JURISDICTIONAL NEXUS: 'CONNECTING' LAWS IN THE EUROPEAN UNION AND INDIA

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INTRODUCTION

In the wake of liberalization, one of the biggest challenges India faced was to develop a comprehensive and robust competition policy in order to sustain and promote competition in the economy as a whole. The enactment of the Competition Act, 2002 (as amended) ("**Act**") and the establishment of the Competition Commission of India ("**CCI**") as its chief enforcement authority was one of the biggest transformations witnessed by the Indian regulatory space in recent times. The Act came into effect in a phased manner – the provisions relating to anti-competitive agreements and abuse of dominance came into effect on 20 May 2009 while the merger control provisions came into effect on 1 June 2011, after undergoing several rounds of changes on account of scepticism and opposition among the business community.

While the CCI has in a relatively short duration positioned itself as a regulator that is eager to engage with the business community, there are persisting issues and ambiguities in the merger control regime that remain unaddressed, particularly in relation to appropriate jurisdictional nexus for notifiability of transactions, calculation of turnover, etc. In this regard, learning can be drawn from more mature jurisdictions such as the United States of America ("**USA**") and the European Union ("**EU**"), thereby bringing India a step closer to unification with international antitrust best practice.

INDIAN MERGER CONTROL – JURISDICTIONAL THRESHOLDS

The regulatory framework in relation to merger control is governed by the Act and is supplemented by the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("**Combination Regulations**") which sets out the mechanism for implementation of the merger control provisions under the Act.

An acquisition of one or more enterprises or merger or amalgamation of enterprises ("**Combinations**"), where certain prescribed assets or turnover thresholds are crossed, will need to comply with the merger control provisions contained in Sections 5 and 6 of the Act and the Combination Regulations. While Section 6 sets out the obligation to notify and the substantive test of "appreciable adverse effect on competition" ("**AAEC**"), which is the standard that the CCI is required to test Combinations, the jurisdictional thresholds are set out in Section 5 of the Act.

The jurisdictional thresholds have both an asset and turnover component, and also incorporate world-wide and Indian thresholds to capture global transactions having an Indian

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element. However, on 4 March 2011, the Ministry of Corporate Affairs, Government of India issued a notification exempting acquisitions where the target enterprise (including its units, divisions and subsidiaries) has assets of less than INR 2500 million in India or turnover of less that INR 7500 million in India from the obligation to notify the CCI under Section 6(2) of the Act ("**Target Exemption**").

An interesting anomaly arising out of the drafting of the Target Exemption is that the exemption is only applicable to acquisitions (of assets, shares, voting rights or control) and does not apply to mergers or amalgamations, given that the wording of the Target Exemption mentions only "acquisitions" but not "mergers or amalgamations". This unfortunate approach fails to consider the fact that the same outcome could be achieved regardless of the structure of the transaction and therefore, a distinction between mergers and acquisitions in the case of a *de minimis* exemption is specious.

If the Target Exemption is not available, a transaction is required to be notified to the CCI if either of the following tests are met:

(a) **Parties Test**: The acquirer and target enterprise, including its divisions, units and subsidiaries on a combined basis or the merged enterprise, post-merger has either: (a) assets in excess of INR 15,000 million in India or turnover in excess of INR 45,000 million in India; or (ii) world-wide assets in excess of USD 750 million, including at least INR 7,500 million in India or world-wide turnover in excess of USD 2,250 million, including at least INR 22,500 million in India; or

(b) **Group Test**: The group to which the target entity or the merged entity will belong post-transaction has either: (a) assets in excess of INR 60,000 million in India or turnover in excess of INR 180,000 million in India; or (ii) world-wide assets in excess of USD 3 billion, including at least INR 7,500 million in India or world-wide turnover in excess of USD 9 billion, including at least INR 22,500 million in India.

In February 2012, the Combination Regulations were amended to include a provision which provides that if, as part of a series of steps in a proposed transaction, particular assets of a seller enterprise are moved to another enterprise (i.e. a separate legal entity), which is then acquired by a third party, the entire assets and turnover of the selling enterprise from which these assets and turnover were hived off (including its units, divisions and subsidiaries but excluding any entities that control the seller) will also be considered when calculating thresholds for the purposes of Section 5 of the Act. This principle of aggregation applies to any transferor company's assets and turnover in entirety (even if only a single asset were to be transferred to a special purpose vehicle ("**SPV**") into which an investment is being made) and the assets and turnover of the SPV, both of which effectively constitute the target enterprise.[3] The Target Exemption has effectively been diluted by this principle of aggregation, given that the assets and turnover of the seller enterprise are required to be aggregated with those of the target enterprise for the purposes of the jurisdictional thresholds.

"INDIAN" ASSETS AND TURNOVER

There is very little guidance under the Act and in terms of CCI precedent in relation to the manner in which the objective criteria under the Target Exemption and the jurisdictional thresholds are to be computed, unlike more mature jurisdictions such as the EU and the US.

[3] Regulation 5(9) of the Combination Regulations.

The Act specifies that "assets" means the book value of total gross assets (e.g. fixed assets, investments, current assets and deferred tax assets), less any depreciation, as shown, in the audited books of account of the target enterprise, in the financial year immediately preceding the financial year in which the proposed transaction falls, and should include the value of any intangibles (e.g., intellectual property rights, brands, permitted use or other commercial rights) reflected in the audited financial statements.

The Act also defines the term "turnover" as the "value of sale of goods or services, excluding indirect taxes". While there are no further guidelines or regulations that elaborate on the concept of turnover, based on the CCI's order in *Mylan/Agila Specialties*[4] it is evident that even if an Indian enterprise derives turnover largely from exports, the revenue figures provided in the consolidated financial statements of the Indian enterprise are required to be treated as "Indian" turnover and the applicability of the jurisdictional thresholds is required to be evaluated on the basis of such turnover. Thus, Indian merger control does not actually refer to *local* turnover when assessing the domestic thresholds. In this regard, it deviates from the approach under most other systems, including the EU. It should be noted that turnover calculation for the purposes of assessing the applicability of the European Merger Control Regulation ("**ECMR**"), aims to allocate turnover on the basis of where competition for the underlying sale of a product or service occurs. Typically, this will be the geography where the service is provided – which will be the place where the customer is located if neither the service provider nor the customer have to travel for the service to be provided.[5] This appears to be an appropriate approach as the location of the customer sets the context in terms of geography, language, general usage habits and customer expectations in which competition occurs. This is the case even where the actual service is provided elsewhere (as, for example, in the case of travel services[6]), because the products are targeted at customers located in a specific jurisdiction and competition with alternative suppliers takes place in this space.

Interestingly, the Indian approach, although simplistic, has the benefit of ease of use given that reference must only be made to the formal accounts of the relevant enterprise(s) for the purposes of allocating the relevant turnover. Unlike, for instance, in the EU, where the merging parties are forced to consider the geographic allocation of turnover by reference to criteria that may be appropriate in order to establish the potential impact of a transaction on the local structure of competition – a sometimes burdensome exercise as these criteria may not be used as points of reference in their internal accounting systems. However, in adopting the above approach, the Indian merger control rules perhaps fail to identify transactions that have a minimum impact on competition in India.[7] Moreover, the test turns out to be too broad since it takes into account turnover derived from businesses which do not have any effect on the structure of competition in India as they involve competitive efforts of the Indian entity abroad. This may potentially affect undertakings in business sectors that are of particular relevance to India, especially where Indian companies compete for business on a global scale. This is the case in relation to service industries which do not require the service provider to

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4 C-2013/04/116.

5 See for example Article 5 (1) second subparagraph ECMR and para 199 *et seq*. of the European Commission's Consolidated Jurisdictional Notice (2008/C 95/01).

6 See for example Case M. 1524 Airtours/First Choice or Case M4600 TUI / First Choice.

7 Arguably, they will – at least in transactions where the undertakings concerned also have activities in countries other than India - not spare the parties the effort of allocating turnover according to where competition for the relevant sale occurs as merger control rules in other jurisdictions are likely to require them to do so.

be close to the location of the purchaser, such as in the information technology sector. In these businesses, undertakings compete for business from customers located in various geographies without having to leave India. The same applies for businesses where transportation costs are less relevant and where Indian undertakings exploit a combination of factors, including access to a skilled labour force, excellent R&D capabilities, and/or a low manufacturing cost base. The pharmaceutical sector provides many examples of Indian undertakings exploiting such favourable conditions at home to export goods globally. In relation to transactions which involve enterprises operating in such businesses, the approach of Indian merger control rules may probably produce skewed results. As such, even if the services or products are being provided to customers located in another country (and consequently, the relevant enterprise effectively has "market presence" in such country), if the enterprise is located or registered in India and books global turnover on its Indian books of accounts, such turnover is considered to be Indian turnover for the purposes of the Act.[8]

Another area of concern is in relation to the CCI's precedents[9] when establishing the value of assets relevant for evaluating whether the jurisdictional thresholds under the Act are met. In this regard, it is pertinent to note that even if only certain assets of an enterprise are being acquired, the entire assets and turnover of the vendor enterprise (on a consolidated basis) and not just the divisions/assets being acquired, are to be considered in order to determine notifiability. This is on account of the fact that the CCI does not recognise a business division or a combination of assets, which have the ability to independently carry out business operations, as an "enterprise". The definition of the term "enterprise" *includes* its "units, divisions and subsidiaries" and therefore, anything less than an individual corporate entity is not considered to be an "enterprise" for the purposes of the Act. Such an interpretation is likely to produce inconsistent results since assets, although not included in the transaction are included in calculating the value of assets for the purposes of applying the jurisdictional thresholds. Given the lack of a transfer of ownership, these assets are in substance irrelevant for establishing the potential effects of a transaction on competitive structures in India.

TREATMENT OF "OFFSHORE" COMBINATIONS

On account of the CCI's position on "turnover" and asset acquisitions, numerous global transactions, particularly completely offshore transactions are notified to the CCI on a purely technical filing basis, although the transaction itself does not produce any appreciable anti-competitive effects on Indian markets. Such filings result in prolonged transaction timelines and additional costs.

Of course, the CCI has the power under the Act to review certain global transactions by virtue of Section 32 of the Act, which states that the CCI "*shall, notwithstanding that a combination has taken place outside India or any party to combination is outside India have power to inquire into such combination if such combination has, or is likely to have, an appreciable adverse effect on competition in the relevant market in India.*" In line with the 'effects' doctrine of public international law, this provision extends the application of the Act

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8 A consequence of this approach is that it leads to double counting of export sales originating in India. They will count towards the Indian thresholds (given the formal approach in this jurisdiction) and towards the thresholds of the country into which they are made (which is likely to use a substantive approach for allocating turnover). This may well lead to a significant expansion of notification requirements in global transactions.

9 *Danone/Wockhardt* (C-2011/08/03); *Aica/BBTCL* (C-2011/09/04) and *NHK Automotives/BBTCL* (C-2011/10/05).

beyond the territoriality principle to Combinations taking place outside India and to parties located outside India. However, to have the power to investigate (and potentially prohibit) such transactions, the CCI must be able to show that the offshore transaction gives rise to or is likely to give rise to an AAEC in India. Further, Item 10 of Schedule 1 of the Combination Regulations proceeds to "exempt" from notification to the CCI those Combinations which take place entirely outside India with *insignificant local nexus* and effect on markets in India ("**Offshore Exemption**").

If the Act itself does not apply to a transaction because it lacks a sufficient local nexus as defined in Section 32 of the Act (*i.e.*, it does not lead to or is not likely to lead to an AAEC), then there is no notification requirement to provide an exemption from in the first place. It is essential to carefully consider the importance of the thresholds set out in the primary legislation. The need to find an actual or at least a likely AAEC as a trigger for the application of Indian law to offshore Combinations is a considerably higher threshold than the (negative) threshold of "insignificant effects on market in India". In this way, Item 10 of Schedule 1 of the Combination Regulations appears to be superfluous. It is difficult to imagine an offshore transaction that is likely to have a sufficiently strong negative impact in India so that it can be considered to have an AAEC (to get it past the threshold of Section 32 of the Act and trigger the application of the Act in the first place) but then meets the Offshore Exemption criterion.

However, based on the CCI's precedents, it appears that the CCI (i) seems to ignore the requirement to find an AAEC in India (thereby ignoring the jurisdictional requirements set out in Section 32 of the Act); and (ii) interprets the benchmark for *insignificant local nexus and effects on competition in India* to be exceeded in all cases in which the asset/turnover thresholds are met. However, this set of *financial data* does not take into consideration the *effect,* which a transaction has or may have on competition in India. In fact, administrative practice does not seem to take into account any of the substantive requirements that need to be met to establish jurisdiction (i.e., the effect of a transaction on the Indian market) and instead relies only on formal asset/turnover thresholds that have no direct relevance for the assessment required under the Act and its implementing regulations. This practice effectively renders both Section 32 of the Act as well as the Offshore Exemption meaningless.

It is true that an application of the jurisdictional criteria under Section 32 of the Act do require a substantive assessment of the effect of the transaction, forcing the parties and the authority to consider aspects of the substantive analysis to establish whether the transaction falls into the scope of the Indian law. However, as stated earlier, such a requirement is a direct reflection of the effects doctrine on which Section 32 of the Act is based. While it is clear that for the purposes of applying merger control rules, a country is free to set up certain formal thresholds that apply to transactions that occur within its territory or involve its nationals, however, it is crucial for a country to satisfy an additional – material – requirement where it wishes to extends its jurisdiction to transactions that do not fall into this category (*i.e.*, off-shore transactions that do not involve Indian companies). The practice of the CCI thus far seems to have ignored this requirement.

In addition to the above, as a matter of procedure, the CCI's focus on the Offshore Exemption shifts the burden of proof for the application of the Act from the CCI to the parties to the transaction. As such, it is incumbent on the CCI to provide adequate proof in order to exercise jurisdiction. However, if the CCI cannot show with sufficient certainty that a transaction is at least likely to produce an AAEC, it lacks jurisdiction to require notification and proceed with an investigation. Thus, in a *non-liquet* situation – i.e., where the fulfillment of this requirement cannot be positively established, the CCI lacks the power to act. On the other hand, the situation differs with regard to the application of the Offshore Exemption – which presupposes the applicability of the Act and the existence of a notification requirement (from which the transaction is exempted). Here, the burden of proof is on the parties to show the fulfillment of this rule, which carries positive implications for them.

The scope of the Offshore Exemption was tested in the case of *Tata Chemicals Limited/Wyoming I,*[10] where the CCI was notified of the proposed merger of Wyoming I, which was an offshore wholly-owned subsidiary of Tata Chemicals Limited, into its holding company, located in India. The parties claimed, *inter alia*, that the Offshore Exemption was applicable in this instance, given that the transaction was an "entirely outbound stream of acquisition" by the holding company. However, the CCI did not agree and observed that since the parties exceeded the jurisdictional thresholds and one of the parties to the merger was located in India, the Offshore Exemption was unavailable. This interpretation was further widened with the CCI holding in *Tetra Laval/Alfa Laval*[11], that if the target enterprise has any *direct or indirect* presence in India through its subsidiaries, in excess of the jurisdictional thresholds, there is *significant local nexus* in India and the transaction is notifiable.

As a result of this interpretation, there have been a number of instances, where the transaction was notified to the CCI, despite not having an India-specific transaction leg, *merely due to presence in India through subsidiaries in unrelated businesses which did not form the subject matter of the acquisition*.[12] A quintessential example of this is the acquisition by Nestle of Pfizer's global nutrition business, which did not have any presence or business operations in India, but was notified to the CCI on account of the fact that Pfizer has other subsidiaries in India, which are engaged in completely unrelated business activities, i.e. the pharmaceutical and animal healthcare sector.[13] The CCI claimed jurisdiction over the transaction on a combined interpretation of the definition of the term "enterprise" in relation to asset acquisitions and the Offshore Exemption. Evidently, activities of the seller in India, which do not form part of the transaction in question, cannot be relied upon to establish the existence of domestic effects produced by the combination of the target business and the acquirer's business.[14] Relying on the fact that the seller has activities in India (albeit being outside the scope of the transaction) widens the scope of application of Indian law to capture transactions that do not fulfill the requirements set out in Section 32 of the Act.

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[10] C-2011/12/12.

[11] C-2012/02/40. Please note that the Offshore Exemption was not expressly sought in this case and the transaction (the acquisition of shares in Alfa Laval by Tetra Laval on the Stockholm Stock Exchange, which resulted in an indirect acquisition of shares in Alfa Laval's subsidiary in India) was notified belatedly to the CCI. The CCI did not impose any penalty for belated notification as it was the first year of the Indian merger control regime.

[12] For instance, *Nestle/Pfizer* (C-2012/08/76), *Bain/Genpact* (C-2013/03/112), *Silver Lake/Dell* (C-2013/02/109), *Titan International/Titan Europe* (C-2013/02/109) and *Zulia Investments Pte Ltd./Kinder Investments Pte. Limited* (C-2013/06/124).

[13] *Nestle/Pfizer* (C-2012/08/76).

[14] Even if the sale of a business active outside India has an indirect effect on the remaining businesses of the seller (in India) – e.g. through reduced debt burdens of the seller resulting from the proceeds of the sale, which gives its remaining businesses new access to financing – such an effect is insufficiently direct and structural in nature (the focus on merger control being on the structural changes brought about by the transaction) to trigger the application of Indian merger control rules.

Recently, the CCI has gone one step further in enforcing the mandatory nature of the Indian merger control regime by imposing penalties on parties for belatedly notifying certain Combinations, which has had the effect of making the global business community sit up and take notice of the Indian regulator. Arguably, a filing deadline does not add any real value for merger control regimes that impose a hold separate requirement until clearance on the parties. Thus, jurisdictions such as the EU have largely abandoned them as unpractical and unnecessarily bureaucratic. In fact, imposing penalties on parties for not adhering to such rules is practically unheard of and unlikely to bring any benefits to the local authority (as opposed to fining them for gun jumping violations). What raises most concerns in the present context, however, is that the particular instances in which the CCI has penalised parties relate to entirely offshore Combinations, having no India nexus.

In *Titan International/Titan Europe,*[15] the CCI imposed a fine of INR 10 million on the parties to the Combination on account of a belated filing, which was voluntarily made to the CCI. The matter related to the acquisition by Titan International, Inc. based in the USA, of the entire share capital of Titan Europe PLC, based in the United Kingdom. However, this resulted in Titan International indirectly acquiring Titan Europe's shareholding of 35.91 per cent. equity interest in Wheels India Limited (not a subsidiary of Titan Europe but an associate company[16] of Titan Europe), thereby triggering the requirement to file a merger notification with the CCI. Thus, the transaction took place entirely offshore and only indirectly affected an Indian entity (*i.e.*, on the strength of shares held by the target in an Indian entity). Even though this shareholding did not give the target control over the Indian entity (Wheels India), the CCI considered this shareholding to give the target a local presence in India. Since Wheels India exceeded the prescribed asset and turnover thresholds, the CCI held that a merger notification ought to have been filed to obtain CCI clearance within the prescribed time limit under Section 6(2) of the Act, i.e. thirty days from the execution of the definitive agreement for acquisition and prior to the consummation of the transaction. .

More recently, the CCI made headlines when it imposed a fine of INR 5 million in *Temasek/DBS Group Holdings*[17]for belatedly notifying a transaction that related to the acquisition of shares by a wholly-owned subsidiary of Temasek, the Singapore Government's investment arm, in DBS Group Holdings Limited (located in Singapore), in consideration for the sale by Temasek's subsidiary in Bank Danamon, an Indonesian bank. Given that the definitive document for the sale of the shares in the Indonesian bank was executed on 2 April 2012, the CCI was required to be notified by May 2012. It is interesting to note that pending the CCI's review, the parties decided to ultimately abandon the transaction for reasons wholly unrelated to the merger control review and withdrew the merger notification. The CCI nevertheless imposed a penalty on Temasek for having violated the requirement to notify the CCI in the first place, regardless of the ultimate effect of the transaction, or the lack thereof.

CONCLUSION

[15] *Titan International/Titan Europe* (C-2013/02/109).

[16] An associate company is a company in which another company holds a significant shareholding, usually more than 20% but less than 50%. Therefore, for accounting purposes, the financial statements of associate companies are not consolidated with those of the company holding the shares in them. The associate company's shares are reflected as an asset on the books of accounts of the company holding these shares.

[17] C-2013/06/124.

The CCI's broad interpretation of the jurisdictional reach of the Act raises some serious concerns. Its treatment of the financial thresholds that trigger merger control requirements within the scope of the Act is formalistic, especially with regard to the geographic allocation of sales based on formal accounting criteria, so much so that it is likely to produce skewed results. Moreover, issues in relation to turnover, such as the inclusion of turnover of businesses that have been sold since the end of the last accounting period and the non-inclusion of turnover generated by businesses that have been acquired since that date merit some reconsideration.. Further, the above approach is also overly broad, in particular by including the assets and turnover of businesses of the seller that are not part of the transaction and therefore cannot contribute to any 'effect' on the structure of competition. In addition, the fact that the CCI appears to ignore the legal requirement envisioned in Section 32 of the Act that a transaction must be at least likely to result in an AAEC in India to trigger the application of the Act is worrying.

The issues outlined above could possibly be a reflection of the regulator's cautiousness, given that the merger control regime in India is fairly nascent. It is also relevant to note that despite its limited resources, in each of the transactions that have required a technical filing, the CCI has granted approval swiftly, i.e. on average between 30-40 days, after quickly satisfying itself that the transactions do not result in any AAEC. Accordingly, a more suitable approach would be for the CCI to re-visit the abovementioned issues as its administrative practices mature in order to enable the CCI to bring its practices into line, not just with the jurisdictional requirements spelt out in the Act but also with international best practices.

Looking at the way the CCI has progressed in this relatively short span of time, the CCI can certainly be credited with being a regulator that seeks to implement sound enforcement practices. It will be interesting to see as to whether the CCI changes its course, as the body of Indian merger control jurisprudence grows and more practically, the number of filings the CCI receives increases substantially. Moreover, the CCI as well as the businesses community would greatly benefit from a certain change of direction wherein the regulator's attention would be directed to those cases which have a material impact on competition in India. Part of such a re-orientation might involve greater interface and exchange of ideas with stakeholders in the application of Indian competition rules as well as with competition enforcers in other jurisdictions; memorandums of understanding entered into with competition regulators in the USA, the EU, Australia, Russia are a big step towards this process that should ultimately result in a reconciliation of extraterritorial application of the Act in instances which have a demonstrable local nexus and effect on the market in India.

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