M&A Hotline

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'GOING PRIVATE' TRANSACTIONS: SET FOR A BOOST?

- SEBI introduces amendments to the delisting framework;
- Threshold limit for a successful delisting offer revised;
- Price discovery mechanism changed;
- Timeline for delisting process shortened;
- Direct delisting pursuant to an open offer allowed;
- Exemption provision from strict compliance introduced;
- Additional onus on the Board of Directors of the companies;
- Use of stock exchange platform allowed; and
- Thresholds for application of special provisions to small companies revised.

INTRODUCTION

The Securities and Exchange Board of India ("**SEBI**") finally notified the SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2015 ("**Amendment Regulations**") on March 24, 2015 introducing certain path breaking changes to the existing delisting framework in India.

Since the notification of the SEBI (Delisting of Equity Shares) Regulations, 2009 ("**Delisting Regulations**"), SEBI had received several representations from market participants highlighting challenges faced in delisting process in India and various suggestions to address those concerns. Last year, SEBI had released its discussion paper on 'Review of Delisting Regulations' ("**Discussion Paper**") to review and revamp the framework contained in the Delisting Regulations. Thereafter, SEBI in its Board meeting held on November 19, 2014 ("**Board Meeting**") had broadly approved the amendments to the Delisting Regulations. Please click here to view our alert on the key amendments approved in the Board Meeting.

Traditionally, delisting of shares has not been encouraged in India since it was perceived to affect negatively the depth and liquidity of the stocks. However, over time, it was realized that in a market driven economy and an overall liberalized environment, the entry and exit from the securities market both should be free from undue barriers so long as minority interests are protected.

Interestingly, in the Discussion Paper, the Committee had observed that that the overall delisting activity had gone down considerably ever since the introduction of the Delisting Regulations[1]. Although off late, lesser number of delistings may also largely be attributed to the buoyant equity market in India. Nonetheless, a need was felt to plug the loopholes in the existing delisting framework to bring it in line with the internationally prevalent practices.

FEATURES OF THE DELISTING REGULATIONS READ WITH THE AMENDMENT REGULATIONS

I. **Who may launch a delisting bid?**

Under the Delisting Regulations, a voluntary delisting could be initiated only by a promoter (i.e. controlling shareholder). However, with the inclusion of the term 'acquirer' in the Amendment Regulations, even an acquirer (as defined under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Regulations**")) may initiate the delisting bid.

II. **Can an acquirer delist pursuant to an open offer under the Takeover Regulations?**

To facilitate direct delisting pursuant to open offers under Regulations 3, 4 and 5 of the Takeover Regulations[2], appropriate amendments have been made in the delisting framework. The Takeover Regulations have also been amended along with the Delisting Regulations with the SEBI notifying the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2015 ("**Takeover Amendment**"). The newly introduced Regulation 5A of the Takeover Regulations sets out that an acquirer may delist the company pursuant to an open offer in accordance with the Delisting Regulations provided that the acquirer declares upfront his intention to delist at the time of making the detailed public statement. Prior to the Takeover Amendment, an open offer under the Takeover Regulations could not be clubbed with a delisting offer making it burdensome for those acquirers who intended to acquire large stakes in listed companies with an intent to take it private in the future. In fact, the Takeover Regulations provided for a one year cool off period between the completion of an open offer under the Takeover Regulations and a delisting offer in situations where on account of the open offer the shareholding of the promoters exceeded the maximum permissible non-public shareholding. This restriction is not affected by the Takeover

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Amendment in that the acquirer will continue to be bound by this restriction if the acquirer's intent to delist the company is not declared upfront at the time of making the detailed public statement.

It is also to be noted that once a competing offer is made, delisting of the company is not permitted. Another important point to bear in mind is that in case of a delisting offer, the completion of the acquisition of shares which triggered the open offer may be completed only after a public announcement is made regarding the success of the delisting offer.

III. **What if the delisting offer made pursuant to an open offer fails?**

In case, the delisting offer made pursuant to an open offer fails, the acquirer would have to make an announcement within 2 working days and then would have to comply with all the requirement of mandatory tender offer under the Takeover Regulations. The acquirer would have to make an application to file the letter of offer with SEBI within 5 working days of such an announcement. Importantly, the offer price shall further stand enhanced by an amount equal to a sum determined at the rate of 10% per annum for the delayed period.

The shareholders who have tendered their shares in the delisting offer will be entitled to withdraw the shares tendered within 10 working days from the date of announcement of failure to delist.

IV. **Are there any additional restrictions on delisting?**

Over and above the existing restrictions under the Delisting Regulations, the Amendment Regulations provide for the following new restrictions:-

- Promoter/ promoter group will not be permitted to propose delisting of equity shares of a company, if any entity belonging to the promoter/promoter group has sold equity shares of the company during a period of six months prior to the date of the board meeting in which the delisting proposal is approved;
- No entity belonging to the acquirer, promoter or promoter group of the company would be permitted to sell shares of the company during the period from the date of the board meeting in which delisting proposal is approved.

V. **When will the delisting bid be deemed successful?**

Under the Delisting Regulations, for a delisting offer to be successful, promoter shareholding post offer was required to reach the higher of (i) 90% of the total issued share capital or (ii) the aggregate pre offer promoter shareholding (along with the persons acting in concert with the promoter) and at least half the offer size. In the past, this provision has proven to be quite onerous for the lack of public participation in delisting in India. In the last 5 years, out of the 9 unsuccessful delisting offers, in case of such 7 offers it was seen that this threshold was not met[3]. Industry players have been advocating lowering of this threshold to a much-attainable limit of 75% promoter shareholding. However, in line with the global standards, SEBI has maintained the threshold limit of 90% under the Amendment Regulations. As per the Amendment Regulations, a delisting offer will be successful only when:-

i. **Promoter Shareholding Limit**: Post offer promoter shareholding (along with the persons acting in concert with the promoter) reaches 90% of the total issued shares of that class; ***and***

ii. **Minimum Public Participation**: At least 25% of the public shareholders holding the shares in *demat mode* as on date of the board meeting participate in the book building process.

Interestingly, SEBI has also introduced a safe harbor provision from the minimum public participation requirement which provides that such requirement shall not be applicable if the acquirer and the merchant banker are able to demonstrate to the stock exchanges that they have delivered the letter of offer to all the public shareholders. SEBI's concerns regarding minimum public participation stem really from the past cases where the acquirers parked their shares by way of offer for sale or institutional placement programme or other arrangements with a certain set of shareholders colluding together to achieve the requisite thresholds for a successful delisting.

VI. **How is the delisting to be priced?**

Previously, under the Reverse Book Building ("**RBB**") mechanism, the highest price at which maximum number of shareholders placed their bids was to be the final offer price. As a natural corollary to this, it was seen that a few investors were able to influence the success of a delisting process since the determining factor under the RBB mechanism was really the price at which maximum number of shareholders tendered their shares and not the price at which shareholders representing a requisite number of shares were willing to exit.

Under the Amendment Regulations, the RBB mechanism has been revised such that now the final offer price shall be determined as the price at which shares are accepted through eligible bids that takes the shareholding of the promoter or the acquirer (along with the persons acting in concert) to 90% of the total issued share capital of that class i.e. *price at which the shareholding of the promoter/acquirer reaches the threshold limit.*

In fact, with a view to completely align the Delisting Regulations with the Takeover Regulations, the Amendment Regulations now provide for the fixation of floor price as under regulation 8 of the Takeover Regulations.

VII. **What are the timelines involved and how has the process changed?**

The timeline involved in the delisting process has been significantly shortened owning to several amendments in the Amendment Regulations. To better illustrate the same, below are the changes brought about to the timelines for completion of delisting process under the Amendment Regulations:

S. No.	Event	Timeline under Delisting Regulations	Timeline under Amendment Regulations
1.	Receipt of in-principle approval from stock exchange.	30 days	5 days
2.	Public announcement to be made upon receipt of in-principle approval from stock exchange.	-	Within 1 working day
3.	Letter of offer to be dispatched to the shareholders from the date of public announcement.	45 days	Within 2 working days

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4.	Opening of offer	Within 55 days	Within 7 days
5.	Bidding period from the date of public announcement.	>3 and <5 days	5 days
6.	Post-offer public announcement.	8 working days	5 working days

VIII. **What will be the platform for transactions under the delisting process?**

One of the major drawbacks of the Delisting Regulations was that RBB process was not cost effective, given that the transaction through tender route attracted capital gains tax. As per the Amendment Regulations, the acquirer/promoter is required to facilitate tendering of shares by the shareholders and settlement through the stock exchange mechanism which shall now only attract the securities transaction tax making the entire delisting process more tax optimized.

IX. **What is the role of the Board of the Company in the entire process?**

Additional onus has been cast on the Board of Directors of the company *as even prior to granting the approval*, it would be required to make a) disclosure to the recognized stock exchanges on which the equity shares of the company are listed that the promoters/acquirers have proposed to delist the company and b) appoint a merchant banker to conduct due-diligence and make a disclosure to that effect to the stock exchange. For the purpose of the due-diligence, the Board would be required to provide to the merchant banker, details of trading in shares and off-market transactions by top 25 shareholders of the company for a period of 2 years prior to the date of the Board meeting. Further, the Board would also be required to certify:

- Company is in compliance with the applicable provisions of securities laws;
- the acquirer or promoter or promoter group or their related entities have not carried out any transaction in contravention of the Delisting Regulations; and
- the delisting is in the interest of the shareholders.

X. **What will be the additional responsibility be on the merchant banker?**

Upon carrying out due-diligence, the merchant banker shall certify the following:

(a) Trading carried out by entities belonging to the acquirer/promoter/promoter group/related entities was in compliance or not, with the applicable provisions of securities law; and

(b) Entities belonging to acquirer/promoter/promoter group/related entities have or not employed any device, scheme or artifice to defraud any shareholder or other person or engaged in any transaction or practice that operates as a fraud or deceit upon any shareholder or any person or engaged in any act or practice that is fraudulent, deceptive or manipulative in connection with any delisting sought or permitted or exit opportunity given or other acquisition of shares.

XI. **What if compliance with Delisting Regulations is not possible?**

Regulation 25A provides for a specific exemption/relaxation from strict enforcement of any of the requirements of the Delisting Regulations, similar to one under the Takeover Regulations or ICDR. SEBI may grant specific exemption from compliance of provisions under the Delisting Regulations, upon an application[4] being made by a promoter/acquirer, if it is of the view that the relaxation is in the interests of the investors in securities and the securities market. This is a welcome change as the SEBI had when approached in the past denied the ability to grant exemption from compliance with the Delisting Regulations citing lack of power under the prevailing legislation[5].

It is to be noted that the provision lays special emphasis upon the principles of natural justice as it provides that SEBI may after granting reasonable opportunity of being heard to the applicant and after considering all the relevant facts and circumstances, pass a reasoned order either granting or rejecting the exemption or relaxation sought.

XII. **Do these provisions apply to small companies?**

Under the Delisting Regulations, any small company qualifying the criteria based on paid up capital, trading history and number of public shareholders may apply for voluntary delisting without following the RBB process. The Amendment Regulations have amended this small company criteria such that now only a company with paid up capital of less than INR 100 Million (which was earlier INR 10 Million) and net worth of not more than INR 250 Million with no trading history for at least a year preceding the date of decision to delist may qualify as a 'small company' for this particular exemption. The other threshold of the company having maximum public shareholders up to 300 in number has been done away with, for the purpose of this exemption.

ANALYSIS

Till date, delisting framework in India has been marred with various shortcomings - the primary concern, amongst others, plaguing the delisting framework in India since the very beginning has been the price discovery mechanism under the Delisting Regulations i.e. the RBB process. The criticism against the RBB process mainly was based on the argument that the RBB process was often exploited by the minority/ public shareholders holding significant stake in order to exercise disproportionate powers to debilitate the price discovery process. Changes now made to the RBB mechanism appear to be more conducive to a fair and reasonable exit mechanism for public/minority shareholders. The thresholds for achieving a successful delisting have been made less onerous under the Amendment Regulations.

SEBI's continued effort to foster an investor-friendly regulatory environment visibly lies in its attempt to make the entire delisting process quicker, less cumbersome and cost-effective. Interestingly, what was visibly a lack of interplay of the various regulations including the Takeover Regulations, Delisting Regulation, ICDR etc. has now been harmonized by way of these amendments. Not to discount the fact that these amendments do come with added burden of responsibilities for the Board of Directors and merchant bankers alike.

A laudable effort towards ensuring a better M&A environment is that SEBI has allowed direct delisting pursuant to an open offer. Execution of take private deals in India has always been difficult given the lack of flexibility to make composite offers under Takeover Regulations as well as Delisting Regulations in India. The Takeover Regulations Advisory Committee[6] had in fact recommended introduction of a provision facilitating direct delisting pursuant to an open

offer which was finally not taken up in the Takeover Regulations. Until now, the only way to make a delisting pursuant to an open offer was to first reduce the non-public shareholding up to 75% within a year in accordance with the Securities Contract Regulation Rules 1957. SEBI's move to allow direct delisting pursuant to an open offer has simplified and reduced the cumbersome take-private process to a single-step mechanism. However, for the take private route to become fully effective, one last milestone i.e. a better framework for minority squeeze out remains to be achieved.

– Tanya Pahwa, Simone Reis & Pratibha Jain
You can direct your queries or comments to the authors

[1] The Discussion Paper revealed that between years 2009 to 2014, a total of 38 delisting offers were made, out of which 29 were successful. As per the Discussion Paper, it was apprehended that in some cases, the success of the offer was due to the tacit understanding between promoters and investors while in cases where the offer failed, it was apprehended that the same was because exit price discovered through the reverse book building ("**RBB**") process was unduly influenced by a set of investors who were speculators.

[2] Regulation 3, 4 and 5 of the Takeover Regulations stipulate open offer obligations in case substantial acquisition of shares or voting rights or acquisition of control of the target company, directly or indirectly.

[3] Discussion Paper

[4] For the purpose of seeking an exemption, the promoter or acquirer or the company shall file an application with the Board along with a duly sworn affidavit, giving details of such exemption and the grounds on which the exemption is sought. The promoter or the acquirer or the company shall along with the application pay a non-refundable fee of rupees fifty thousand, by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board.

[5] In the matter of proposed voluntary delisting of equity shares of Ambattur Enterprises Limited (Formerly Known As T & R Welding Products (India) Ltd.) under SEBI (Delisting Of Equity Shares) Regulations, 2009, available on http://www.sebi.gov.in/cms/sebi_data/attachdocs/1330427984251.pdf

[6] TRAC committee was set up on September 04, 2009 under the chairmanship of Shri. Achutan to review the Takeover Regulations