

M&A Hotline

June 07, 2013

SCHEME OF ARRANGMENT BY LISTED COMPANIES- SEBI CLARIFIES AND MODIFIES NORMS

The Securities Exchange Board of India ("SEBI") had vide circular dated February 4, 2013 ("Feb Circular") prescribed fresh norms, to be complied with by listed companies, while undertaking a scheme of arrangement under sections 391-394 of the Companies Act, 1956 ("Cos Act"). As discussed in our previous hotline on this subject, although the intention behind the norms prescribed under the Feb Circular was fairly noble i.e. protection of public/minority shareholders, it was felt that the norms were onerous and ambiguous and thus could potentially affect the ability of listed companies to undertake M&As or restructuring(s) by way of a scheme of arrangement. Recognizing the concern of the market participants, SEBI vide a recent circular dated May 21, 2013 ("Current Circular") has made an attempt to (a) clarify the scope of the Feb Circular; and (b) dilute some of the stringent requirements prescribed under the Feb Circular. Our previous hotline on this subject can be accessed [here](#).

WHAT DID THE FEB CIRCULAR STATE?

Historically, SEBI had made several efforts to monitor scheme of arrangements undertaken by listed entities. The key efforts in this direction were (a) the introduction of Clause 24(f) in the listing agreement which requires a listed entity to file the scheme of arrangement with the stock exchange at least one month before it is filed before the court for sanction; (b) the introduction of Clause 24(g) in the listing agreement which states that any scheme of arrangement presented before the court should not violate any securities law or stock exchange requirements; (c) the introduction of Clause 24(i) in the listing agreement which requires listed entities to file, along with the scheme of arrangement under Clause 24(f), an auditors certificate stating that the entity has complied with the accounting standard prescribed by the central government and (d) September 3, 2009 circular¹ which inter alia specified the requirements for considering application under clause 19(7) of the Securities Contracts (Regulation) Rules, 1957 ("SCRR") seeking relaxation from the strict enforcement of the listing requirements specified under rule 19(2) of the SCRR.

Even with the above legal requirements in place, SEBI has on several occasions raised concerns that listed entities while undertaking scheme of arrangements were making inadequate disclosures, providing exaggerated valuation and undertaking schemes which were to the detriment of the public/minority shareholders. To address this concern, SEBI introduced the Feb Circular that inter alia required listed companies to undertake stringent compliances while undertaking a scheme of arrangement.

The Feb Circular, in addition to the compliances to be undertaken by listed companies to give effect to a scheme of arrangement, also prescribed, the process and conditions for seeking permission of SEBI for listing, (i) equity shares of an unlisted company under a Scheme of Arrangement, (ii) equity shares with differential rights, and (iii) warrants stapled with non-convertible debentures, in each case without having to comply with the initial public offer requirements under Rule 19(2)(b) of SCRR. One of the key requirements introduced by SEBI under the Feb Circular was the obligation on the listed company to place before its audit committee, a valuation report with respect to the scheme of arrangement issued by an independent chartered accountant ("Independent Valuation"). The audit committee was thereafter required to consider the Independent Valuation and prepare a report recommending the scheme.

The Feb Circular also prescribed that the scheme should expressly mention that the scheme would be implemented only after the following approvals are obtained:- (a) shareholder's approval through special resolution passed through a postal ballot and e-voting and (b) approval of at least 2/3rd of the public shareholders of the listed company ("Public Shareholder Approval").

WHAT WAS THE CONCERN?

The Feb Circular raised the following key questions and concerns:-

- Question I :** Does the Feb Circular apply to all schemes of arrangements that are undertaken by listed entities or does it only apply in cases of reverse listings i.e. where a listed entity merges/amalgamates with an unlisted resultant company?

The question of whether the Feb Circular applies to all schemes of arrangement involving listed entities or it only applies to schemes for reverse listing that require exemption from SEBI under rule 19 (7) of the SCRR, has been litigated before the Madras High Court in In Re: The Kill Kotagiri Tea and Coffee Estates Company Limited, dated April 1, 2013, wherein the Madras High Court had ruled that the Feb Circular only applied to schemes of arrangement that required an entity to seek exemption from SEBI under rule 19(7) of SCRR i.e. reverse listings.

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2. **Question II:** Is an Independent Valuation of the scheme required even when there is no change in the shareholding pattern?
3. **Question III:** Would the Public Shareholder Approval be required even when the promoter, promoter group or their associates are not issued any additional shares under the scheme of arrangement?
4. **Question IV:** What would be the scope of the powers of the stock exchange and SEBI after the scheme is approved by the High Court?

SEBI'S RESPONSE

Allaying the fear of the market participants, SEBI vide the Current Circular has responded to some of the concerns discussed above in the following manner:-

1. **Response to Question I :** SEBI has clarified that the Feb Circular would apply to all listed companies undertaking a scheme of arrangement under the Cos Act which will include amalgamation, merger, reconstruction, reduction of capital or any other arrangement undertaken under Part IV and Chapter V of Part VI of the Cos Act. In other words, the compliance requirements specified under the Feb Circular would have to be complied with by listed companies even in cases where no exemption from rule 19(2)(b) of SCRR is sought from SEBI. This clarification from SEBI contradicts the order of the Madras High Court in the matter of In Re: The Kill Kotagiri Tea and Coffee Estates Company Limited.
2. **Response to Question II:** SEBI has stated that an Independent Valuation shall not be required when there is no change in the shareholding pattern of the listed/resultant company. In other words when, (a) there is no change in the proportion of the shareholding of any of the existing shareholders of the listed company in the resultant company; (b) no new shareholder is being allotted equity shares of the resultant company; or (c) no existing shareholder exits the listed company pursuant to the scheme, Independent Valuation would not be required. SEBI has also provided illustrations to demonstrate what constitutes 'change in shareholding'.
3. **Response to Question III :** SEBI, while diluting the requirement of a Public Shareholder Approval has stated that a Public Shareholder Approval will only be required when, (a) additional shares are allotted to promoter/promoter group; (b) the scheme of arrangement involves the listed company and any other entity involving the promoter/promoter group; and (c) the parent listed company has acquired the equity shares of the subsidiary, by paying consideration in cash or kind in the past to any the shareholders (promoter/promoter group) of the subsidiary and thereafter the same subsidiary is merged with the parent listed company under the scheme. Further, the Current Circular reduces the Public Shareholder Approval from approval of 2/3rd of the public shareholders voting on the scheme to approval of more than 1/2 of the public shareholders voting on the scheme. Therefore, a simple majority of the public shareholders voting on the scheme would now be sufficient for complying with the Public Shareholder Approval. SEBI has also clarified under the Current Circular that only Public Shareholder Approval need to be procured through postal ballot and e-voting.

WHAT NEXT?

It appears that by virtue of the Feb Circular and the Current Circular, SEBI has gone an extra mile to protect the interest of the public/minority shareholders. Although it is debatable whether in principle the scope of the circular should be wide enough to include all schemes of arrangement undertaken by listed companies, nevertheless the clarification in this regard should be welcomed. Further, the dilution of the requirement for Independent Valuation and Public Shareholder Approval has provided some breather to the listed companies proposing to undertake internal/group restructuring.

Having said that, there are certain outstanding concerns/questions which may require further analysis and clarifications from SEBI. For instance, the language in the Feb Circular (para 5.17 to 5.19) is not very clear on whether SEBI would have the powers to examine the scheme after the high court has approved it or SEBI's mandate will only be limited to the question of whether an exemption under rule 19(7) should be granted. If SEBI's mandate is review the scheme after the scheme is sanctioned by the high court, it is unclear whether the sanction of the high court would be subject to the approval by SEBI. Whilst in one of the instances (albeit prior to the Feb Circular), the Bombay High Court had sanctioned the scheme subject to the approval of the stock exchange, it is unclear whether now all scheme of arrangement(s) by listed companies will suffer the same fate². The norms as it stands currently is still fairly time consuming and onerous and thus could affect M&As and restructuring by listed companies via the scheme of arrangement route.

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You can direct your queries or comments to the authors

¹ SEBI/CFD/SCRR/01/2009/03/09, September 3, 2009

² Elpro International Ltd., In re (2008) 86 SCL 47 (Bom.)

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