

PE 'handshake' deals rise after SEBI ban on superior voting rights

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MUMBAI: Private equity (PE) funds are structuring their deals with promoters differently, after the recent SEBI guidelines prohibiting listed companies from issuing shares with superior voting rights or dividends.

Till now, PE funds, usually secured their exit price by way of a 'put option' arrangement with the company. Under this, the company would buy back the PE fund's holding at a mutually agreed internal rate of return (IRR).

However, the recent regulatory amendment renders this structure invalid for listed companies. PE funds are now said to be looking to enter into separate MoUs with promoters whereby after a specified period of investment, the promoter can buy back the shares at an agreed IRR. The difference being that earlier exit options used to be structured with obligation on the company and/or the promoter. Now, the obligation is only on the promoter.

However, experts believe that legally, such 'handshake deals' as they are termed, are likely to hit a roadblock if they were to go awry.

"Such 'handshake deals' could be in direct contravention of the SCRA and are liable to attract a penalty of up to Rs 25 crore. They also have a very low probability of enforceability," says Kartik Ganapathy, Partner, Nishith Desai Associates, told ET.

Reiterating this, Akhil Hirani, partner, Majmudar and Co, points out that a structure, which is contrary to regulatory provision, is unlikely to be enforced by a court.

A 'put' option means an option holder (in this case the PE fund) has the right to require the other party, namely the option grantor (in this case company/promoter), to buy shares held by the option holder on the occurrence of certain events and on the basis of a pre-agreed or target IRR. In other words, the option grantor has the obligation to buy the shares put to him by the option holder. 'Put' options are also viewed as providing exit routes to the investor under these circumstances where the promoter fails to achieve other exit routes for the investor, such as public listing of the investee company through an initial public offering, etc.

People familiar with the issue told ET that several such deals have taken place in the domestic PE space. For instance, a leading corporate with a presence in the PE space recently inked one such deal with an infrastructure company. The fund has bought 8-9% in preferred capital at a stipulated price with a 'put' option against the promoter.

"These arrangements, or deals, are creative solutions to mitigate risk. However, since pure commercial considerations are driving these deals, very rarely will these deals end up in court. So, enforcement may not be an issue to contend with," said the head of a leading domestic PE company.

"Globally, shares with differential voting rights (superior or inferior) are quite common. However, in India, not many companies have used this route, primarily due to lack of awareness," SMC Capital's equity head Jagannadham Thunuguntla told ET. "More than preventing issue of fresh shares with superior rights, the amendment is about allowing firms to come out with shares with inferior rights," he added.

Closer home, companies that have issued DVR shares are Tata Motors and Pantaloon Retail. Overseas — in the US — DVR shares have been issued by Google, Ford and Berkshire Hathaway.