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Insolvency Resolution of Listed Companies – SEBI Introduces Exemptions

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Between 31 May to 1 June, the Securities and Exchange Board of India (SEBI) amended a number of securities regulations to provide certain dispensations for listed companies undergoing the corporate insolvency resolution process (CIRP) under the Insolvency and Bankruptcy Code 2016 (IBC).

These amendments follow SEBI's discussion paper of March 2018, which set out specific proposals for adjusting the regulatory framework to allow listed companies to comply with their obligations under securities laws.

This note discusses certain key points with respect to these amendments.

CROSSING THE PUBLIC FLOAT LIMIT

The latest amendment to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Regulations) will allow the buyer in an IBC resolution plan to acquire more than 75% of the relevant listed company. This amendment complements another amendment in August 2017, which exempted acquisitions pursuant to IBC resolution plans from the mandatory open offer obligations of the Takeover Regulations.

Acquisitions beyond 75% of a listed company are generally restricted because of the 'public float' rule, which requires at least 25% of every listed company's shares to be in public (i.e. non-promoter) hands. However, in a financial distress situation (e.g. under the IBC) the value of a listed company is extremely depressed and any investment of new equity, or conversion of existing debt into equity, is going to significantly dilute the holdings of existing shareholders.

With this amendment, further consolidation beyond 75% is now permitted. For example, Tata Steel, which received only 72% in exchange for its initial investment into Bhushan Steel, can now invest the additional INR 45 billion contemplated under its IBC resolution plan and take its holding to 98%.

Two additional points should be noted here.

First, given that the text of the amendment refers to "*acquisition pursuant to a resolution plan*", the benefit of the amendment should be available to all IBC resolution plans, including plans approved prior to the amendment. If, however, a particular resolution plan did not explicitly contemplate a debt-for-equity conversion or future investment of additional equity, the amendment may not help.

And second, SEBI has not provided any additional dispensation for the maximum time within which the public float must be restored, so the default period of one year would still apply. In certain cases, one year may not be enough to bring about a turnaround of the listed company, and improve its market valuation, such that a secondary sell-down (to restore the public float) becomes beneficial for the acquirer.

Separately, the amendment to the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (LODR Regulations) indicates, helpfully, that the former promoter's shareholding, pursuant to any promoter reclassification, will be considered as part of the public shareholding. Normally, such shareholding, despite reclassification, is not treated as *public* to prevent promoters from diluting the public float limit by reclassifying any part of the promoter or promoter group shareholding.

EXEMPTION FROM DELISTING

It is not easy to delist a listed company in India. In addition to the minimum shareholder approval and participation requirements, high exit prices (discovered through the reverse book-building method) have led to many promoters abandoning their delisting efforts.

With the latest amendments, the delisting procedure under the SEBI (Delisting of Equity Shares) Regulations 2009 (Delisting Regulations) will no longer apply to any delisting of equity shares pursuant to an IBC resolution plan, if the following conditions are satisfied:

(a) the plan sets out a specific delisting procedure; or

(b) the plan provides an exit option to existing public shareholders at a price not less than the liquidation value (as applied in the order of claims prescribed under the IBC),

and if the promoters are also exiting, but at a higher price, the exit price for public shareholders is not less than such higher price.

The amendment's drafting suggests that (a) and (b) are alternatives.

In practice, however, given the financial condition of most companies undergoing the CIRP, the liquidation value for equity shareholders could be zero, so the exit opportunity may not mean much for them.

The other change to the Delisting Regulations is clarificatory in that a company that has undergone CIRP may apply for re-listing of its delisted equity shares, notwithstanding the five-year/ ten-year cooling off period under the Delisting Regulations.

The one comment here is that SEBI should have also amended the Securities Contracts (Regulation) Rules 1957 (Securities Rules), which set out the governing rules and repeat some of the grounds for delisting set out under the more detailed Delisting Regulations. For example, the three-year minimum listing requirement will still apply to any delisting pursuant to an IBC resolution plan (given that the requirement finds mention in both the Delisting Regulations and the Securities Rules). The risk of this additional requirement impacting an IBC delisting, however, is low, as most companies under the CIRP have been listed for several years, but the point here is that any amendments should also be considered with respect to the principal law or regulation (in addition to the subordinate rules)

Separately, the amendment provides that the details of the proposed delisting as well as the justification for the exit price will need to be disclosed to the stock exchanges, within a day of the approval of the resolution plan. As a compliance matter and also to properly implement their acquisition objectives, acquirers would need to ensure that these points are covered as action items under the resolution plan and that the resolution professional effects these disclosures in time.

CERTAIN CHANGES TO THE LODR REGULATIONS

SEBI has made a number of IBC-related changes to the LODR Regulations. These are summarised as follows:

- Listed companies undergoing the CIRP do not have to comply with the provisions of the LODR Regulations dealing with the composition and roles and responsibilities of the board of directors and board committees. These roles and responsibilities must now be fulfilled by the resolution professional. This is line with the IBC's general scheme of entrusting the corporate debtor's management and governance function to the resolution professional and committee of creditors, but the resolution professional will need to be careful in interpreting and applying some of the provisions of the LODR Regulations (e.g. certain board responsibilities involve seeking shareholder approval, but this would be a redundant requirement in an IBC context).

- Shareholder approval requirements will not apply in relation to the following matters: (i) approval of material related party transactions; (ii) cessation of majority shareholding in, or exercise of control over, a material subsidiary; and (iii) transfer or lease of more than 20% of a material subsidiary's assets (on an aggregate basis, for a given financial year).

- The stock exchange pre-clearance requirement will not apply to any schemes of arrangement under an IBC resolution plan. This will be a hugely welcome step for acquirers, as the time taken to obtain pre-clearances could have made the 270-day IBC deadline unviable.

- Certain provisions of the LODR Regulations dealing with promoter reclassification (e.g. the restriction on promoters having post-reclassification special rights) will not apply if reclassification is contemplated under an IBC resolution plan and the promoter and promoter group being reclassified as public shareholders do not remain in control of the company. The intent here may be that any involvement of the former promoters, after a resolution plan is approved, should be controlled by the provisions of section 29A of the IBC.

- A number of IBC-related and CIRP-related disclosures will need to be made by the listed company (without applying any judgment as to the materiality of the information). The disclosable matters include application filings and admission, appointments and replacements of the resolution professional, notification of meetings of the committee of creditors and salient features (not involving commercial secrets) of resolution plans. These additional disclosure requirements are a positive step and will enhance transparency of the CIRP, in particular, for the listed company's shareholders.

In addition, information in relation to (b), (c) and (d) above will need to be disclosed to the stock exchanges, in each case, within a day of the approval of the resolution plan.

CONCLUSION

These amendments were necessary to facilitate the timely resolution of financially stressed listed companies. SEBI's role in actively pushing these amendments must also be recognised and appreciated.

Two pending proposals from SEBI's discussion paper, relating to trading restrictions and an extended timeframe (two years) for restoring the public float limit, also ought to be considered. With respect to the first proposal, temporary trading suspensions should certainly be considered, as these can mitigate any risk of insider trading, or market manipulation, and are already in place in other jurisdictions (e.g. the UK). An extended timeframe for restoring the public float limit is also a sensible proposal, but maybe the regulator wishes to first observe the outcomes of the existing amendments.

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