

Delisting made easier: SEBI amends the delisting norms

Introduction

The Indian securities market regulator, Securities Exchange Board of India (“SEBI”) has overhauled the regulatory norms for voluntary delisting in India. Delisting of Indian companies is governed by the SEBI (Delisting of Equity Shares) Regulations, 2009 (“**2009 Regulations**”). SEBI had publicly announced the proposed changes to these regulations on November 19, 2014. However, the amendments have been notified only on March 24, 2015 with immediate effect. SEBI’s intent behind these changes has been two-fold i.e. to make the cumbersome delisting process easier for companies and to simultaneously align it with the investors’ interests.

This newsletter discusses the recent revisions to the 2009 Regulations carried out through the SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2015 (“**2015 Amendment**”) and analyzes the impact on the delisting process, including the pros and cons for companies as well as investors.

1. Reasons for voluntary delisting

Delisting of securities is essentially a business decision that companies take based on commercial considerations. They opt to delist their securities for eliminating ongoing costs associated with listing (*such as annual listing fee, fee payable to share transfer agents*), and dispense onerous compliances under listing agreements. Promoters may want to delist the securities in order to increase their shareholding and acquire full control over the company’s affairs. Further, lack of trading on stock exchange is another reason which makes continuous listing pointless. Under the 2009 Regulations, delisting is a complex process that requires approvals from the board of directors, shareholders, and concerned stock exchange. Apart from the corporate and stock-exchange approvals, the process involves various other steps such as appointment of merchant banker who, in turn, is responsible for determining floor price and final price, opening of escrow and special bank accounts, making public announcements, issuing offer letters, tendering shares, and transfer of consideration.

2. Changes under the 2015 Amendment and impact

After enactment of the 2009 Regulations, India Inc. witnessed only 38 delisting offers out of which 29 were successful, 7 offers failed as minimum number of shares were not tendered, and in remaining 2, the offer price was rejected by the acquirer.¹ On the other hand, the number of listed companies has constantly been on a rise with 5,650 companies listed on BSE as on April 24, 2015.² Total delisting offers and successful delistings in the last 5 years

¹ This information is captured in paragraph 7 of SEBI’s discussion paper on “Review of Delisting Regulations” dated May 09, 2014

² The total number of BSE listed companies is available at <http://www.bseindia.com/> last accessed on April 24, 2015

have thus been very low which indicates that Indian companies find it difficult to delist. The major challenges faced can be attributed to high shareholders' bid prices resulting in exorbitant final offer price, low shareholders' participation in book building process, and lengthy timelines associated with completing delisting.³ In the wake of these challenges, the 2015 Amendment aims at facilitating delisting and has introduced substantial changes to simplify the 2009 Regulations. The key changes are as follows:

(a) *Reduction in timelines:* The 2009 Regulations provided lengthy statutory timelines for completing various steps. The 2015 Amendment has reduced the maximum time involved in grant of in-principle approval by stock exchange, delisting public announcement after stock exchange approval, dispatch of offer letters, opening of the offer, and final announcement regarding outcome of such offer. Thus, the maximum time within which the above steps must be completed has been reduced to approximately 20 days as against 138 days under the 2009 Regulations.

(b) *Changed thresholds for successful offer:* The threshold for a successful delisting offer has been changed. Under the 2009 Regulations, delisting was successful if post-delisting the total promoter shareholding⁴ was higher of either 90% of the issued share capital or aggregate of pre-offer promoter shareholding and 50% of offer size. The 2015 Amendment has revised the threshold to 90% of the issued share capital. Further, a new condition is added which requires that at least 25% of public shareholders holding demat shares must participate in the book-building process.⁵

(c) *New responsibilities for board of directors:* The 2015 Amendment imposes new responsibilities on the boards of companies. Per Regulation 8(1A), the board has to (i) disclose the delisting proposal to the stock exchange and appoint merchant banker for due diligence; and (ii) furnish details of trading and off-market transactions of top 25 shareholders to the merchant banker and, provide additional information, as and when sought by them. There was no such obligation under the 2009 Regulations. Additionally, upon receipt of the merchant banker's due diligence report the board must certify and confirm that the company is compliant with securities laws, has not participated in any fraudulent practice concerning any earlier delisting scheme to deceive shareholders, and the proposed delisting is in shareholders' interest.

(d) *Tendering shares through stock exchange:* The 2009 Regulations did not provide any specific mechanism for tendering shares which was carried out on an off market basis. The 2015 Amendment requires the acquirer to enable tendering and settlement of public shares through specified stock exchange mechanism.⁶ Now, a separate window for acquiring shares during delisting would be provided by stock exchanges having nationwide trading terminals.⁷ Orders for buying and selling of shares would be placed through stock brokers and execution and final settlement of the trades would be facilitated by clearing corporations. The public

³ Ibid

⁴ Promoter shareholding will include shares held by persons acting in concert and shares acquired from public through the delisting offer. However, this will exclude shares held by custodian and overseas depository receipts

⁵ Book building process as prescribed under Schedule II of 2009 Regulations is used to determine the final purchase price at which promoters will acquire shares from public

⁶ See Regulation 13(1A)

⁷ The new mechanism is provided in SEBI circular dated April 13, 2015

announcement during delisting must contain details of the stock broker, acquisition window and the clearing corporation.

(e) *Relaxation from strict compliances:* The 2009 Regulations did not allow any exemptions from compliance with the conditions contained therein which is in contrast with the 2015 Amendment that now enables SEBI to relax strict enforcement of delisting regulations in certain instances, provided that the relaxation is in “interest of investors and securities market”.⁸ However, this phrase is nowhere defined. For seeking exemption, an acquirer may make an application to SEBI with a non-refundable fee of INR 50,000 (US\$ 806 approximately⁹) and an affidavit giving details of and reasons for the exemption sought. The scope of this provision is wide since SEBI’s power to grant relaxation is completely discretionary in the absence of any existing guidelines in this regard. Thus, each application will be determined on a case to case basis.

(f) *Other key changes:* The 2015 Amendment has added new disqualifications for delisting. Unlike the 2009 Regulations, now according to regulation 4(1A), a listed company cannot propose to delist, if the promoter or promoter group has sold equity shares within 6 months prior to the date of board meeting in which delisting proposal is approved. Further, the method of determining the final offer price has also been amended. Now, the final price will be such price as quoted in eligible bids at which the promoter shareholding increases to 90% of the total issued share capital. Earlier, the final offer price was the price at which maximum shares were tendered during delisting.

Given that the changes are about a month old, completion of delisting offers under the new regime is yet to be tested. The change promises faster completion of delisting process due to significant reduction in statutory timelines and streamlining of the process. However, no specific timeline has been prescribed for submission of merchant banker's due diligence report and SEBI's decision regarding grant of relaxation from compliances. This may cause delays in the delisting process. Use of stock exchange as a platform for tendering shares will ensure increased transparency and, hopefully, increased shareholders' participation. Selling shares through stock exchange would also bring in tax benefits to investors in the form of lower taxes on capital gains arising from such sale and, thereby, motivate them to participate in the delisting. Any sale of share otherwise than through stock exchange, is liable for long term capital gains tax at 20% and short term capital gains tax at applicable slab rates. However, when shares are sold through stock exchange, short term capital gains is taxed at 15% and long term capital gains is exempted from any tax liability. Prior to the 2015 Amendment, the final offer price was that at which maximum shares were tendered. This led to shareholders grouping together with a common understanding to charge exorbitant prices and extremely high bids were placed with the motive of making huge profits through delisting. Though promoters can exercise their option not to accept the final price, the delisting is deemed, per regulation 19, to have failed in case of rejection of final price. However, the new method for computation of final price safeguards interest of acquirers and aims at preventing manipulation by shareholders.

⁸ See Regulation 25A

⁹ 1 US\$ = INR 62

From a shareholders' perspective, the major prickly point was the practice of promoters transferring shares to acquaintances few months prior to delisting and re-purchasing them at favorable price during the delisting offer. Clearly, the consequential outcome was absence of a fair exit price which defeats the objective of book building process. The prohibition on trading by promoters 6 months prior to delisting aims at preventing such practice.

3. Interplay with Takeover Regulations

Simultaneous to the 2015 Amendment, SEBI amended the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**Takeover Code**”) *vide* SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2015, notified on March 24, 2015 with immediate effect. This amendment allows voluntary delisting pursuant to an open offer under the Takeover Code. Under the Takeover Code, voluntary delisting was prohibited for 12 months after an open offer even if an acquirer’s shareholding exceeded 75% of the issued share capital pursuant to open offer. It was mandatory for the company to take remedial steps for bringing down non-public shareholding which forced acquirers desirous of delisting to sell their shares after completion of the open offer. Pursuant to the March amendment, an acquirer can declare its intent to delist a target company at the time of making a detailed public statement of the open offer.¹⁰ The provisions now stipulate that the underlying transaction which triggers the open offer requirement will not be effective unless delisting is successful under the 2009 Regulations.¹¹ In the event that delisting fails, Regulation 5A(2) mandates the acquirer to make a public announcement to that effect within 2 days and proceed with the open offer process. Thus, takeover and delisting can take place in a composite manner. For any acquirer if the eventual business objective is to manage an unlisted company, the failure of the delisting could impact consummation of the primary transaction. Delisting during takeover under the 2009 Regulations substantially deterred M&A transactions as the time involved stretched on for months at large due to the complexities in delisting process under 2009 Regulations and the associated 12 months’ prohibition on delisting after the open offer. In this light, changes under the 2015 Amendment are expected to reduce time involved, streamline the process and bring higher accountability which will facilitate and boost M&A transactions.

Conclusion

The 2015 Amendment aims at striking a balance between a company’s commercial need to delist and protect the interest of public shareholders. It not only brings about amendments to simplify the delisting process, but also incorporates new obligations to ensure fair conduct by the board of directors and promoters. Permitting delisting pursuant to open offers is also a welcome step and may act as impetus for M&A activities in India. However, certain aspects such as timeline for submission of merchant banker’s report, grant of exemption by SEBI etc. may require further clarifications through SEBI directions to ensure smooth and effective delisting.

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¹⁰ See Regulation 5A(1) of the Takeover Code

¹¹ See Proviso to Regulation 22(1) of the Takeover Code