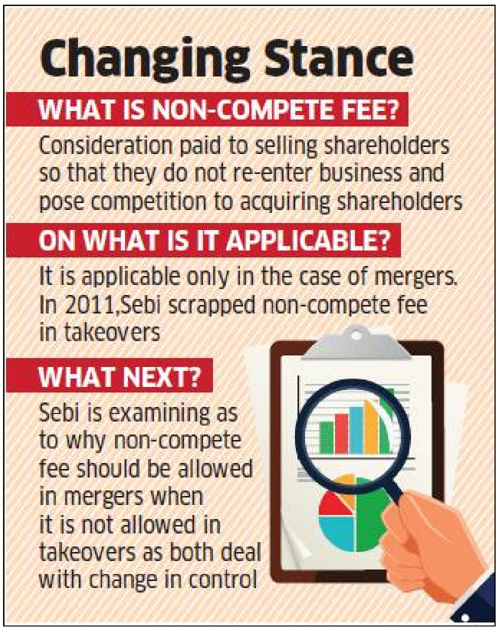
Post HDFC Life-Max Life deal, Sebi reviews the concept of non-compete fees

By *Reena Zachariah*, ET Bureau | Updated: Oct 10, 2016, 04.55 PM IST

MUMBAI: The Securities and Exchange Board of India (Sebi) is reviewing the concept of non-compete fees paid to promoters selling stakes in mergers after the issue flared up in the HDFC Life-Max Life deal. The promoter of Max Life is getting an additional Rs 850 crore in the form of non-compete fees as part of the merger.

Currently, in case of takeovers, regulations do not allow non-compete fees to be paid to exiting promoters. Instead, any such payment has to be factored into the open-offer price to other shareholders. Sebi now wants to address the exemption given to such fees in case of merger schemes.

“We are reviewing existing provisions governing schemes of arrangement to plug loopholes,” said a senior regulatory official familiar with the development. “We have noticed that corporates only follow the law in letter and not in spirit”.



Payment Sparked an Uproar

In the case of the HDFC Life-Max Life merger, the non-compete fee of Rs 850 crore had sparked an uproar with proxy advisory firms and the mutual fund body voicing concerns that it was against the interests of minority shareholders.

A non-compete fee is paid to exiting promoters so they don’t set up or join a rival entity. According to one proxy advisory firm, a non-compete fee may not have been needed in the HDFC Life-Max Life merger. The sizeable stake held by Max Life's promoters in the merged entity itself would have been deterrent enough.

Some market participants feel that since there is a change of control involved in both takeovers and in mergers, there should be uniformity in rules.
“The regulator needs to raise the standard now to proscribe non-compete clauses in the interests of minority shareholders to bring parity in restructuring mechanisms,” said Sumit Agrawal, ex-Sebi official and partner at Suvan Law Advisors. “There seems no rationale to have different set of minority shareholder protection norms in a takeover structure and in a merger or demerger.”

Protecting Minority Investors

Currently, the regulatory framework offers certain provisions that protect minority investors in both situations.

In a merger, the scheme has to be approved by the board of directors of the respective companies. Secondly, though there is no bar on non-compete fees, the minority shareholders have been empowered to approve or reject such an arrangement. Rules require that the entire merger scheme can be acted upon only if the votes of public shareholders favouring the resolution are at least twice those voting against it.

In a takeover, the committee of independent directors of the target company is required to give its recommendation on the open offer price, based as per Sebi’s formula.

“While non-compete fee as a structure is prevalent in merger and acquisition transactions in private companies, in public companies this issue has been a matter of discussion due to the interests of minority shareholders involved,” said Mehul Savla, director of RippleWave Equity Advisors.

Non-compete fees are justifiable in certain circumstances, said Sandeep Parekh, founder, Finsec Law Advisors and a former Sebi executive director. “Such payments are typically subject to approval of a high court as also majority of uninterested shareholders,” he said. “With these safeguards, it is hard to argue for a complete ban.”

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