

SEBI enhances role of Stock Exchanges and Independent Directors for Schemes of Arrangement involving Listed Companies

The Securities and Exchange Board of India ('SEBI') vide its Circular dated 3 November, 2020 ('Circular') has further streamlined the processing of draft scheme involving a listed company which is filed with SEBI for seeking its 'No Objection' to the proposed arrangement summarized therein.

Additionally, SEBI vide the Circular has enhanced the role of the Independent Directors wherein the capital market regulator has said that the Independent Directors must ensure that the interest of the minority shareholders is not adversely impacted as a result of implementation of the Scheme of Arrangement.

SEBI has further empowered the Stock Exchange by amending the Circular No CFD/DIL3/-CIR/2017/21 dated March 10, 2017 (further amended vide SEBI Circular dated 23 March, 2017, 03 January, 2018 and 12 September, 2019 respectively) which lays down the framework for Scheme of Arrangement by Listed Companies.

Background

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, ('LODR') read with Circular No CFD/DIL3/-CIR/2017/21 dated March 10, 2017 provides that Scheme of Arrangement ('Scheme') involving Listed Companies must be filed with all the Stock Exchanges (where shares of the Company are listed) for seeking their observations before such Scheme is filed with jurisdictional bench of the National Company Law Tribunal ('NCLT').

The LODR regulations further provide that the draft Scheme filed with the Stock Exchange should also be forwarded to SEBI for their observations and comments.

Basis review of the Scheme and after consultation with SEBI, the respective Stock Exchanges are required to issue their Observation Letter/ No Objection Certificate to the Scheme of Arrangement which is required to be filed with NCLT along with the Scheme.

In order to further strengthen the processing of the draft scheme by SEBI/Stock Exchange and to ensure that draft Scheme are in compliance with applicable SEBI regulations, guidelines as laid down by the Circular dated March 10, 2017 has been further amended as under:

Amendments:

Para Reference	Amendments Made	RBSA Comments
Para I A (2)- Submission of Documents -Sub Para 2(c)	<p><i>Report from the Audit Committee recommending the Draft Scheme, taking into consideration, inter alia, the Valuation Report. The Valuation Report is required to be placed before the Audit Committee of the listed entity. The Audit Committee report shall also comment on the following:</i></p> <p>A) Need for merger/demerger/ amalgamation/arrangement; B) Rationale of the Scheme; C) Synergies of business of the entities involved in the Scheme; D) Impact of the Scheme on the Shareholders; E) Cost benefit analysis of the Scheme</p>	<p>The Amendment has enhanced the role of the Audit Committee wherein the Committee will now be required to comment upon the commercial rationale behind undertaking the Scheme as part of their report and as to how the same will be beneficial for the Company.</p>
Para I A (2)- Submission of Documents Insertion of Sub Para I A (2) (i)	<p><i>Report from the Committee of Independent Directors recommending the draft Scheme, taking into consideration, inter alia, that the scheme is not detrimental to the shareholders of the listed entity.</i></p>	<p>The Amendment puts the onus on the Independent Directors wherein they too like the Audit Committee Members will have to review the Scheme from the perspective of ensuring that the interest of the minority shareholders is not getting adversely impacted because of the Scheme.</p> <p>This is a welcome amendment as report of the Independent Directors will give a much-needed comfort to the minority shareholders who are generally apprehensive about the well being of their investments whenever a Scheme of Arrangement is being proposed.</p>
Para 4 (a) – Valuation Report	<p><i>All listed entities are required to submit a valuation report from a Registered Valuer.” For the purpose of this clause, the Registered Valuer shall be a person, registered as a valuer, having such qualifications and experience and being a member of an organization recognized, as specified in Section 247 of the Companies Act, 2013 read with the applicable Rules issued thereunder</i></p>	<p>As per the Amendment, all Listed Companies are required to now obtain the Valuation Report from a Registered Valuer.</p> <p>Earlier, the valuation report was required from an Independent Chartered Accountant.</p> <p>The Amendment is in line with the requirements of Section 230(2)(c)(v) of the Companies Act, 2013 which provide that in case of a Compromise or Arrangement, valuation report in respect of shares, property or assets (tangible or intangible) or share swap ratio will be obtained from a Registered Valuer only.</p>
Para 9- Approval of Shareholders to Scheme through e-Voting Explanation to A (9) (b) (v)	<p><i>For the purpose of this clause, the expression “substantially the whole of the undertaking” in any financial year shall mean twenty percent or more of value of the company in terms of consolidated net worth or consolidated total income during previous financial year as specified in Section 180(1)(a)(ii) of the Companies Act, 2013. For the purpose of this clause, the term ‘public’ shall carry the same meaning as defined under Rule 2 of Securities Contracts (Regulation) Rules, 1957.</i></p>	<p>The Amendment is more clarificatory in nature which rectifies an incorrect reference to Section 180(a)(i) of the Companies Act, 2013 as provided earlier.</p> <p>Vide the said amendment and in line with intent of the Explanation, reference to the definition of “substantially the whole of the undertaking” as provided in Section 180(a)(ii) of the Companies Act, 2013 has been made.</p>
Para B (4) – Obligations of Stock Exchange	<p><i>Stock Exchanges shall provide the ‘No-Objection’ letter to SEBI on the draft scheme; in co-ordination with each other.</i></p> <p><i>SEBI shall issue Comment letter upon receipt of “No-Objection’ letter from Stock Exchanges having nationwide trading terminals.</i></p> <p><i>In other cases, SEBI shall issue Comment letter upon receipt of “No-Objection’ letter from the Designated Stock Exchange.</i></p>	<p>The Stock Exchanges are now required to issue the No-Objection letter to SEBI on the Draft Scheme as compared to an Observation Letter/ No Objection Letter which was required earlier.</p> <p>SEBI shall issue its comments on the Scheme only once a ‘No- Objection’ letter has been received from the Stock Exchanges stating its observations and comments as to whether the Scheme is in compliance with applicable SEBI Regulations/Rules</p>

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Para C (1) & C (2c)- Process- ing of the Draft Scheme by SEBI	<p>The words 'Observation letter or' in Para C(1) and Para C(2c) stand deleted</p>	<p>The said amendment is more consequential in nature on account of the amendment made to Para B(4) as mentioned above</p>
Para III - Application for relaxation under Sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957 Sub- Para A (5)- Requirements to be fulfilled by Listed Entity for Listing of Equity Shares	<p><i>It shall be ensured that steps for listing of specified securities are completed and trading in securities commences within sixty days of receipt of the order of the Hon'ble High Court/NCLT, simultaneously on all the stock exchanges where the equity shares of the listed entity (or transfer entity) are/were listed.</i></p> <p><i>Before commencement of trading, the transferee entity in addition to disclosing the information in the form of an information document on the website of the stock exchange/s shall also give an advertisement in one English and one Hindi newspaper with nationwide circulation and one regional newspaper with wide circulation at the place where the registered office of the transferee entity is situated, giving following details:"</i></p> <ol style="list-style-type: none"> <i>a) Name of the Company;</i> <i>b) Address of Registered Office and Corporate Office of Company;</i> <i>c) Details of change of name and/or object clause;</i> <i>d) Capital structure – pre and post scheme of amalgamation. This shall provide details of the authorized, issued, subscribed and paid up capital (Number of instruments, description, and aggregate nominal value);</i> <i>e) Shareholding pattern giving details of its promoter group shareholding, group companies – pre and post scheme of amalgamation;</i> <i>f) Names of its ten largest shareholders – number and percentage of shares held by each of them, their interest, if any;</i> <i>g) Name and details of Promoters – educational qualifications, experience, address;</i> <i>h) Name and details of Board of Directors (experience including current / past position held in other firms);</i> <i>i) Business Model / Business Overview and Strategy;</i> <i>j) Reason for the amalgamation;</i> <i>k) Restated Audited Financials for the previous three financial years prior to the date of listing;</i> <i>l) Latest restated audited financials along with notes to accounts and any audit qualifications. (Financial statements should not be later than six months prior to the date of listing);</i> <i>m) Change in accounting policies in the last three years and their effect on profits and reserves;</i> <i>n) Summary table of contingent liabilities as disclosed in the restated financial statements;</i> <i>o) Summary table of related party transactions in last 3 years as disclosed in the restated financial statements;</i> <i>p) Details of its other group companies including their capital structure and financial statements;</i> <i>q) Internal Risk Factors (Minimum 5 and Maximum 10);</i> <i>r) Outstanding litigations and defaults of the transferee entity, promoters, directors or any of the group companies;</i> <i>s) Regulatory Action, if any – disciplinary action taken by SEBI or Stock Exchanges against the Promoters in last 5 financial years;</i> <i>t) Brief details of outstanding criminal proceedings against the Promoters;</i> <i>u) Particulars of high, low and average prices of the shares of the listed transferor entity during the preceding three years;</i> <i>v) Any material development after the date of the balance sheet; and</i> <i>w) Such other information as may be specified by the Board from time to time.</i> 	<p>Vide the said amendment, Companies seeking relaxation under Rule 19(7) of the Securities Contracts (Regulation) Rules, 1957, additional details have been prescribed which are to be included in the newspaper advertisement to be published by the Company before commencement of trading of securities along with disclosing the information in the form of an information document to be disclosed on the website of the Stock Exchanges.</p> <p>Key additional information which are now required to be disclosed include details around internal risk factors, regulatory action, if any – disciplinary action taken by SEBI or Stock Exchanges against the Promoters in last 5 financial years, brief details of outstanding criminal proceedings against the Promoters.</p>

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Para III (B)- Application by a listed entity for Listing of Equity Shares with Differential Rights as to Dividend, Voting or Otherwise:	<i>Para III B of Annexure I to the Circular shall stand repealed.</i>	Vide the Amendment, the relevant provisions providing for relaxations from strict compliance with IPO requirements under Securities Contracts (Regulation) Rules, 1957 for listing of equity shares with differential voting rights have been removed.

The above - mentioned amendments, except the amendments made to Para III (A)(5) shall be applicable for all the Scheme filed with the Stock Exchange after 17 November, 2020. Where as the amendment made to Para III (A)(5) shall be applicable for all the listed companies which are seeking listing/or trading approval for the securities from the Stock Exchange after 3 November, 2020.

Key Takeaways:

The Amendments made by SEBI (except the one which are clarificatory/consequential in nature) aim at making the process of approving the Scheme more robust to ensure that there is strict adherence to the SEBI Rules and Regulations governing Scheme of Arrangement involving Listed Companies. As a result of the above amendments, Independent directors will now play a very crucial role during the approval process of the Schemes by the Companies wherein they will have to give their sign off to the Scheme without leaving any room of doubt as far as the viability of the Scheme is concerned for the minority shareholders.

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