



ERGO

Analysing developments impacting business

SEBI AMENDS REGULATIONS TO IMPLEMENT FRAMEWORK FOR LISTING OF COMPANIES WITH SUPERIOR VOTING RIGHTS SHARES

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INTRODUCTION

This is further to our Ergo Update dated [5 July 2019](#) regarding Securities and Exchange Board of India's (**SEBI**) in-principal approval to the framework for enabling initial public offer of ordinary equity shares by tech companies having equity shares with superior voting rights (**SR Shares**).

As indicated in our earlier Ergo, SEBI has now implemented the framework by notifying amendments to the respective regulations applicable to listed/ to be listed companies having SR Shares.

CHANGES INTRODUCED

- Eligibility requirements for companies having SR Shares for initial public offer

The amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (**ICDR Regulations**) have introduced certain additional requirements for initial public offer of ordinary equity shares by companies having SR Shares. Some of the key requirements include:

- **Tech-intensive criteria:** The company should be making intensive use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology for providing products, services or business platforms with substantial value addition.
- **Shareholding criteria:** The SR Shares were issued only to the promoter(s)/ founder(s), who hold executive position(s) in the company. Further, such promoter(s)/ founder(s) should have held SR Shares for at least 6 (six) months prior to filing of the red herring prospectus with SEBI.
- **Net worth criteria:** Companies with promoters holding SR Shares, who are members of the promoter group having a collective net worth of more than INR 5,000,000,000 (Indian Rupees Five billion) (calculated by excluding the investment in the company), would be ineligible.
- **Voting right criteria:** The voting rights ratio of SR Shares as against ordinary equity shares should be between 2:1 (minimum) and 10:1 (maximum).

- **Class criteria:** There can be only one class of SR Shares and other than having superior voting rights, they should be equivalent to ordinary equity shares in all respects.
- Other requirements under the ICDR Regulations
 - Promoters' contribution: The SR Shares held by the promoters will be counted towards minimum promoters' contribution of 20% (twenty percent) to be brought in prior to the opening of the initial public offer.
 - Lock-in: The SR Shares will be under lock-in until conversion into ordinary equity shares or till 3 (three) years or 1 (one) year (as applicable), whichever is later. During the lock-in period, the transfer of SR Shares will not be permitted even if such transfer is amongst the promoters or promoter group.
 - Rights issues: The shareholders of SR Shares cannot renounce their right to subscribe under a rights issue. Further, SR Shares received under a rights issue would remain under lock-in till they are converted into ordinary equity shares along with existing SR Shares.
 - **Bonus issues:** If there is any bonus issue on SR Shares, then such bonus SR Shares would have the same voting rights as compared to ordinary equity shares and will also have to be converted into ordinary equity shares along with the existing SR Shares.
- Higher Governance

SEBI has introduced higher governance norms in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2019 (**LODR Regulations**) for listed companies having SR Shares. The amendment imposes following governance requirements for such companies as compared to companies not having SR Shares:

Sr. No	Particulars	Requirement for companies having SR Shares	Requirement for companies not having SR Shares
(1)	Board of directors	Atleast 1/2 (half) should be independent directors	If chairman is non-executive - atleast 1/3 (one third) should be independent directors If chairman is a promoter or related to promoter or person occupying management position - atleast 1/2 (half) should be independent directors
(2)	Audit committee	All members should be independent directors	Atleast 2/3 (two-third) members should be independent directors

(3)	Nomination and remuneration committee	Atleast 2/3 (two-third) should be independent directors	Atleast 1/2 (half) should be independent directors
(4)	Stakeholder relationship committee	Atleast 2/3 (two-third) should be independent directors	Atleast 1 (one) should be independent directors
(5)	Risk management committee	Atleast 2/3 (two-third) should be independent directors	Majority of members should be directors of the company
(6)	Cap on voting rights	Maximum 74% (seventy four percent) voting rights (including ordinary shares) for shareholders of SR Shares	75% (seventy five percent) cap on equity shareholding of promoter shareholders

➤ Limitations on rights of SR Shares:

Following limitations are imposed on exercise of rights relating to SR Shares:

- The SR Shares will remain at par with ordinary equity shares in every respect including dividends, except for voting on resolutions.
- The shareholders of SR Shares are required to have the same voting rights as the ordinary equity shareholders (i.e. one SR share will have only one vote) with respect to following resolutions:
 - appointment or removal of an independent director or the statutory auditor of the company;
 - voluntary transfer of control of the company by the promoter to another entity;
 - related party transactions, as defined under the LODR Regulations involving a shareholder of SR Shares;
 - voluntary winding up of the company;
 - changes to the charter documents of the company, other than changes affecting SR Shares;
 - initiation of a voluntary resolution process under the Insolvency and Bankruptcy Code, 2016;
 - utilization of funds for purposes other than in the ordinary course of business by the company;
 - substantial value transactions determined in accordance with the materiality threshold prescribed under the LODR Regulations;
 - approval of delisting or buy-back of shares of the company by special resolution; and

- such other matter as may be notified by SEBI from time to time.

➤ Mandatory Conversion

- The SR Shares should be mandatorily converted into ordinary equity shares within a maximum period of 5 (five) years from listing of ordinary equity shares of the listed company. The said timeline can be extended for upto an additional period of 5 (five) years upon passing a resolution by the shareholders of the non-SR Shares. The shareholders of the SR Shares cannot vote on such resolution.
- The SR Shares will automatically convert into ordinary equity shares upon the occurrence of the following material events: (i) demise or resignation of the promoter; (ii) merger or acquisition of the company leading to a shift in control from the shareholders of the SR Shares; and (iii) sale of SR Shares (after the lock-in period) prior to the lapse of the validity period of such SR Shares.

➤ Exemption upon conversion of SR Shares under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2019

Any increase in the voting rights of a shareholder beyond the threshold limits stipulated under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST Regulations), due to conversion of SR Shares into ordinary equity shares, has been exempted from the obligation to make an open offer under the SAST Regulations. This exemption is available so long as such increase in voting rights is not coupled with acquisition of 'control'.

➤ Buy-back and Delisting

The SEBI (Buy-back of Securities) Regulations, 2018 and the SEBI (Delisting of Equity Shares) Regulations, 2009 have been amended to provide for treatment of the SR Shares equal to ordinary equity shares for the purpose of buyback and delisting under the respective regulations.

Comment:

SEBI has introduced the above amendments to bring in a more robust framework for companies having SR Shares thereby opening up a plethora of opportunities for the promoters/founders of the technology companies to have superior voting rights compared to the other shareholders and helping monetize their shareholding through an initial public offer. The promoters/ founders will be able to retain control over the company through SR Shares (subject to stricter governance requirements) even though such promoters/ founders are minority shareholders.

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