

M&A Hotline

March 08, 2013

SCHEME OF ARRANGEMENT BY LISTED COMPANIES - SEBI PRESCRIBES NEW NORMS

Securities and Exchange Board of India ("SEBI") has vide the circular dated February 4, 2013 (the "Circular"), streamlined and consolidated the requirements to be adhered to by listed companies for,

- undertaking a scheme of arrangement under Sections 391-394 of the Companies Act, 1956 ("Scheme of Arrangement"); and
- listing, equity shares with differential rights and warrants that are stapled with non-convertible debentures without having to comply with the requirements under Rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957 ("SCRR").

BACKGROUND

SEBI had issued the circular SEBI/CFD/SCRR/01/2009/03/09 dated September 3, 2009 (the "2009 Circular") enabling listed companies to seek specific 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 SCRR¹. While reviewing the applications received under the 2009 Circular, SEBI realized that such applications were generally supported by inadequate disclosures, convoluted schemes of arrangement, exaggerated valuations etc. that could adversely affect the interests of minority shareholders. As a remedial measure, SEBI has fully rescinded and replaced the 2009 Circular with the Circular.

APPLICABILITY

While SEBI's attempt to rationalize the process is commendable, it appears that the language of the Circular suffers from certain ambiguities. To start with, the scope of the Circular is not absolutely clear. One view is that the Circular is a complete code applicable to all Schemes of Arrangement involving listed companies with certain provisions applicable only to Schemes of Arrangement requiring exemption from Rule 19(2)(b) of SCRR. The contrary view is that the Circular is the replacement of the 2009 Circular, intended to regulate only such Schemes of Arrangement that seek listing of securities of an unlisted company without fulfilling the norms under Rule 19(2)(b) of SCRR and is therefore, not applicable to any other Scheme of Arrangement involving listed companies. For instance, Clause 5.1 of the Circular obligates *all listed companies desirous of undertaking a Scheme of Arrangement* to file an application seeking in-principle approval of stock exchanges under Clause 24(f) of the listing agreement together with the prescribed supporting documents. However, the prescribed supporting documents include, *pre and post amalgamation shareholding pattern of the unlisted company and audited financials of last 3 years of the unlisted company*. It is not clear if this requirement would be applicable if the Schemes of Arrangement does not involve an unlisted company.

It would be helpful if SEBI clarifies whether the Circular is generally applicable to all Schemes of Arrangement involving listed companies with certain specific requirements that are applicable only to the Schemes of Arrangement that warrant waiver from the requirements under Rule 19(2)(b) of SCRR.

SNAPSHOT

While the requirements for listing equity shares with differential rights and warrants stapled with non-convertible debentures are identical under the 2009 Circular and the Circular, certain additional requirements are prescribed with respect to Scheme of Arrangement by listed companies. The requirements applicable to Scheme of Arrangement by listed companies are as follows:

1. *Requirements before the Scheme of Arrangement is submitted to the high court*
 1. File the Scheme of Arrangement with the relevant stock exchanges under Clause 24 (f) of the listing agreement seeking in-principle approval of the stock exchanges, together with the following supporting documents (in addition to the documents required under the listing agreement):
 1. Valuation report of an independent chartered accountant;
 2. Report of the audit committee of the listed company recommending the Scheme of Arrangement after evaluating, inter alia, the valuation report of the independent chartered accountant;
 3. Fairness opinion by merchant banker;
 4. Pre and post amalgamation shareholding pattern of the unlisted company;
 5. Audited financials of last 3 years (financials not being more than 6 months old) of unlisted company;

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6. Compliance with Clause 49 of the listing agreement; and
 7. Complaints Report as prescribed under the Circular.
2. The Scheme of Arrangement and the supporting documents filed with the stock exchanges should immediately thereafter be uploaded on the website of the listed company.
 3. Stock exchanges have to forward to SEBI, (i) the Scheme of Arrangement and the supporting documents within 3 working days of receiving them and (ii) their "objection/ no-objection" letter on the Scheme of Arrangement within next 30 days or within 7 days of date of receipt of satisfactory reply on the clarifications sought.
 4. Upon receipt of "objection/ no-objection" letter from the stock exchanges, SEBI shall endeavor provide its comments on the Scheme of Arrangement to the stock exchanges within next 30 days.
 5. Listed company shall submit to stock exchanges a 'complaints report' recording the details of complaints/comments received by it on the Scheme of Arrangement within 7 days of expiry of 21 days from the date of filing of Scheme of Arrangement with stock exchanges. The 'complaints report' shall be forwarded by the stock exchanges to SEBI and shall also be included by the company in the notice sent to the shareholders.
 6. Upon receipt of comments from SEBI, the stock exchanges shall issue an observation letter to the company incorporating the comments received from SEBI within 7 days of receipt thereof. The validity of the 'observation letter' of stock exchanges is 6 months from the date of issuance within which the Scheme of Arrangement needs to be submitted to the High Court.
2. *Requirements after the scheme is sanctioned by the high court*
 1. **Specific requirement:** If the Scheme of Arrangement results in, or provides for, listing of shares of an unlisted company without complying with the under Rule 19(2)(b) of SCRR (IPO norms) then a specific application has to be filed with SEBI under Rule 19(7) of SCRR seeking exemption. Upon approval of the Scheme of Arrangement by the high court, this application has to be filed with SEBI if the Scheme of Arrangement fulfills the following conditions:
 1. The equity shares issued under the Scheme of Arrangement and sought to be listed are proposed to be allotted by an unlisted issuer (transferee entity) to the holders of securities of a listed entity (transferor entity);
 2. At least 25% of the post-scheme paid up share capital of the transferee entity shall comprise of shares allotted to the public shareholders in the transferor entity;
 3. The transferee entity will not issue/ reissue any shares, not covered under the Scheme of Arrangement;
 4. As on date of application, there are no outstanding warrants/ instruments/ agreements which give right to any person to subscribe to the equity shares of the transferee entity in future. If there are such instruments stipulated in the Scheme of Arrangement, the percentage referred to in (ii) above shall be computed after giving effect to the consequent increase of capital on account of compulsory conversions of such outstanding instruments; and
 5. The shares of the transferee entity issued in lieu of the locked-in shares of the transferor entity will be subject to lock-in for the remaining period.
 2. After obtaining the sanction of the high court, the listed company shall submit the prescribed documents to the stock exchanges being (i) the approved Scheme of Arrangement (ii) Result of voting (iii) Explanation with respect to any changes made from the draft scheme submitted previously (iv) complaints report (v) exemption application from Rule 19(2)(b) of the SCRR (vi) status of observation letters.
 3. After receipt of the aforesaid documents, the stock exchange shall submit its recommendations, if any, to SEBI and SEBI shall endeavor to provide its comments/ approval on the same within next 30 days.
 4. The transferee company shall take steps for listing the shares within 30 days of the receipt of order of the high court and it shall commence trading formalities within 45 days of the date of the order after issuing the public notice in newspapers.
3. *Lock-in*

In case of a division of a listed entity merging with a newly formed or existing unlisted issuer, there will be no additional lock-in, if the paid-up share capital of the unlisted issuer is only to the extent of requirement for incorporation purposes. However, in case the paid-up share capital of the unlisted issuer is more than the requirement for incorporation, the promoters' shares shall be locked-in to the extent of 20% the post-merger paid-up capital of the unlisted issuer and the balance of the entire pre-merger capital shall also be locked-in, both for a period of 3 years from the date of listing of the shares of the unlisted issuer.

ANALYSIS

One more approval

It appears that the Circular prescribes mandatory prior approval of SEBI for all Schemes of Arrangement involving listed companies. This was not the case before for Schemes of Arrangements that did not require exemption from Rule 19(2)(b) of SCRR. However, this change appears to be in line with provisions of the Companies Bill, 2012. Clause 230 of the Companies Bill, 2012 provides that the companies involved in a scheme of arrangement shall send the notice of meeting of shareholders (along with the prescribed set of documents) to the statutory authorities including SEBI, Reserve Bank of India, Competition Commission of India, registrar etc. and such authorities are in turn obligated to provide their comments to the scheme within a span of 30 days.

Furthermore, it appears that listed companies are now required to approach the stock exchanges twice to get the Scheme of Approval sanctioned; first, before filing the Scheme of Arrangement with the High Court and then, after receipt of the final High Court approval. This two stage approval process is likely to make the process more time consuming and onerous for listed companies.

Submission of complaints report

SEBI's attempt is to make the entire process of approval of Scheme of Arrangement more transparent. With the entire Scheme of Arrangement available on the websites of the listed company and the stock exchanges from a very early stage in the process, all the stake holders are given an opportunity to familiarize with the proposed scheme. Also, the introduction of 'complaints report' will enable the stakeholders to raise their concerns, if any, in the initial stages itself.

Timing of filing application under Rule 19(7) of SCRR

Part A refers to equity shares proposed to be issued by unlisted company while Part B refers to already issued and delivered equity shares. This could impact the timing of making the application under Rule 19(7) of SCRR seeking exemption from requirements under Rule 19(2)(b) of SCRR. It may not be logical to seek approval of SEBI after the shares are already issued and delivered. Also, Part A requires listed company to file the application under Rule 19(7) of SCRR but Part B requires stock exchanges to ensure that such application is filed by the unlisted issuer.

The Circular requires 'the shares held by the promoters to be locked in to the extent of 20% of the post-merger paid up capital of the unlisted company, for a period of 3 years from the date of listing of shares of the unlisted company and the balance of the entire pre-merger capital of the unlisted company to be locked in for a period of 3 years from the date of listing'. The Circular does not clarify consequence of promoters' shareholding post-merger being less than 20% of the total paid up capital.

The Circular mandates every listed company to file with the stock exchange, a report of its audit committee recommending the Scheme of Arrangement after evaluating, inter alia, the valuation report of the independent chartered accountant. This would lead to the audit committees assuming a larger responsibility, since it will now be expected to carefully examine the Scheme of Arrangement and attendant documents before putting down its recommendations to the stock exchanges.

Valuation woes

The compulsory requirement that at least 25% of the post-scheme share capital of the transferee entity should be held by the public shareholders in the transferor entity is retained in the Circular as it was under the 2009 Circular. While the requirement is meant to ensure requisite participation of public/ retail shareholders in the resultant company, substantial difference in the valuations of the transferor and transferee companies can make compliance with this requirement extremely difficult.

The Circular is a commendable attempt to rationalize the procedure for seeking exemption from the requirements under SCRR and protect the interests of the minority shareholders but the exact scope of the Circular may need more clarity. If the Circular is meant to apply to all Schemes of Arrangement involving listed companies then the drafting ambiguities in the Circular need to be resolved.

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¹ Rule 19(2) (b) of the SCRR deals with the requirements with respect to the listing of securities on a recognized stock exchange: (1)- (2) Apart from complying with such other terms and conditions as may be laid down by a recognised stock exchange, an applicant company shall satisfy the stock exchange that:-i)-ii)-iii)-. At least 10 per cent of each class or kind of securities issued by a company was offered to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted subject to the following conditions: (a) minimum 20 lakh securities (excluding reservations, firm allotment and promoters' contribution) was offered to the public; (b) the size of the offer to the public, i.e., the offer price multiplied by the number of securities offered to the public was minimum Rs. 100 crores; and (c) the issue was made only through book building method with allocation of 6 per cent of the issue size to the qualified institutional buyers as specified by the Securities and Exchange Board of India.

India: Provided that if a company does not fulfil the conditions, it shall offer at least 25 per cent of each class or kind of securities to the public for subscription through advertisement in newspapers for a period not less than two days and that applications received in pursuance of such offer were allotted: Provided further that a recognised stock exchange may relax any of the conditions with the previous approval of the Securities and Exchange Board of India, in respect of a Government company within the meaning of section 617 of the Companies Act, 1956 (1 of 1956), and subject to such instructions as that Board may issue in this behalf from time to time.

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