

M&A Hotline

March 16, 2010

NO TAKEOVER EXEMPTION IN RE: CITADEL REALTY AND DEVELOPERS LIMITED

INTRODUCTION

The question of whether an exemption from making a mandatory public announcement under Regulation 11(2)¹ of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (“**Takeover Regulations**”) pursuant to a preferential allotment can be granted in case of a financially sound company was discussed by Securities and Exchange Board of India (“**SEBI**”) in its recent order dated February 17, 2010 in the matter of Citadel Realty and Developers Limited (“**TargetCompany**”)².

BACKGROUND AND FACTS:

Marathon Realty Private Limited (“**Acquirer**”), one of the promoters of the Target Company held 26.51% equity shares and the promoter group cumulatively held 61.29% equity shares in the Target Company. Fibre Box (Bombay) Private Limited (“**FBPL**”), an associate company of the Acquirer had placed an inter-corporate deposit (“**ICD**”) of Rs. 73,80,000 with the Target Company and the Acquirer had infused a sum of Rs. 21,20,081/- over a period of time for meeting with day-to-day expenses of the Target Company. The Target Company proposed to allot 5,93,755 equity shares at a price of Rs. 16.41/- per equity share for an aggregate sum of Rs. 97,43,520/- to the Acquirer as consideration for retiring the ICD provided by FBPL as well as repaying the money advanced to the Company by the Acquirer.

Upon the proposed preferential issue of equity shares, the Acquirer's shareholding could increase to 36.98% i.e. 10.47% higher than the actual holding and the promoter group's cumulative shareholding could increase to 66.81% i.e. 5.52% higher than the actual holding, thereby triggering Regulation 11(2) of the Takeover Regulations.

In view of this proposed arrangement, the Acquirer filed an application dated September 1, 2009, with SEBI under Regulation 3(1)(l)³ read with Regulation 4(2) seeking exemption from the applicability of Regulation 11(2) of the Takeover Regulations on the following grounds:

- That the acquisition of further equity shares by the Acquirer would not involve change in control of the Target Company, and that the same would also not result in breach of minimum public shareholding of 25% under the listing agreement.
- That the acquisition of further equity shares would help the Target Company (i) to increase its reserves; (ii) to have a positive network; (iii) to undertake diversified real estate activities with the help of and in collaboration with the Acquirer; (iv) provide reasonable returns to the shareholders in the years to come; and
- The acquisition of shares in this manner by the Acquirer, will be in the interest of the public shareholders.

ANALYSIS

Prior to the amendment in September 2002, preferential allotments were exempted from the application of the Takeover Regulations. However, post the amendment, SEBI has been giving exemptions from mandatory public announcement requirements on a case to case basis.

In the present case, the Target Company is neither a sick company nor has it shown an inability to raise finance from other sources to pay off the ICD. Further, the Acquirer has not made out a case justifying that such a preferential allotment would indeed be in the interest of the public shareholders.

From the publicly available facts of the case, it seems that the terms of the ICD may not have entitled the ICD holder to the option of converting the ICD into equity shares of the Target Company. Had this option been part of the terms of the ICD, it would have been a publicly known fact (since such terms would have been disclosed to the public through the stock exchange). Consequently, this fact could have been used as a stronger reason to justify to SEBI that there was indeed no change in control as the public would already have factored the implication of conversion of the ICD into equity shares.

RECOMMENDATION OF THE TAKEOVER PANEL AND SEBI ORDER

Upon SEBI forwarding the application to the Takeover Panel, the Takeover Panel in its report observed that the Target Company is not a sick company, and that preferential allotment per se is not eligible for automatic exemption under Regulation 3 of the Takeover Regulations. Further, it was also observed that the proposal of preferential allotment was not in the interest of the public shareholders and therefore the application warranted rejection.

SEBI, after considering the recommendations of the Takeover Panel and the submissions by the Acquirer, rejected

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the exemption application on the following grounds:

a. Preferential Allotment of shares is not exempted automatically from the applicability of Chapter III of the takeover Regulations. Such an exemption is granted on a case to case basis and in the present case, the Target Company has neither been declared a sick company nor is the repayment of ICD to FBPL under any corporate debt restructuring scheme.

b. The proposal of preferential allotment is not in the interest of public shareholders.

CONCLUSION

SEBI has been granting exemptions from open offer in case of preferential allotment in the past such as in Secur Industries Limited⁴ especially to provide some succor to companies undergoing liquidation or financial hardship. In the matter of Secur Industries, SEBI, after giving due regards to the poor performance and financial condition of the target company in the past financial years, had granted exemption from making the mandatory public announcement for the acquisition of shares.

However, in the matter of Citadel Realty, it appears that no convincing argument was made by the promoters to SEBI for obtaining the exemption. As a matter of conjecture, it is possible that SEBI may have considered the above proposal if the Target Company was a sick company, or that repayment of the ICD to FBPL was the result of a duly approved corporate debt restructuring scheme, or as hypothesized above if the ICD was a convertible instrument.

- Sahil Shah & Vaidhyanadhan Iyer

1 Regulation 11(2) of the Takeover Code warrants a mandatory public announcement where an acquirer together with persons acting in concert is holding 55% or more but less than 75% of shares or voting rights and wants to acquire additional shares either by himself or through persons acting in concert.

2 The said application was made by the Target Company on behalf of the promoter under Regulation 3(1)(f) read with Regulation 4(2) of the Takeover Regulations.

3 Regulation 3(f) is a residual cause under which exemption may be sought from the applicability of mandatory public announcement requirements under Chapter III of Takeover Regulations.

4 Hotline dated July 29, 2009 titled 'Takeover Exemption by SEBI for Secur Industries Ltd'.

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