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Analysing developments impacting business

NEW RULES FOR PROMOTER RE-CLASSIFICATION IN LISTED COMPANIES

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Introduction

On 16 November 2018, the Securities and Exchange Board of India (SEBI), by way of the SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2018 (Amended Regulations) has amended and replaced Regulation 31A of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 relating to the reclassification of existing promoters of listed companies as public shareholders. The new framework has been introduced based on the recommendations of the Kotak Committee on Corporate Governance.

Process for reclassification

➤ Application seeking reclassification

- As a first step, the promoter seeking reclassification (Outgoing Promoter) must make an application to the listed entity (Company), explaining the rationale behind seeking such reclassification and the manner in which the following conditions are satisfied (Reclassification Application).

Conditions to be satisfied by the Outgoing Promoter

- The Outgoing Promoter and Persons Related to the Outgoing Promoter (as defined in the Amended Regulations to mean persons with respect to that promoter(s) seeking re-classification who fall under sub-clause (ii), (iii) and (iv) of Regulation 2(1)(pp) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.) must not hold more than 10% of the total voting rights in the Company.
- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not, directly or indirectly, exercise control over the affairs of the Company.
- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not continue to have any special rights through any formal or informal arrangement, including through any shareholder agreements.
- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not be represented (including by way of a nominee director) on the

board of directors or act as a key managerial person (as defined in Companies Act, 2013) of the Company.

- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not be: (i) a 'wilful defaulter' as per the Reserve Bank of India guidelines; or (ii) a 'fugitive economic offender' as per the Fugitive Economic Offenders Act, 2018.
- The Company is required to intimate the stock exchanges where its shares are listed (Exchanges) of the receipt of the Reclassification Application within 24 hours of receipt of such application.
- Evaluation by the board of directors
 - Upon receipt of such a Reclassification Application, the board of directors of the Company is required to evaluate the same. The Amended Regulations does not envisage that the board of directors need to recommend the declassification. For proceeding with the reclassification, the following conditions must be satisfied:
 - the Company must be compliant with minimum public shareholding (MPS) requirements.
 - trading in the shares of the Company must not have been suspended by the Exchanges.
 - the Company must not have any outstanding dues owed to SEBI, Exchanges or depositories.
 - The Company is required to intimate the Exchanges of the outcome of the meeting of its board within 24 hours of such meeting. Further, the minutes of such meeting must record the views of the board with respect to the Reclassification Application.
- Shareholders' approval
 - The board of directors must place the proposed reclassification before the shareholders of the Company, along with the views of the board of directors on the proposed reclassification.
 - There must be a gap of minimum 3 months and maximum 6 months between the date of meeting of the board and the date of meeting of the shareholders considering the proposed reclassification. At this meeting of the shareholders, the Outgoing Promoter and the Persons Related to the Outgoing Promoter cannot vote on the resolution pertaining to such reclassification. The shareholders of the Company must approve the proposed reclassification by way of an ordinary resolution.
 - The Company is required to intimate the Exchanges of the outcome of the meeting of its shareholders within 48 hours of such meeting.
- Application to the Exchanges
 - If the shareholders of the Company approve the proposed reclassification, then an application in this regard has to be made to the Exchanges within 30 days from the date on which the shareholders of the Company have approved the proposed reclassification. Thereafter, the Exchanges will consider such an application and approve or reject the Reclassification Application.

- The submission of such an application must be disclosed to the Exchanges within 24 hours. Further, upon receipt of the decision of the Exchanges on the Reclassification Application, must be disclosed to the Exchanges within 24 hours of its receipt.

➤ Ongoing compliance requirements

The Outgoing Promoters must ensure continued compliance with the following conditions, failing which, it will automatically be reclassified as a promoter:

- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not hold more than 10% of the total voting rights of the Company;
- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not, directly or indirectly, exercise control over the affairs of the Company;
- The Outgoing Promoter and Persons Related to the Outgoing Promoter must not have any special rights over the Company through any formal or informal arrangement (including through any shareholder agreements); and
- The Outgoing Promoters must ensure that the Outgoing Promoters and Persons Related to the Outgoing Promoter are not represented (including by way of a nominee director) on the board of directors or act as a key managerial person, of such Company, for a period of 3 years from the date of such reclassification.

➤ Reclassification and transmission, succession, inheritance and gift of shares

Immediately upon transmission, succession, inheritance and gift of shares held by promoter/persons belonging to the promoter, the recipient/inheritor of such shares will be classified as promoter/persons belonging to the promoter group (as applicable). If the recipient who is so classified as a promoter intends to re-classify as public shareholder, such recipient must follow the entire procedure prescribed under the Amended Regulations.

➤ Reclassification pursuant to insolvency proceedings

The procedure described above for reclassification of promoter will not be applicable, if such reclassification is pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, subject to the condition that the Outgoing Promoter must not remain in control of the Company.

➤ Listed entities with no promoters

Under the Amended Regulations, a Company will be considered as 'listed entity with no promoter' if due to reclassification or otherwise, the Company ceases to have a promoter.

COMMENTS

The Amended Regulations have streamlined the process for reclassification of promoters and provides for one set of rules applicable to all reclassifications. Several ambiguities under the old regime have been addressed and certain loopholes have also been plugged (such as the introduction of restriction on declassification of wilful defaulters and fugitive economic offenders).

The clarification regarding the persons entitled to vote on reclassification resolutions puts to rest controversies regarding the ability of Outgoing Promoters and persons acting in concert with the Outgoing Promoters to vote. Further, in another welcome

move, onerous restrictions under the earlier regime for categorising a company as 'professionally managed' have been removed.

From an M&A perspective, under the earlier regime, ambiguities persisted as to the role of existing promoters after the completion of an acquisition transaction. Under the Amended Regulations, a clear process for reclassifying persons ceding control and holding an insignificant stake has been provided for.

Having said the above, the Amended Regulations have come with its own set of considerations which are quite relevant for transactions involving change of control. We have summarised the key considerations below:

- Outgoing Promoters will continue to be classified as promoters for potentially up to 9 months post closure of the transaction and remain liable under applicable laws, despite ceding control of the Company post closure of the transaction;
 - Post the transaction, for the purposes of ensuring continuity, the new promoter may want the Outgoing Promoter to continue being involved in the Company, either on the board or as a key managerial person. Under the Amended Regulations, this will not be possible if the Outgoing Promoter wishes to declassify themselves as promoters;
 - In a number of cases, the Company may not satisfy MPS requirements immediately after the change of control and open offer. In such situations, a one year time period is available to the Company for meeting MPS requirements. In terms of the Amended Regulations, declassification of Outgoing Promoter would be possible only after Company ensures compliance with MPS requirements, thereby delaying the declassification of the Outgoing Promoter.
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