

M&A Hotline

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SEBI ON CLEANING SPREE – ISSUES CLARIFICATIONS ON TAKEOVER EXEMPTIONS, SCHEMES OF ARRANGEMENTS

- SEBI circular issued on December 22, 2017 provides a standard format for making applications for exemptions under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- The above circular prescribes guidelines which would need to be adhered to for being exempt from making an open offer, for settlement of shares into a trust
- SEBI circular issued on January 3, 2018 makes clarifications and relaxes conditions applicable for schemes of arrangement involving listed entities

It appears that the dawn of the New Year 2018 has ushered in several clarifications from the Securities and Exchange Board of India (“SEBI”), which seems to be tidying up regulatory cobwebs to reveal a clearer picture on certain aspects of its laws. On December 22, 2017, SEBI released the Circular No.

SEBI/HO/CFD/DCR1/CIR/P/2017/131 (“SEBI Takeover Exemption Circular”)¹, whereby it introduced a format making an application for exemption from making an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Takeover Code”), and clarified the situations in which an exemption would be provided for an individual promoter of a listed company settling his shares into a trust. Further, SEBI released Circular No. CFD/DIL3/CIR/2018/2 on January 3, 2018 (“SEBI Circular on Schemes”)², which introduces certain relaxations in respect of its Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017 (“SEBI March 10 Circular”), relating to schemes of arrangement. These circulars are explored in greater detail below.

I. SEBI TAKEOVER EXEMPTION CIRCULAR

a. Introduction of format for exemption application

Regulation 11 of the Takeover Code empowers SEBI to grant exemptions from the obligation to make an open offer triggered by an acquisition of shares / control of a target company beyond a prescribed threshold. Under the Regulation, an acquirer seeking exemption must file an application with SEBI along with a duly sworn affidavit, providing details of the proposed acquisition along with the grounds on which the exemption is sought.

The SEBI Takeover Exemption Circular has introduced a standard format for such applications, so as to ensure uniformity in the disclosures under these applications. All applications filed after the date of the circular are to adhere to this format. Under this format, applicants are required to disclose specific details about the acquirer, the target company, and the proposed acquisition, including, *inter alia*, the following:

- Regarding the acquirer / its PACs: whether the acquirer (or its persons acting in concert (“PAC”)) are part of the promoter group, details of prior applications under Regulation 11(1) of the Takeover Code, details of any proceedings before SEBI, details of any directions by SEBI against the acquirer / its PACs;
- Regarding the target company: details of the board composition of the target company, details of its share capitalization, total equity shareholding / voting rights pre- and post-acquisition, net-worth and other financial parameters, minimum offer price of its shares calculated as per Regulation 8 of the Takeover Code;
- Regarding the proposed acquisition: whether the acquisition would result in a change of control of the target company, details of any approvals required for the acquisition, grounds for seeking exemption.

The application is to be accompanied with a duly sworn affidavit from the acquirer confirming the truth of the details disclosed therein, along with a copy of the board resolution authorizing such application where the acquirer is a body corporate. Soft copies are also to be emailed to an email ID mentioned in the circular.

The introduction of a standard format is a welcome move, as it ensures that all applicants are able to provide relevant details to SEBI upfront, without requiring any back-and-forth on exchange of information, which could lead to unnecessary consumption of time.

b. Clarifications on settlement of shares into a trust

The schedule to the SEBI Takeover Exemption Circular provides clarifications in respect of settlement of shares by a promoter / promoter group, into a trust controlled by such promoter. The point of debate in these situations involved the question of whether an open offer obligation persists pursuant to a proposed settlement of shares by a promoter / promoter group, into a trust, presumably as a part of the wealth and succession planning of such promoters. The line of argument taken by promoters was that though there is a transfer of shares between two entities, the control effectively would vest in the same promoter group and there was no change in the ultimate beneficial ownership of the person exercising voting rights in the target company; therefore no open offer should be warranted.

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SEBI has issued several orders³ addressing this point in the recent past, and prescribing conditions based on which exemptions were granted; however, the exemption applications have always been examined on a case-by-case basis, leading to significant expense of time in the turning around of documents and requisitions by SEBI for further information.

Keeping this in mind, the SEBI Takeover Exemption Circular has listed down certain conditions that, if complied with, could reduce the time taken for processing such exemption applications. The conditions appear to be a consolidation of comments issued by the SEBI Takeover Panel under Regulation 11(5), in the previous orders issued by SEBI. These conditions, which need to be captured specifically in the trust deed executed by the parties, include, *inter alia*, the following:

- The trust should be a mirror image of the promoters' holdings, i.e. there is no change in ownership / control over the shares / voting rights of the target company, and any change in trustees / beneficiaries, or any change in the ownership / control over the shares or voting rights of the trust is to be disclosed to SEBI and the concerned stock exchanges within 2 days of such change;
- Only individual promoters, their immediate relatives, or lineal descendants, are trustees and beneficiaries;
- The beneficial interest of the beneficiaries of the trust has not been and would not be transferred, assigned, or encumbered in any way (including by way of pledge / mortgage);
- Ownership and control of the shares / voting rights will be treated as vesting not only with the trustees, but also indirectly with the beneficiaries, as far as all provisions of the SEBI Act, 1992 and all the regulations enacted thereunder ("**SEBI Laws**") are concerned;
- In case of dissolution of the trust, the assets are to be distributed only to the beneficiaries / their legal heirs;
- Trustees should not be entitled to transfer / delegate their powers to any person other than themselves;
- The trust should confirm, annually, that it is in compliance with the exemption order passed by SEBI, which confirmation should be disclosed by the target company as a note to the shareholding pattern filed at the end of the financial year under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015;
- The trust should get its compliance status certified from an independent auditor annually, and furnish the certificate on the stock exchanges for public disclosure, with a copy endorsed to SEBI.

Additional conditions required to be satisfied are as follows:

- The transferors (i.e. the persons settling their shares into the trust) were disclosed as promoters in the shareholding pattern filed with the Stock Exchanges for a period of atleast 3 years prior to the transfer (except for holding on account of inheritance);
- There is no layering in terms of trustees / beneficiaries in the trusts;
- The trust deed does not contain any limitation of liability of the trustees / beneficiaries in relation to the provisions of the SEBI Laws.

It is pertinent to note that the above guidelines apply only to a shareholder being part of the promoter / promoter group settling his shares into a trust, and not to any other category of shareholders doing the same. Consequently, it is unclear whether SEBI will afford the same standard of conditions for any other shareholder settling his shares into a trust, or whether the standard would be more relaxed.

Further, in relation to the trustees of the trust, SEBI issued an order dated March 24, 2017 in the matter of the proposed acquisition of shares and voting rights in *Batlilboi Limited*⁴, wherein it was reluctant to grant an exemption approval for settlement of shares into a trust, where one of the trustees was a private corporate body, even if such trustee was wholly owned and controlled by the promoters themselves. The reasoning behind this is that such trustee being a private limited company, there may be issues of transparency in determination of control / change in control of such entity, and thereby of the target company. In *Batlilboi Limited*, the Takeover Panel was inclined to reject the application even though the private limited company undertook to disclose all changes in its shareholding, and acknowledged that all provisions of the SEBI Laws, would apply to it in case of a change in shareholding, and that it would be liable as a trustee of the trust. This condition of all trustees being individuals has been retained in the guidelines prescribed under the SEBI Takeover Exemption Circular; it remains to be seen whether SEBI will provide some flexibility on this aspect while examining applications on a case-to-case basis.

II. SEBI CIRCULAR ON SCHEMES

The SEBI Circular on Schemes makes certain clarifications and eases certain processes under the existing regulatory framework governing schemes of arrangements involving listed companies, which comprises of the SEBI March 10 Circular and the SEBI Circular No. CFD/DIL3/CIR/2017/105 dated September 21, 2017, both of which addressed, *inter alia*, the conditions and processes to be followed for a scheme of arrangement involving listed entities to be submitted for the sanction of the National Company Law Tribunal ("**NCLT**"). SEBI's objective behind issuing the SEBI Circular on Schemes is purportedly to make efficient the processing of draft schemes, and to ensure that the schemes are not used as tools to bypass regulatory requirements. The changes brought about by the SEBI Circular on Schemes, which amends the provisions of the SEBI March 10 Circular, are as follows:

a. Exemption from application of circular: The SEBI March 10 Circular, which was earlier not applicable to schemes of merger of wholly owned subsidiaries ("**WOS**") with their parent companies, have now additionally been made inapplicable to schemes of mergers of divisions of the WOS with the parent company. In this manner, mergers involving undertakings of a WOS with a parent company, which may be commercially more desirable than mergers of the WOS itself with the parent, are also exempt from the conditions to be met under the SEBI March 10 Circular, easing the process for such mergers. This is a welcome and rational move, as ultimately, the merger is between entities who are controlled by the same person, and should not be required to comply with the conditions under the SEBI March 10 Circular for internal restructuring processes.

b. Independent chartered accountant and merchant banker: The SEBI Circular on Schemes now makes it mandatory for (i) the valuation report to be provided by an *independent* chartered accountant, and (ii) the fairness opinion on the impact of the scheme to be provided by an *independent merchant banker who is registered with SEBI as a merchant banker*. The circular further qualifies 'independence' as including the absence of any material conflict

of interest among themselves or with the company, including that caused by common directorships / partnerships.

c. Clarification on 25% pre-scheme shareholding: In respect of schemes of arrangement involving unlisted entities, Paragraph I(A)(3)(b) of the SEBI March 10 Circular requires that the public shareholders (of the listed entity) and the qualified institutional buyers (of the unlisted entity) should hold not less than 25% in the combined entity. The SEBI Circular on Schemes clarifies that the 25% threshold in this condition is to be calculated on a fully diluted basis.

d. No formalities post sanction of the scheme by the NCLT: The SEBI Circular on Schemes has done away with the requirement to submit, to the stock exchanges, several documents upon sanction of the scheme by the NCLT. These documents include (i) a copy of the sanctioned scheme, (ii) result of the voting by shareholders for approving the scheme, (iii) statement explaining any changes to the scheme, along with reasons for the same, (iv) status of compliance with the Observation Letter / No Objection Letter of the stock exchange, (v) application seeking exemption from the requirement of minimum offer and allotment to the public in an offer document, under Rule 19(2) (b) of the Securities Contract (Regulation) Rules, 1957, and (vi) report on complaints received on the draft scheme.

e. Exceptions to promoter lock-in requirements: The promoter of an unlisted entity into which a listed company or its division is merging, is required to lock-in his shares in the manner specified in the SEBI March 10 Circular. The SEBI Circular on Schemes has relaxed this requirement in respect of: (i) any pledge of shares in favour of scheduled commercial banks / public financial institutions, as collateral security for loans, and (ii) transfer of shares *inter-se* among promoters, as long as the lock-in period continues after the transfer. This is in keeping with the flexibility provided under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 for the transfer of locked-in shares between persons bound by the lock-in obligations thereunder.

f. Relaxation of timeline for listing of shares: The SEBI Circular on Schemes has relaxed the timeline for listing of shares issued pursuant to a scheme. Listing of shares and trading in the same should now commence within 60 days of receipt of the approval for the scheme from the NCLT, simultaneously in all stock exchanges where the shares of the listed entity (or transferor entity) are / were listed.

In issuing the SEBI Takeover Exemption Circular and the SEBI Circular on Schemes, SEBI appears to be undertaking an exercise to streamline its administrative processes, in the hope of reducing the time spent on seeking clarifications from SEBI on hitherto ambiguous points. While this move could help in easing the process of interaction by listed entities and / or their shareholders with the regulatory body, we hope that SEBI remains flexible in the application of the above rules and guidelines, and examines each case before it, keeping in mind its unique factual background.

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You can direct your queries or comments to the authors

¹ Available at: https://www.sebi.gov.in/legal/circulars/dec-2017/exemption-application-under-regulation-11-1-of-sebi-substantial-acquisition-of-shares-and-takeovers-regulations-2011_37083.html

² Available at: https://www.sebi.gov.in/legal/circulars/jan-2018/circular-on-schemes-of-arrangement-by-listed-entities-and-ii-relaxation-under-sub-rule-7-of-rule-19-of-the-securities-contracts-regulation-rules-1957-_37265.html

³ SEBI order dated March 7, 2017, In the matter of proposed acquisition of shares and voting rights in NIIT Limited, available at: https://www.sebi.gov.in/sebi_data/attachdocs/1488888588405.pdf; SEBI order dated March 10, 2017, In the matter of proposed acquisition of shares and voting rights in Thacker and Company Limited, available at: https://www.sebi.gov.in/sebi_data/attachdocs/1489141623250.pdf; SEBI order dated March 24, 2017, In the matter of proposed acquisition of shares and voting rights in Batliboi Limited, available at: https://www.sebi.gov.in/sebi_data/attachdocs/14903533100%83.pdf.

⁴ Available here: https://www.sebi.gov.in/sebi_data/attachdocs/14903533100%83.pdf

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