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AMENDMENTS TO SEBI CIRCULAR ON SCHEMES OF ARRANGEMENT BY LISTED ENTITIES

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The Securities and Exchange Board of India (SEBI) has issued a circular dated 03 November 2020 (Ref: SEBI/HO/CFD/DIL1/CIR/P/2020/215) (2020 Amendment Circular), amending certain provisions of the SEBI Circular dated 10 March 2017 (Ref: CFD/DIL3/CIR/2017/21) as amended and modified from time to time (2017 Circular). The 2020 Amendment Circular specifies detailed requirements that listed entities need to comply with while undertaking schemes of arrangement or while being involved in schemes of arrangement.

Background

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) states that a scheme of arrangement/ amalgamation/ merger/ reconstruction/ reduction of capital undertaken by a listed entity (Scheme) must be in compliance with the applicable securities laws. The Listing Regulations, inter alia, provides that a listed entity involved in a Scheme or desirous of undertaking a Scheme, shall obtain an observation letter or a no objection letter, as the case may be, from the stock exchanges before filing the Scheme with the relevant bench of National Company Law Tribunal.

The 2020 Amendment Circular has been issued with a view to strengthen the scrutiny and compliance and ensuring that Schemes are referred to SEBI only after the stock exchanges are certain that the Schemes are in compliance with SEBI Act, 1999, rules, regulations and circulars issued thereunder. The 2020 Amendment Circular shall be applicable to all listed entities proposing Schemes with effect from 17 November 2020, except Para 7 of the 2020 Amendment Circular, which shall be effective from 03 November 2020.

Material amendments specified in the 2020 Amendment Circular are detailed below:

Audit committee of the listed entities to comment upon the rationale of the Schemes

SEBI has widened the scope of scrutiny of the audit committee of the listed entities proposing the Scheme. In addition to recommending the Scheme to the Board of Directors of the listed entity after taking into consideration the valuation report, the audit committee is now required to comment upon the business and economic rationale, need for the merger/ demerger/ amalgamation/ arrangement, synergies of business of the entities involved in the Scheme, its impact on the shareholders and cost benefit analysis of the Scheme.

Committee of independent directors of listed entities to consider and recommend the Scheme

The 2020 Amendment Circular marks an enhanced level of scrutiny on the Schemes. Similar to the onus cast on the committee of independent directors to make recommendations on the open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, the 2020 Amendment Circular now casts an obligation upon the committee of independent directors to recommend the Scheme to the board of directors of the listed entity, after taking into consideration whether the Scheme is detrimental to the interest of the shareholders.

Submission of valuation report from the registered valuer a necessity

Under the 2017 Circular, listed entities were required to obtain a valuation report from an independent chartered accountant, whereas under the Companies Act, 2013 a valuation report was required to be obtained from a registered valuer. The 2020 Amendment Circular enables a registered valuer who may or may not be a chartered accountant to provide a valuation report in relation to the Scheme.

This amendment has been made in line with the requirements of Section 247 of the Companies Act, 2013.

Stock exchanges to refer the Schemes to SEBI post providing 'No-objection' letter

The 2017 Circular provided flexibility to stock exchanges to provide either an 'observation letter' or 'no-objection letter' in relation to the draft Scheme. However, the 2020 Amendment Circular directs the stock exchanges to provide their 'no-objection letters' in coordination with each other, instead of providing their observations on the Scheme.

Additional disclosures to be provided in the newspaper

The 2020 Amendment Circular provides certain additional disclosures to be provided by the entity seeking listing of its specified securities on the stock exchanges. Disclosures in connection with latest restated audited financials, summary table of related party transactions in last 3 years, business model/ overview and strategy, internal risk factors, criminal proceedings against the promoters, disciplinary action taken by SEBI or stock exchanges against the promoters in the last 5 financial years etc. shall also be required to be disclosed in the newspaper prior to making final listing application to SEBI/ stock exchanges.

Repealing provisions for listing of equity shares with differential voting rights

SEBI at its board meeting held on 27 June 2019 had proposed a framework (DVR Framework) for issuance of equity shares with differential voting rights (DVRs) based on the consultation paper which had been circulated for public comments in March 2019 (Consultation Paper). In the Consultation Paper, SEBI had categorically stated that DVRs with superior voting rights if issued to promoters in promoter led companies will enable such promoters in retaining decision-making powers and rights vis-à-vis other shareholders.

The 2017 Circular provided that listed entities may make an application to SEBI to seek relaxation from complying with provisions of Rule 19(2)(b) of the Securities Contracts Regulation Rules, 1957, for listing of DVRs on the stock exchanges pursuant to a Scheme, subject to fulfillment of certain conditions. The 2020 Amendment Circular has repealed the aforesaid provisions to bring the 2017 Circular in line with the amendments notified in the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018, Listing Regulations, Regulations, the SEBI (Buy-back of Securities) Regulations 2018,

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, SEBI (Delisting of Equity Shares) Regulations 2009.

Comment

The substantial modifications notified in the 2020 Amendment Circular will subject a listed entity proposing a Scheme to stricter levels of scrutiny, compliance and transparency. SEBI has further echoed the pivotal role of the audit committee, independent directors and the stock exchanges in scrutinizing the transactions proposed in the Scheme. However, it remains to be seen whether: (i) SEBI issues any further clarifications/ guidance on the constitution of committee of independent directors and the sequence of recommendations of the Scheme by the audit committee and the committee of independent directors to the board of directors of the listed entity; and (ii) the independent directors, forming part of the audit committee, will be able to form part of the 'committee of independent directors' and recommend the Scheme to the board of the listed entities.

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