Touchstone Partners

GREY MATTERS

TAKE PRIVATE DEALS NOW A REALITY IN INDIA?

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Background

The Securities and Exchange Board of India (***SEBI***) has recently notified certain amendments to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the ***Takeover Regulations***) which seek to simplify and streamline the delisting process and pricing regime for control transactions involving Indian listed companies. The recent amendments come on the back of the suggestions made by a sub-group of SEBI's Primary Market Advisory Committee in June this year, which were followed by the proposal being approved by SEBI at its board meeting in late September.

As we explain in this paper, whilst the changes do raise several questions, they are a step in the right direction and raise the prospect of take private deals becoming a reality in the context of Indian listed companies.

Delisting – A Cumbersome and Uncertain Process

Historically, the process of delisting in India has been regulated by a bespoke set of regulations, i.e., the SEBI (Delisting of Equity Shares) Regulations, which were originally framed in 2009 and recently overhauled in June 2021 (the ***Delisting Regulations***), but has been beset with various regulatory and practical challenges:

Overlapping Regulations – In order to successfully delist a listed company under the Delisting Regulations, an acquirer needs to acquire at least 90% of the share capital in the company. On the other hand, a mandatory open offer is triggered under the Takeover Regulations once an acquirer agrees to acquire 25% of the total share capital (or control by other means), in which case the acquirer is required to make an open offer for an additional 26% stake in the company. If the delisting offer under the Delisting Regulations were to fail, whether as a result of the acquirer failing to reach the 90% delisting threshold or otherwise, the acquirer was still required to resume and complete the open offer under the Takeover Regulations, resulting in the acquirer inheriting a listed company.

Pricing Uncertainty – Unlike with an open offer under the Takeover Regulations where the pricing is fixed based on certain specified criteria, the exit price in a delisting offer is "discovered" using an electronic reverse book building process without any ceiling on the maximum exposure for the acquirer. Whilst the acquirer is entitled to make a counter offer, it would have no say in actually determining the exit price and can only either accept or reject the price which is eventually discovered.

Approval Uncertainty – In addition to the approval of the board of directors of the target company, an acquirer is also reliant on securing the approval of a special resolution (i.e., three fourths majority) of the shareholders, with two-thirds of the total number of

votes cast by public shareholders having to be in favour of the resolution.

Potential Sell down – Following a failed delisting offer, if as a result of the triggering acquisition and open offer under the Takeover Regulations, the total public float is reduced below the minimum public shareholding (***MPS***) threshold of 25%, the acquirer would need to ensure that the total non-public shareholding is reduced to 75% or below within 12 months. Given the time bound nature of this obligation as also the limitations imposed by SEBI on the methods which can be adopted to reinstate the MPS, acquirers are often constrained to sell their shares at a discount to the original purchase price. A second delisting offer can be attempted only after the MPS has been restored.

Not surprisingly, there have been no notable instances of control transactions involving third-party acquirers resulting in a successful delisting of the underlying target company.

Recent Amendments – A Glass Half Full

The recent amendments to the Takeover Regulations seek to enable incoming acquirers to make an initial consolidated delisting and takeover offer at a fixed price, thereby mitigating the associated pricing uncertainty. The reference to "indicative price" under the amended rules is somewhat confusing, but the intention appears to be to exempt such offers from the price discovery process under the Delisting regulations. However, acquirers are mandated to factor in a suitable premium that they are willing to pay for the delisting offer, over and above the takeover offer price (i.e., which would apply if the delisting offer were to fail) as well as the book value of the company. Whilst the distinction between "delisting premium" and "control premium" is understandable, the reference to book value appears to be an overreach, especially in the context of frequently traded stocks.

Crucially, the new rules provide an extended timeframe for acquirers to comply with the MPS requirement in case the initial delisting offer were to fail but the acquirer were to nonetheless breach the MPS threshold as a result of the takeover offer. An incoming acquirer would now have a period of 12 months following a failed delisting offer to attempt a second delisting offer (albeit at the discovered price under the Delisting Regulations), and only in case of failing to delist the company within such timeframe, it would be required to sell down to 75% or lower to restore the MPS within a further period of 12 months.

On the flip side, the new rules are loaded against incumbent promoters and controlling shareholders, who are prevented from using the consolidated mechanism under the Takeover Regulations to delist a company, and would therefore necessarily need to pursue the price discovery process under the Delisting Regulations. Any move to allow incumbents to benefit from the new rules would likely mean having to dispense with the Delisting Regulations altogether. Having said that, the exclusion of even persons who are "directly / indirectly associated with the promoter or any person(s) in control" seems unwarranted. Such a broad exclusion could potentially come in the way of bona-fide shareholder arrangements, which could be necessary, for example, in situations where the delisting offer fails and the third-party acquirer is forced to scale down the shares to be acquired from the incumbent promoter.

Another unintended consequence is the lack of clarity on the applicability of the more elaborate process under the Delisting Regulations. Rather confusingly, the new rules expressly provide that all the provisions of the Delisting Regulations would apply equally to any attempt at delisting under a consolidated offer under the Takeover Regulations. The timeframe and requirements for a delisting offer under the Delisting Regulations are rather different (and in certain respects, overlapping) with those involved in an open offer under the Takeover Regulations. An acquirer cannot be expected to first comply with all the requirements under the Delisting Regulations and then have to comply with the open offer related requirements under the Takeover Regulations in case the delisting offer were to fail. Indeed, the SEBI

committee had expressly flagged the uncertainty and complications arising from such sequential requirements.

The new rules should be clarified to require consolidated offers to comply with the provisions of only the Takeover Regulations. The additional delisting requirements should be limited to seeking the approval of the shareholders of the target company by way of a special resolution and the in-principle and final approvals of the stock exchanges. Consistent with the recommendations of the SEBI committee, the "majority of minority" rule should be amended to require the affirmative approval of only a simple majority (as opposed to a two-thirds majority) of the public shareholders who vote on the proposal.

Concluding Thoughts

The move to rework the directionally contradictory approaches involving the Takeover Regulations, MPS requirement and the Delisting Regulations was long overdue and is indeed a welcome step. The added feature of pursuing a delisting offer at a fixed price should provide acquirers with greater visibility on the potential outlay involved in acquiring listed targets in India. Whilst there can be no certainty of ensuring a successful delisting, financial and strategic acquirers alike should be enthused with the extended timeframe provided by the new rules to reach the delisting threshold.

One hopes that the procedural irregularities under the new rules can be addressed sooner rather than later. Depending on the success of delisting offers under the new regime, it may not be inconceivable to have a consolidated set of regulations governing takeover and delisting offers, with incumbent promoters and controlling shareholders being eligible to the same delisting process as incoming acquirers.

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