed Transaction, the Indian regulators have unanimously opined that such a major financial decision with far reaching consequences will be taken only after due examination of the merits of the scheme and whether India has the capability to implement it.

When RBI Deputy Governor K C Chakrabarty was asked whether Bharti-MTN deal failure would quicken the process of complete convertibility, he replied, "*Nothing will quicken the capital account convertibility*".[18] On the other hand the South African Government expected the Indian Government to

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[17] www.welcome-nri.com/cac.htm

[18] RBI SAYS NO TO FULL RUPEE CONVERTIBILITY, Press Trust of India, October 06, 2009 http://profit.ndtv.com/2009/10/06195342/RBI-says-no-to-full-Rupee-conv.html

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agree in writing to permit CAC and thereby DLC before the expiry of the exclusivity period. This face-off between the two Governments would go down in history as the Waterloo of Bharti Airtel – MTN deal.

❖ **What were the other regulatory concerns for the Indian regulators?**

It is assumed that DLC would render the existing Indian FDI policy infructuous as Indian authorities would not be able to monitor sectoral caps on direct and indirect investment that are imposed on 13 industry sectors, including telecom sector. It is also feared that entities that are ineligible for investing in Indian companies could acquire stakes through transactions carried out on the overseas exchange, in violation of the FEMA. Both the abovementioned apprehensions can be negated to a great extent by strictly adhering to disclosure mechanism. The DLC should be obligated to disclose all corporate transactions on the floor of the stock exchange and off the floor in either country to the regulators and public shareholders of both the countries.

There is a precedent wherein BHP Billiton DLC makes mandatory disclosures in both the jurisdictions where its twins are listed. It is believed that DLC has the potential to weaken the SEBI's oversight of the stock market and it can also lead to trading activity being taken away from stock exchanges in India resulting in a likely revenue loss for the Indian exchequer.

❖ **SEBI – 'showing sportsman spirit and turning into a spoilsport'**

The role of SEBI in the entire scheme of events is of great interest and has left many wondering about its stand on the deal. On June 18, 2009, Bharti Airtel sought clarification from SEBI under the SEBI (Informal Guidance) Scheme, 2003 on whether the acquisition of 36% economic interest in Bharti Airtel by MTN through GDRs would trigger the open offer requirement under Regulation 10 of the Takeover Code. SEBI delivered Informal guidance on June 22, 2009 and clarified that such acquisition would only trigger the disclosure requirements under Chapter II of the Takeover Code and not the open offer obligation. It was also clarified by SEBI that the open offer obligation under Regulation 10 of the Takeover Code would be triggered on conversion of the GDRs into underlying equity.

Mr. Deepak Mehra, a shareholder of Bharti Airtel appealed to Securities Appellate Tribunal ("**SAT**") against the Informal Guidance of SEBI on why open offer should not get triggered upon issuance of GDRs but SAT dismissed the same on August 28, 2009 and upheld the decision of SEBI. It was thought that SEBI has made its stand in relation to the deal clear but the twist in the tale rendered all the assumptions incorrect.

On September 22, 2009, SEBI decided in its board meeting to amend the provisions of the Takeover Code in relation to the exemption granted to ADRs and GDRs. Prior to the amendment under regulation 3(2) of the Takeover Code, acquisition of ADRs / GDRs were exempted from open offer requirement under Chapter III of the Takeover Code till the time of its conversion into underlying equity shares. It was generally understood that this position would remain unchanged even when customary voting arrangements are entered into between the depository banks and the ADR / GDR holders. Under the proposed new provision, such exemption from open offer would be available only till the time the ADR / GDR holders remain as passive investors without any kind of voting arrangement with the overseas depository on the underlying equity shares.

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Typically, the following two models are followed as far as voting rights on GDRs with underlying equity shares are concerned.

Model 1: In this model, the voting rights on the underlying shares remain with the depositary who shall be instructed by the management of the company to vote on their behalf. Such type of arrangements were in vogue during the initial years when GDRs / ADRs came into vogue.

Model 2: In this model, the voting rights on the underlying shares remain with the depositary who shall be instructed by the GDR / ADR holders of the company to vote on their behalf. Off late, the depositary agreements have been changed so as to allow GDR/ADR holders to instruct the depository to vote on their behalf.

This amendment is in direct contradiction with the Informal Guidance that SEBI delivered to Bharti Airtel on June 22, 2009. Mr. Siddharth Shah, Head of Corporate and Securities Law Practice at Nishith Desai Associates, opined that "*this change could throw a spoke in the wheel for the Bharti-MTN deal as this would conflict not only with the MTN shareholders' desire to exercise control over Bharti without having to make an open offer but could also make the structure difficult from an FDI perspective*".[19]

The amendment ignited a twofold issue for the deal which had the potential to derail the Proposed Transaction. The amendment obligated MTN and / or its shareholders to make an open offer for acquisition of additional 20% shares from the public shareholders of Bharti Airtel under Regulation 10 of the Takeover Code on acquisition of Bharti Airtel GDRs if such GDRs entitled its holders to exercise voting rights on underlying shares. The open offer would have cost the South African company another USD 6.78 billion which posed a serious threat to the commercial viability of the deal.

❖ **Did SEBI amendment trigger any exchange control issues?**

The second and far more critical issue was the possibility of MTN crossing the permitted FDI sectoral cap of 74% under the current FDI policy. The FDI policy permits only 49% FDI in an Indian telecom company under the automatic route which may be further raised up to a maximum of 74% subject to the prior approval of Foreign Investment Promotion Board. Sing Tel, Singapore already holds a stake in Bharti Airtel and under the Proposed Transaction, if MTN acquired 36% economic interest in Bharti Airtel and on top of it if MTN had to acquire 20% shares in the open offer then it could have breached the FDI sectoral caps.

The possible way out of this hazy maze was to circumvent the open offer obligation by issuing GDRs with only economic interest and no voting rights to MTN and / or its shareholders. This would in effect have rendered the position of MTN as toothless tigers in Bharti Airtel, without any say in the management and control of the company. This definitely, would not have been acceptable to MTN or its shareholders.

[19] http://economictimes.indiatimes.com/News/News-By-Industry/Telecom/Bharti-may-hit-takeover-wall/articleshow/5044400.cms

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Another very unrealistic solution was to seek an exemption from the open offer obligation from SEBI. The intention of SEBI had become explicit pursuant to the hurried amendment and it didn't look like SEBI would have been inclined to grant an exemption and if that was the case SEBI would not have rushed into this amendment during the pendency of the deal when they had already given their nod to a contrary position.

EPILOGUE

Motivated more by political considerations than commercial considerations, the deal was declared dead as early as September 11, some reports suggest. The breakdown of the deal, which could have catapulted Bharti Airtel – MTN coalesce as the third largest telecom operator in terms of subscriber base with more than 200 million subscribers and revenues in excess of USD 20 billion is undeniably a huge setback to India Inc. and the Indian telecom sector, particularly.

What remains to be seen is the stand that the South African Government takes vis-à-vis cross border merger of MTN? The deal, if it had gone through, would have created the single largest inward investment into South Africa. South African Government, however, let go of that opportunity to "*keep the family silver at home*". Unless that protectionist attitude changes, and the shareholders realize the value of the Bharti MTN combine, the corporate marriage between the two organizations is likely remain a chimera.

The question is - ***Having made two missed calls, will Bharti Airtel call MTN again?***

As you would be aware, we have been providing regular information on latest legal developments. M&A Lab is our initiative to provide you knowledge based analysis and more insight on latest M&A deals. You can direct your views / comments / suggestions on our initiative to siddharth@nishithdesai.com, nishchal@nishithdesai.com, ruchir@nishithdesai.com, sambhav@nishithdesai.com and aruns@nishithdesai.com.

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