

Capital Markets Hotline

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SEBI OPENS PANDORA'S BOX WITH NDTV RULING

In a move that has created significant ambiguity, the Securities and Exchange Board of India ("SEBI") has recently ruled in the matter concerning NDTV Limited ("NDTV") that acquisition of warrants and call option rights is sufficient to trigger an open offer under certain circumstances.¹ This decision comes as a major hindrance for structuring investments into listed companies, and also adversely impacts various promoter funding avenues.

BACKGROUND

NDTV is a company incorporated in New Delhi, with its securities listed on BSE and NSE. In 2008, RRPR Holding Private Limited ("RRPR"), Prannoy Roy and Radhika Roy (collectively, the "Promoters") initiated an open offer for purchase of NDTV shares. In order to fund this open offer, RRPR (on behalf of the Promoters) availed a loan of Rs. 450 crore from Indiabulls Financial Services Ltd. To repay this, the Promoters availed a loan Rs. 375 crore from ICICI Bank.

Finally, the Promoters repaid the loan from ICICI Bank by taking a loan of Rs. 350 crore from Vishvapradhan Commercial Private Limited ("VCPL"), pursuant to loan agreement dated July 21, 2009 ("Loan Agreement"). Simultaneous with the Loan Agreement, two other affiliates of VCPL, being Subhigami Trading Private Limited and Shyam Equities Private Limited, entered into call option agreements with RRPR which gave them the right to purchase 14.99% and 11.01% equity shares of NDTV from RRPR respectively at a fixed price of Rs. 214.65 per share ("Call Option Agreements").

SEBI, vide a show cause notice, alleged that the loan obtained by the Promoters from VCPL was not a normal investment transaction, and that VCPL's primary purpose was to acquire control over NDTV (through RRPR). To this effect, SEBI postulated that pursuant to the Loan Agreement and Call Option Agreements, VCPL acquired control over NDTV (i.e. through RRPR).

Some of the key terms of the Loan Agreement considered by SEBI in this regard were as follows:

1. The loan was unsecured, carried no interest and was repayable on the 10th anniversary of the drawdown date.
2. As consideration for the loan, RRPR issued warrants to VCPL, which were convertible at par into 99.99% equity shares of RRPR ("Conversion Option"). This option was exercisable by VCPL at its *sole discretion, at any time during the tenure of the loan or thereafter*.
3. VCPL had the right to purchase all the equity shares of RRPR held by the Promoters at par value ("Purchase Option").
4. RRPR increased its holding in NDTV to 26% as a condition precedent to availing the loan.
5. VCPL had the right to nominate one member to the board of RRPR, whose presence was mandatory to constitute quorum. Further, VCPL had certain veto rights in both RRPR and NDTV (through RRPR), predominantly on matters relating to the share capital of RRPR and NDTV. VCPL was also mandated not to interfere with the editorial policies of NDTV.
6. The Loan Agreement will be in force till the *later* of (a) the loan being repaid, and (b) exercise of the call option under the Call Option Agreements.
7. The Promoters were required to exercise their voting rights in NDTV to give full effect to aforementioned terms.

Some of the key terms of the Call Option Agreements considered by SEBI in this regard were as follows:

1. The consideration under each Call Option Agreement was Rs. 2 lakhs. The call option may be exercised by VCPL *at any time*.
2. Any money paid to RRPR (upon exercise of the call option) will be used by RRPR for repayment of the loan to VCPL.
3. VCPL had a right of first refusal against the Promoters (re: NDTV shares), and the Promoters were also bound by a non-compete during the tenure of the agreement.

ISSUE FOR DETERMINATION

Whether the mere execution of the Loan Agreement and Call Option Agreements resulted in VCPL acquiring 'control'² over NDTV as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997 ("Takeover Code 1997")?

DEFENSE ARGUMENTS AND SEBI ORDER

While various legal concepts were examined by SEBI, the crux of the decision can be summarized in the following

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1. Commercial terms of the loan. While the commercial terms of the loan were not 'market-standard' *per se*, VCPL provided the following justifications:

- this was an asset-recourse loan, backed by the underlying collateral of NDTV shares. The call option, Conversion Option and Purchase Option were all aimed at securing the same collateral in different ways;
- the commercial decision was that upon exercise of the call option, the arbitrage between the market price of NDTV's shares and the exercise price can be capitalized on; and
- irrespective of the nature of commercial terms, these terms *per se* cannot trigger any adverse implications under the Takeover Code 1997.

SEBI Analysis. While SEBI did not conclude that 'control' was acquired merely because of the non-market terms, SEBI placed significant emphasis on the following aspects in arriving at its decision:

- The exercise price of the call option was far in excess of the market price (at the time of entering into the Call Option Agreements). Typically, collateral is undervalued, and not overvalued. Further, despite the constant value erosion of NDTV's shares, VCPL never took efforts to enforce its collateral;
- NDTV's share price history does not lend credence to the argument that any price arbitrage could be achieved (between market price and exercise price); and
- VCPL's admission that the loan was provided on the premise of value appreciation of NDTV shares is sufficient to suggest that the principal purpose of the loan was to acquire beneficial interest in the shares of NDTV rather than receive financial returns from the loan.

2. Voting Rights. According to VCPL, the provision of the Loan Agreement which required the Promoters to exercise their voting rights in NDTV to give effect to the terms of the Loan Agreement is merely a cooperation/ assurance clause. This does not result in VCPL acquiring the voting rights of the NDTV shares held by RRPR in all respects.

SEBI Analysis. This clause has the effect of the Promoters ceding their voting rights in favor of VCPL, at least to the extent of 26% shares of NDTV held by RRPR and the 26% shares of NDTV covered under the Call Option Agreements.³ Hence, VCPL has acquired positive decision making rights over NDTV.

3. Exercise of warrants/ call option. It was argued by VCPL that despite the agreements permitting exercise of call options/ warrants at any point (even after repayment of loan), legally, this should not impact the analysis of whether 'control' has been acquired or not. This is because as per the Takeover Code 1997, 'control' is not acquired by subscribing to convertible instruments/ entering into optionality arrangements till such time the actual conversion right/ option is exercised.

SEBI Analysis. The right to exercise the warrants/ call option is so open-ended and uncircumscribed by any pre-requisite that it is as good as having control over the shares in one's hands without any further act

4. Veto Rights. As per SEBI, the aspect of 'veto rights' amounting to 'control' was not relevant to be examined since 'control' was acquired purely by entering into the Loan Agreement and Call Option Agreements.

Based on the above, SEBI concluded that the Loan Agreement and Call Option Agreements resulted in VCPL acquiring 'control' over NDTV, and ordered VCPL to make an open offer as per Takeover Code 1997.

ANALYSIS

On a rather unfortunate note, this order by SEBI has disturbed a settled position of law without any cogent reason for the same. While we admit that the overall transaction between VCPL and RRPR is not standard in nature, it is well settled that in case of call option arrangements, 'control' is not acquired until the call option is actually exercised. In addition, SEBI's analysis that mere execution of open ended call option agreements results in deemed exercise of the call option is devoid of any legal backing.

Further, SEBI seems to have alluded that certain standard practices followed by most lenders in the market can result in acquisition of control. For instance, it is standard for lenders to have certain protective rights against the borrower and its assets, and also standard to insist that borrowers vote their shares (in the underlying portfolio company) in a manner that does not prejudice the lender's interests. SEBI however seems to suggest that such voting assurance clauses will automatically result in the borrower ceding all the voting rights associated with such shares in favor of the lender. This effectively alters the very perspective with which protective covenants are viewed in the context of lending transactions (both at the listed company level and the promoter level), and also dilutes certain key protections typically sought by lenders.

Net-net, this decision by SEBI seems to be a clear case of overreach. It will be interesting to see how SAT views this matter (if appealed) – and to what extent SEBI's position will stand vindicated.

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You can direct your queries or comments to the authors

¹ In the matter of NDTV Ltd., in respect of Vishvapradhan Commercial Private Limited (WTM/ GM/ EFD/ 31/ 2018-19)

² 'Control' includes 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.

³ It is not entirely clear why SEBI considers RRPR to hold 52% equity shares in NDTV. This conclusion is not supported by the facts mentioned in the order.

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