Fair Competition
For Greater Good

COMPETITION COMMISSION OF INDIA

(Combination Registration No.C-2016/01/366)

22nd March 2016

Notice under Section 6 (2) of the Competition Act, 2002 given by FIH Mauritius Investments Ltd.

CORAM

Devender Kumar Sikri
Chairperson

S. L. Bunker
Member

Augustine Peter
Member

U. C. Nahta
Member

M.S. Sahoo
Member

G. P. Mittal
Member

Legal Representatives of the parties:

Vinod Dhall and TT&A, New Delhi

Order under Section 31(1) of the Competition Act, 2002

1. On 14th January 2016, the Competition Commission of India ("**Commission**") received a notice filed by FIH Mauritius Investments Ltd. ("**FIH Mauritius**" or "**Acquirer**") under sub-section (2) of Section 6 of the Competition Act, 2002 ("**Act**"). The notice was given pursuant to execution of Share Subscription Agreement among and between Sanmar Engineering Services Limited ("**SESL**"), promoters of SESL and FIH Mauritius on 13th January 2016. (Hereinafter, FIH Mauritius, SESL and SHL Alpha are collectively referred to as "**Parties**").

2. The proposed combination, structured as an acquisition and filed under Section 5(a) of the Act, contemplates the following steps; (i) FIH Mauritius of the Fairfax group of companies ("**Fairfax Group**") will subscribe to 30% equity shares of SESL, by virtue of which FIH Mauritius will acquire certain affirmative voting rights in SESL; (ii) SESL will acquire the shares of its sister company, SHL Securities (Alpha) Limited ("**SHL Alpha**"); and (iii) Subsequently, a wholly owned subsidiary of FIH Mauritius will make additional investments in SESL. The above steps constitute the proposed combination ("**Proposed Combination**").

3. FIH Mauritius, a private company incorporated under the laws of Republic of Mauritius, is stated to be created for the purpose of making investments in India. It is a wholly owned subsidiary of Fairfax India Holdings Corporation (Canada) ("**FIHC**"), an India-focused investment arm of Fairfax Financial Holdings Limited ("**FFHL**") and is a part of the Fairfax group, headquartered in Toronto, Canada.

4. SESL, a public limited company incorporated in India, is controlled by Sanmar Consolidations Limited which holds majority of its equity share capital. SESL provides customer support and service for engineering products. SESL also undertakes comprehensive onsite maintenance contracts for certain engineering products, accessories and equipment.

5. SHL Alpha, a public limited company incorporated in India, indirectly holds the chemical businesses of Chemplast Sanmar Limited ("**CSL**"), a public limited company, incorporated in India, and Sanmar Speciality Chemicals Limited ("**SSCL**"), a public limited company incorporated in India. SESL, CSL and SSCL belong to Sanmar group which is engaged in, *inter alia*, chemicals businesses including polymers, organic, inorganic and speciality chemicals such as PVC resins, caustic soda, chlorochemicals, refrigerant gas and industrial salt.

6. On the basis of the submission of the Acquirer, it is observed that there is no horizontal overlap, direct or indirect, between the activities of the Fairfax Group and the chemical business of Sanmar group in India.

7. As regards the vertical relationship, based on the submission of the Acquirer, it is observed that neither the parties to the combination, i.e. Fairfax group, SESL and SHL Alpha, nor their controlled entities or group companies, are present in vertically linked markets. Further, it is also stated that none of these entities provide any inputs to other group entities.

8. The Commission considered and assessed the proposed combination in its meeting held on 24th February 2016 and directed the parties to proposed combination to justify the 'non-compete clause' which restricts, *inter alia*, the promoters of the entities belonging to Sanmar group to undertake directly or indirectly, or be associated in any manner with business that manufactures PVC, choloromethane and / or caustic soda other than through their existing entities engaged in the said business. Further, there are certain restrictions on FIH Mauritius regarding investment in competing businesses of the chemical business of Sanmar group. Accordingly, a letter under Regulation 14 of the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("**Combination Regulations**") was issued to which the Acquirer replied in due course along with request for an opportunity for personal hearing before the Commission.

9. In its meeting held on 22nd March 2016, the Commission considered the submissions of the Acquirer on the Non-compete clause and heard the authorised representatives of the Parties on the same.

10. Based on the submission of the parties to the combination, the Commission (by majority) observed that in absence of the Proposed Combination, there is a risk that a significant player engaged in the manufacture of PVC, chloro-methane, caustic soda etc. may not be in a position to provide competitive constraint to other players engaged in similar business, thus, reducing overall competition in the market and therefore, found the Non-compete clause to be reasonable.

11. Considering the facts on record and the details provided in the notice given under sub-section (2) of Section 6 of the Act and assessment of the proposed combination on the basis of factors stated in sub-section (4) of Section 20 of the Act, the Commission is of the opinion that the proposed combination is not likely to have appreciable adverse

effect on competition in India and therefore, the Commission, hereby, approves the same under sub-section (1) of Section 31 of the Act.

12. This order shall stand revoked if, at any time, the information provided by the Parties is found to be incorrect.

13. The Secretary is directed to communicate to the Parties accordingly.

Dissent Note on Non-Compete Obligation

Per: M. S. Sahoo, Member

1. I have gone through the above majority order of the learned Commission approving the proposed combination under Case No. C-2016/01/366, including the associated non-compete obligation. While I agree with the approval of the learned Commission to the proposed combination as such, I do not approve of the non-compete obligation envisaged along with the said combination for the reasons explained in this dissent note.

2. I have considered the following material in the matter:
   a. Notice in Form I filed on 14.01.2016 by FIH Mauritius Investments Limited (FIHM) under section 6(2) of the Act, through *'Vinod Dhall In collaboration with TT&A';*
   b. Response dated 02.03.2016 filed by FIHM through *''Vinod Dhall In collaboration with TT&A'* in response to Commission's letter dated 24.02.2016 seeking detailed justification of the scope of non-compete obligation; and
   c. Oral submissions of the FIHM at the hearing before the learned Commission on 22.03.2016.

3. It is useful to appreciate the construct of non-compete obligation under the Competition Act, 2002 (Act):
   a. The Act envisages approval for a proposed combination, which is defined in section 5 of the Act to mean (a) acquisition of enterprises, or (b) merger or amalgamation of enterprises. An acquisition enables the acquirer to acquire some amount of control

over an enterprise and thereby, possibly, market power in the relevant market for products of that enterprise. The Commission is required to assess if such acquisition of control over enterprise / market power has an appreciable adverse effect on competition (AAEC) within the relevant market and approves the same if it does not. Similarly, the Commission assesses and approves mergers and amalgamations. The Act does not envisage approval for any transaction which does not amount to a combination. [……]

b. The parties to a proposed combination at times, simultaneously or in connection with the said combination, agree to do something or to restrain from doing something. Agreement to restrain a person from doing something is known as 'restraint' in competition parlance. Such restraints are generally of three categories, namely, (i) restraints which have no bearing on the proposed combination, (ii) restraints which are incidental to or which help or facilitate the proposed combination, and (iii) restraints which are directly related and necessary to the proposed combination. The restraint in the category (iii) are subordinate to the main transaction, i.e., combination, and are necessary to make the combination effective. These are called 'ancillary restraints'. Whether a restraint is ancillary or not depends on the given facts and circumstances, not because the parties to the combination regard them so. The Act does not envisage explicit approval for any restraint along with a proposed combination. However, the ancillary restraints enjoy a special privilege, mostly by practice, in the scheme of approval of combinations. These are considered approved on efficiency grounds along with the approval for the proposed combination, unless they appear unreasonable or disproportionate. This practice protects the ancillary restraints even if these are inconsistent with any provision in the Act or in any other law. For example, a non-compete obligation, which is usually an ancillary restraint with a proposed combination, does not become void by virtue of section 3 of the Competition Act, 2002 or section 27 of the Indian Contract Act, 1872, if the proposed combination is approved.

c. A non-compete obligation is a typical ancillary restraint with a proposed combination. While the Act is silent about it, the regulations made thereunder require the parties to state the details of scope of the non-compete obligation, in terms of the enterprises, products, geography and period covered and justification for each of these. The Commission examines if the non-compete obligation is an ancillary restraint and, if so, whether it is reasonable, balanced and proportionate. [……] modifies the restraint,

if it is not justified in the given facts and circumstances. As stated by the acquirer in para [……] of its response dated 02.03.2016, *"In Advent International Corporation / MacRitchie Investments Pte. Limited,* [……] *the parties voluntarily offered to reduce it to a period of three years which was accepted by the Hon'ble Commission"*. The Commission usually permits non-compete obligation in case of sizable equity investment and as long as that investment is held by the acquirer or for a certain period after the seller has sold the business. However, the extent and nature of non-compete obligation varies from case to case. For example, the obligation is usually on the seller who is selling a business, while it is on both the parties in case of joint ventures.

d. The law (the Act, regulations and decisional practice) does not envisage any non-ancillary restraint along with a combination. It permits an ancillary restraint to the extent it is reasonable. It permits a non-compete obligation only if it is ancillary to the proposed combination. It does not permit a non-compete obligation which is not ancillary to a proposed combination. Importantly, it does not permit a non-compete obligation if it is the primary purpose of the parties to the proposed combination and the combination is only a facade. Thus, an agreement not to compete is valid only if it is ancillary to a proposed combination and to the extent, it is reasonable in the given facts and circumstances.

4. It is necessary to understand the transactions reported in the notice filed by FIHM:

a. It has been stated in para [……] of the notice that the share subscription agreement dated 13.01.2016 (SSA), which has been entered into by (a) FIHM, (b) Sanmar Engineering Services Limited (SESL), and (c) SHL Securities (Alpha) Limited (SHL Alpha), is the trigger event for filing the notice with the Commission. The SSA formalises FIHM's subscription to [……] equity shares of SESL representing 30% of the latter's paid up capital for a consideration of [……]. Therefore, the proposed combination, as stated in summary of the combination in terms of regulations 13(1B) in Part V of the notice, is as under:

> "*Type of the Combination*
>
> *2. FIH Mauritius proposes to subscribe to 30% equity shares in SESL. SESL will in turn acquire shares of SHL Alpha which will result in FIH Mauritius indirectly investing in the chemical business held by SHL Alpha*

3. The proposed transaction amounts to a combination under section 5(a)(i)(A) of the Competition Act, 2002."

b. It has been stated in para [……] of the response dated 02.03.2016, "[……]"[……] of the said response states: "[……]*"*. Thus, the proposed combination (30% equity investment) is incidental while the primary transaction is a [……] investment [……] by a subsidiary of FIHM, namely, [……] (Lender 1). [……]. The details [……] are as under:

Sl. No.	Particular	Description
1	[……]	[……]
2.	[……]	[……]
3.	[……]	I. [……] II. Control over SESL through [……] III. [……] IV. Security / protection available under the applicable laws.
4.	[……]	[……]
5.	[……]	[……]

c. The incidental transaction confers certain rights on FIHM. These include:

i. [……]

ii. FIHM, which will hold 30% equity, [……] while the promoters of SESL, who will collectively hold 70% of equity, shall have the right to [……]

iii. [……]

d. Both the primary transaction and the incidental transaction together have a non-compete obligation, which, as stated in Para [……] of the notice, is as under:

"(i) Pursuant to the Shareholder's Agreement. FIH Mauritius shall not be entitled to invest in more than 20% of the share capital of a competing business which is engaged or is in process of establishing a business to manufacture PVC, chloromethanes and / or caustic soda.

(ii) At any time during the period when (i) [……]*, or (ii) FIH Mauritius/ its transferee hold more than 15% of the equity shares of SESL, the sponsors and*

promoters themselves or in association with or through another person/ entity (without consent from FIH Mauritius/ its transferee) shall not undertake directly or indirectly, or be associated in any manner with another business that manufacturers PVC chloromethanes and / or caustic soda, except to further the business of SHL Chemicals Group…"

e. [……]

f. From the above, it is clear that the primary transaction is [……] investment [……]. An incidental transaction is an equity investment [……]. [……]. The substance of the entire transaction is an investment and not an acquisition of business or enterprise. The incidental transaction is a combination under section 5(a)(i)(A) of the Act, while the primary transaction is not. Both the primary and incidental transactions have a non-compete obligation, which has been claimed by FIHM to be an ancillary restraint.

5. It is important to understand the import of the non-compete obligation, as extracted in Para 4(d) above:

Sl. No.	Scope of non-compete obligation	From the perspective of	
		FIHM	SESL
1.	Who has the obligation?	FIHM has the obligation. Its associates, subsidiaries, assignees, or transferees do not have. [……]	Sponsors and promoters of SESL, namely, [……], and any person directly or indirectly controlling, controlled by, or under control with, any of these have the obligation.
2.	What is the nature of obligation?	FIHM cannot invest in more than 20% of share capital of a competing business. It can invest up to 20% of share capital and invest any amount [……] of a competing business.	Promoter and sponsors cannot associate in any manner with a competing business. They cannot invest even up to 20% of share capital or any amount in [……] of a competing business, as FIHM can do.
3.	What is the period	FIHM has the obligation as	Promoters and sponsors have

	of obligation?	long as it holds any equity share in SESL. [……]. It has no obligation if its transferee holds equity shares in SESL.	the obligation when (a) [……], (b) FIHM holds 15% equity, or (c) a transferee holds 15% equity. They have obligation even when FIHM / [……] do not hold any [……] or equity in SESL.

6. FIHM has justified the non-compete obligation as (a) it is an ancillary restraint, and (b) it is reasonable, proportionate and balanced between the parties. Let us examine this in the context of primary transaction and incidental transaction separately.
    a. Is the non-compete obligation an ancillary restraint?
        i. Primary transaction: A combination can have an ancillary restraint under the Act. However, the primary transaction is not a combination and hence, it cannot envisage an ancillary restraint. Further, an exactly similar [……] transaction [……], which is being undertaken along with the primary transaction, does not envisage any non-compete obligation, as such obligation is not ancillary (directly related or necessary) to that transaction. Hence the non-compete obligation cannot be an ancillary restraint with the primary transaction, which in substance is not an acquisition of business or enterprise.
        ii. Incidental transaction: This is a combination, though not in substance. Nevertheless, a reasonable non-compete obligation can be considered as an ancillary restraint.
    b. Is the restraint reasonable, proportionate and balanced between the parties?
        i. Primary transaction: The restraint is not reasonable, as it has no link with the primary transaction. It envisages obligation on promoters and sponsors even when FIHM has no investments [……]. The restraint is not balanced, as FIHM has no obligation when [……], while the promoters and sponsors have the obligation even when [……]. The restraint is disproportionate as FIHM invests [……] with all pervasive control over the borrower, as detailed in Para 4(c) above.
        ii. Incidental transaction: FIHM has no restraint when it does not hold any equity share of SESL. But promoters and sponsors have restraint even when FIHM

does not hold any equity share. They have restraint when a transferee of shares from FIHM holds 15% of equity shares. Besides, the restraint has different meaning for the parties. It restrains FIHM from investing more than 20% in equity of a competing business, while it restrains promoters and sponsors from associating with any competing business in any manner. The promoters and sponsors have to suffer such onerous restraint to protect the interest of acquirers in equity investment of [……]! Thus, the restraint is not reasonable, proportionate and balanced.

c. Is the restraint / obligation justified otherwise?

i. Primary transaction: FIHM has submitted that it is taking the risk of investment [……] and the restraint is a risk insurance to ensure undivided attention of the promoters and sponsors of SESL to the business. I do not find any merit in this submission. The risk in investment [……] has been reasonably addressed by [……], credibility of the borrower, control over the borrower, [……], etc., as may be seen from Para 4(b) above. Further, a similar [……] investment [……] does not envisage any non-compete obligation. In support of its claim, FIHM has cited two instances where the Commission has permitted non-compete obligations. This submission has no merit either. These two instances are acquisitions of substantial equity stake (both in percentage and value terms) in enterprises and hence distinguishable in facts. These are not non-compete obligations associated with investment in [……].

ii. Incidental transaction: FIHM has argued for non-compete obligation mostly to protect the interest of Lender 1 in primary transaction [……]. It is thus clear that non-compete obligation is not an ancillary restraint with the incidental transaction (combination). It is not a restraint as long as FIHM has equity interest in SESL. Further, as claimed by FIHM, the sponsors and promoters have excellent reputation and track record. It does not stand to reason that the promoters and sponsors will neglect the business even though they have 70% equity of SESL and their fortune is linked to performance of SESL.

7. I find some submissions of FIHM discomforting. A few examples are:

a. FIHM has very aggressively submitted that the non-compete obligation is balanced between the parties. This is not borne out by the fact. The non-compete

obligation means more than 20% equity stake for FIHM, while it means 'association in any manner' for promoters and sponsors. Further, FIHM has no obligation linked to [……], while promoters and sponsors have obligation even when FIHM has no holding of [……]. FIHM has obligation only when it has equity holding in SESL, [……].

b. To a specific query at the hearing [……], FIHM responded that [……] and terminate the obligation and it has no ability or incentive to influence or block the decision in relation to [……]. This response does not answer the query. Nor is it factually correct. [……]. Further, with the kind of [……] control that FIHM would have in SESL, as narrated in 4(c) above, it is difficult to believe that it would not have the ability to influence the decision [……].

c. [……]

8. It is important to keep in mind the following while taking a view on non-compete obligation:

a. If a person wishes to cast a non-compete obligation on any person, including the promoters of the target enterprise or joint venture partners, for whatever consideration, including subscription to [……] of the enterprise, it is welcome to have it to the extent and in the manner permissible under the applicable laws, including the Indian Contracts Act, 1882, the Competition Act, 2002, etc. A non-compete obligation must not be approved tacitly along with a proposed combination under the Competition Act, 2002, unless it is an ancillary restraint. It is so because the provisions of the Competition Act, 2002 are in addition to, and not in derogation of any other law for the time being in force, and the provisions of the Competition Act, 2002 have the effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

b. The Competition Act, 2002, which is a product of the new economic order, makes provision for economic liberty and protects and enforces the same. The economic liberty must not be truncated except in the manner and to the extent provided in the Act or any other applicable law. A non-compete obligation, by its very nature, compromises on the economic liberty, but it is permitted to the extent it is an ancillary restraint with a proposed combination and it is reasonable, balanced and proportionate in the given facts and circumstances.

iii. No transaction, other than a combination, can have a non-compete obligation under the Act. One must not structure a transaction, which is not a combination in substance, in such a manner that it resembles a combination or it generates an incidental transaction which amounts to combination so as to derive the benefits, including non-compete obligation, associated with combinations under the Act. Giving colour of combination to an otherwise [……] transaction or icing up a [……] transaction by a combination is not in the interest of competition.

9. I thus observe that in the given matter, the primary transaction is [……] investment. It is not a combination. Hence it cannot have a non-compete obligation as an ancillary restraint under the Act. Further, the non-compete obligation [……] is not reasonable, proportionate and balanced between the parties. The incidental transaction is an equity investment of [……] towards 30% equity stake in an enterprise along with attached [……], affirmation rights on several matters and [……]. Though this incidental transaction is intended to compensate for the [……] primary transaction, it is a combination and can have a non-compete obligation as an ancillary restraint. But the non-compete obligation linked to incidental transaction is not reasonable, proportionate and balanced between the parties. The substance of the entire transaction, as submitted by FIHM and also observed by me, is not an acquisition of business or enterprise and hence it cannot have a non-compete obligation. Therefore, I do not approve of the non-compete obligations, as stated in Para 4(e) above.