Impact of the Competition (Amendment) Act, 2023 on Alternative Investment Funds

On September 10, 2024, various amendments to the Competition Act, 2002 (Competition Act) introduced by the Competition (Amendment) Act, 2023 (**2023 Amendment**) read with the Competition (Combinations) Regulations, 2024 (**2024 Regulations**) and other rules including the Competition (Criteria for Exemption of Combinations) Rules, 2024 (**Exemption Rules**), came into effect. Two of these amendments have a significant impact on Alternative Investment Funds (**AIF**) registered with the Securities and Exchange Board of India (SEBI) under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (**SEBI AIF Regulations 2012**).

Exemptions for VCFs expanded

Prior to the 2023 Amendment, the Competition Act exempted[1] any acquisition by a venture capital fund from the provisions of the Section 6[2] of the Competition Act. For the purpose of this exemption, the definition of a 'venture capital fund' (**VCF**) was as per Clause (b) of the Explanation to clause (23 FB) of Section 10 of the Income Tax Act, 1961, which covered VCFs under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 and the "VCF" sub-category of Category I AIFs under the SEBI AIF Regulations 2012. Consequently, Category II and III AIFs were excluded from this definition of a VCF as were other sub-categories of Category I AIFs, such as angel funds, infrastructure funds, SME Funds and social venture funds. Further, as per Section 6(5) of the Competition Act read with the Competition Commission of India (Procedure in regard to the transaction of business relating to combination) Regulations, 2011 (Combination Regulations), acquisition by a VCF had to be reported to the Competition Commission , by way of Form III, within 7 (seven) days from the date of transaction.

The 2023 Amendment has expanded the aforementioned exemption[3] for VCFs to cover all sub-categories of Category I AIFs. Further, the requirement to notify the Competition Commission within 7 (seven) days from the date of transaction has also been done away with. However, it should be noted that Category II and Category III AIFs still do not benefit from this exemption.

Change in the definition of "Control"

Prior to the 2023 Amendment, 'control' was defined to mean controlling the affairs or management of one or more enterprises. The 2023 Amendment has widened the definition of control and henceforth, 'control' means the ability to exercise material influence, in any manner whatsoever, over the management or affairs or strategic commercial decisions. 'Control' has always been a nebulous concept under the Competition Act and the new definition of 'control' means that henceforth it is much more likely that AIFs will be deemed to have control over their investee companies.

It is common for AIFs to have rights such as the rights veto rights over the promoters of their investee companies and/or the right to nominate directors to the board of directors of such investee companies. Out of

[1] This exemption was contained in Section 6(4) of the Competition Act

[2] Section 6(1) of the Competition Act prohibits, and declares as void, combinations which cause or is likely to cause an appreciable adverse effect on competition within the relevant market in India. Section 6(2) of the Competition Act provides that any person or enterprise that proposes to enter into a combination, shall give notice to the Competition Commission disclosing the details of the proposed combination after approval for the combination or execution of documents for the combination, but before consummation of the combination. Section 5 of the defines a combination as an acquisition of control, shares, voting rights or assets of one or more enterprises, exceeding specified value thresholds.

[3] The new exemption is contained in Section 6(9) of the Competition Act

the four factors that may trigger obligations under the Competition Act pursuant to a combination, on account of an acquisition of control, shares, voting rights or assets if the specified value thresholds are exceeded, “control” is subjective, while the other three factors are objective.

The schedule to the Exemption Rules provides a number of exemptions[4] for acquisitions of shareholding/voting rights, but these exemptions do not apply to the acquisition of control. Therefore, if an AIF acquires a minority stake in a company, which either in the ordinary course of business or is solely as an investment, it may nonetheless be construed that the AIF ‘controls’ that investee company on the basis of its rights, such as veto rights or the right to nominate directors to the board of such company and obligations under Section 6 of the Competition Act may be triggered.

ELP Comments

When an AIF invests in a portfolio company, it is very common for the AIF to acquire rights such as veto rights, or the right to nominate directors or observers in such company or gain a right or ability of access commercially sensitive information of the company. In many instances, AIFs do not exercise such rights, which merely remain on paper. However, the mere existence of such rights may now be construed as an acquisition of “control” by the AIF over the investee company. This therefore gives raise to the obligation to report such acquisition to the Competition Commission using Form I, which entails a filing fee of INR 30,00,000 (Thirty lakh only), a substantial burden for many AIFs.

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

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[4] Two of these exemptions are as follows:
- *Ordinary course of business* (**OCB**) *(Rule 1)*: Acquisitions of shares/ voting rights in the OCB by underwriters, stockbrokers, and mutual funds, as the case may be, are exempted if:
  - It is an acquisition of unsubscribed shares by an underwriter as per an underwriting agreement or a stockbroker’s acquisition of shares, provided that the underwriter or stockbroker does not hold more than 25% of the target company's total shares/ voting rights.
  - It is an acquisition of shares/ voting rights by a mutual fund provided that the mutual fund does not hold more than 10% of the target company's total shares/ voting rights.
- *Solely as an investment (SAI) (Rule 2): Acquisition of shares/ voting rights shall be treated as SAI if:*
  - Acquisition of shares/ voting rights does not exceed 25% of shareholding in the target; and
  - There is no acquisition of control in the target, and
  - Acquirer does not gain a right or ability to have a representation on the board of directors of any enterprise either as a director or as an observer, and
  - Acquirer does not gain a right or ability to access commercially sensitive information (CSI) of any enterprise; and
  - Acquirer, its group entities and their affiliates do not have any horizontal overlap or any vertical or complementary activities with the target including its downstream group entities and its affiliates.
- **Carve-out for acquisition up to 10% of shares/ voting rights of the target.** Even if an acquisition of shares/ voting rights result in overlaps or relationships as set out in Rule 2 as above, such acquisitions will qualify as SAI, provided it is not more than 10% of shares/ voting rights and it meets all other conditions as set out above apart from the requirement to not have any overlaps