

M&A Hotline

July 11, 2023

SCHEMES OF ARRANGEMENT- SEBI CONSOLIDATES RECENT AMENDMENTS

With a new chairperson in Madhabi Puri Buch, the Securities and Exchange Board of India ("SEBI") has introduced several regulatory changes. It has, over the course of the past year, tightened the regulatory framework and upgraded decades-old laws. These include regulations on buybacks, the role of mutual fund trustees, alternative investment funds, real estate investment trusts and the investor grievance redressal mechanism.¹

The "Master Circular on Scheme of Arrangement" published on 20 June 2023 ("2023 Circular"), superseded the existing master circular dated November 23, 2021. The 2023 Circular consolidates and streamlines the existing SEBI regulations for listed companies with respect to:

- undertaking a scheme of arrangement under Sections 230 to 234 and Section 66 of the Companies Act, 2013 ("Companies Act"), whichever applicable, as well as Regulations 11, 37 and 94 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR"); and
- listing of shares and warrants offered along with non-convertible debentures ("NCD") without having to comply with the requirements under Rule 19 (2) (b) of the Securities Contracts (Regulation) Rules, 1957 ("SCRR").

The salient requirements under (1) and (2) above have been highlighted in this hotline.

It is noteworthy that the provisions of the 2023 Circular do not apply to schemes which provide solely for the merger of a wholly owned subsidiary or its division with the parent company. However, such draft schemes must be filed by the listed entity with the stock exchanges for the purpose of disclosures,² which will be published on these stock exchanges' websites.

■ Requirements for listed companies undertaking a scheme of arrangement

A listed entity must liaise and submit the requisite documents to a stock exchange having nationwide trading terminals before submitting its draft scheme for sanction to the National Company Law Tribunal ("NCLT"). The stock exchange, in turn, provides an observation letter/no-objection letter and sends the information to SEBI. The listed entity is obliged to disclose the scheme and information submitted to the stock exchange on its website. The stock exchange may issue an observation letter, which, if received, ought to be disclosed on the website within 24 (twenty four) hours of its receipt.

■ Documents to be filed

Listed entities are required to file the following documents alongside the scheme of arrangement with the stock exchange:

(a) Valuation Report

A valuation report containing the relative fair value per share and fair share exchange ratio³ from a Registered Valuer⁴ should be submitted by all listed entities, except in cases where there is no change in the shareholding pattern of the listed entity/resultant entity. The 2023 Circular specifies a 'change in the shareholding pattern' to mean:

- a change in the proportion of shareholding of any of the existing shareholders of the listed entity in the resultant company; or
- a new shareholder being allotted equity shares of the resultant company; or
- an existing shareholder exiting the company pursuant to the scheme of arrangement.

(b) An auditor's certificate certifying compliance of the scheme with the accounting standards specified by the central government⁵ has to be filed with the stock exchange, in the prescribed format. Mere disclosure by the auditor of deviations in accounting treatments shall not satisfy this requirement.

(c) An Audit Committee report recommending the draft scheme of arrangement with specific comments on (i) need for such arrangement; (ii) rationale of the scheme; (iii) synergies of the business of the entities involved in the scheme; (iv) impact of the scheme on the shareholders; and (v) cost benefit analysis of such scheme.

(d) A fairness opinion by a SEBI registered merchant banker on the valuation report.

(e) The shareholding patterns before and after amalgamation of an unlisted entity.

(f) The audited financial statements for the last 3 (three) years of an unlisted entity.

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(g) A detailed compliance report in the specified format, duly certified by the company secretary, chief financial officer and the managing director confirming the compliances including with the applicable accounting standards.

(h) A report from the committee of independent directors recommending that the draft scheme is not detrimental to the shareholders of the listed entity.

(i) A declaration from the listed entity on any past default of listed debt obligations of the entities forming part of the scheme.

(j) A no-objection certificate from the lending banks and financial institutions and debenture trustees, from not less than 75% (seventy five percent) of secured creditors in value.

Impact: Whilst some of the documents are typical requirements for the stock exchanges/SEBI to formulate their view on the Scheme, SEBI could have removed the documentation requirements which overlap with the requirements of Companies Act. For example, the auditor's certificate confirming the accounting treatment provided in the scheme of arrangement. An NoC from the lenders has traditionally been part of the NLCT approval process, and they play a critical role in the determination by the NCLT on whether a court convened meeting is required to be called upon or if it can be dispensed with. That process had worked well for a number of years as part of the NCLT, and before that, the High Court procedures. Therefore, it is unclear why SEBI, as clarified in its 2022 circular,⁶ requires these NoCs to be submitted at the beginning of the process, even before a receipt of an NoC from the relevant stock exchange.

■ **Voting by public shareholders-**

A listed entity must ensure that the scheme of arrangement submitted with the NCLT for sanction provides for voting by public shareholders through e-voting if the scheme of arrangement involves:

(a) additional shares being allotted to the promoter, promoter group, or the related parties, associates or subsidiaries of the promoter or promoter group;

(b) an entity involving the promoter, promoter group, or the related parties, associates or subsidiaries of the promoter or promoter group;

(c) equity shares being acquired, either directly or indirectly, from a shareholder of a subsidiary who is either the promoter, promoter group, or the related parties, associates or subsidiaries of the promoter or promoter group and this subsidiary if being merged with the listed parent entity;

(d) a merger of an unlisted entity which results in reduction in the voting share of pre-scheme public shareholders of the listed entity in the transferee / resulting company by more than 5% (five percent) of the total capital of the merged entity; or

(e) the transfer of whole or substantially the whole of the undertaking of the listed entity⁷ and the consideration for such transfer is not in the form of listed equity shares.

In these specified events from (a) to (e) ("**Categories**"), the scheme of arrangement shall be acted upon only if the votes cast by the public shareholders in favour of the proposal are more than the number of votes cast by the public shareholders against it.

Impact: In cases where group structures are being re-organised to align promoter shareholding in all entities forming part of the group or in situations where it is perceived that there could be erosion of shareholder value by virtue of implementation of the scheme, this provision shall ensure that public (or non-promoter) shareholder votes are given due importance before the Scheme can be acted upon.

The explanatory statement/ notice/proposal sent to the shareholders in relation to this resolution shall contain all the material facts relating to the scheme, including the:

- observation letter of the stock exchange;
- pre and post arrangement or amalgamation capital structure and shareholding pattern; and
- fairness opinion obtained from a merchant banker on the valuation of assets/shares done by the Registered Valuer.

If the scheme of arrangement is between a listed and unlisted entity, then the listed entity shall also include the applicable information pertaining to the unlisted entity⁸ involved in the scheme in the explanatory statement/ notice/proposal.

If the scheme does not fall within the Categories, then the aforementioned requirement of approval by the public shareholders shall not be applicable. Instead, an undertaking certified by the auditor and duly approved by the board of the listed entity should be submitted, clearly stating the reasons for non-applicability of the voting requirement.

Impact: While the ambit of the explanatory statement has been widened to ensure all the shareholders are briefed in advance on all the material facts relating to the scheme before it is put to vote, this actually adds on to the compliance burden on the company which needs to ensure that all data points are covered in adequate detail in the notice itself.

■ **Additional conditions for specified situations-**

(a) In the event the scheme of arrangement is between listed and unlisted entities, the following additional conditions need to be satisfied:

- Unlisted entities can be merged with a listed entity only if the listed entity is listed on a Stock Exchange having nationwide trading terminals; and
- The pre-scheme public shareholders (of the listed entity) and qualified institutional buyers shareholding (of

the unlisted entity) cannot be less than 25%⁹ in the post scheme shareholding pattern of the “merged” company.

(b) In the event a listed entity seeks listing of its non-convertible debentures (“NCD’s”) and/or non-convertible redeemable preference shares (“NCRPS”) issued pursuant to the scheme of arrangement, the following additional conditions need to be satisfied:

- Eligibility criteria, where the listed entity which has listed its specified securities may seek listing of NCDs and/or NCRPS issued pursuant to a scheme of arrangement **only** if the listed entity is a part of such scheme of arrangement and such NCDs and/or NCRPS are issued to the holders of specified securities of the listed entity¹⁰;
- Minimum tenure of the NCD’s and/or NCRPS shall be one year;
- Valuation report to include valuation of the underlying NCD’s/NCRPS to be issued;
- Specified disclosures should be included in the draft scheme such as details of security cover (if secured NCD’s), details of debenture trustee, credit rating etc;
- (v) NCDs/NCRPS to only be in dematerialised form;
- If the securities are NCD’s, then an appropriate charge or security has to be created; and
- All other applicable laws have to be complied with¹¹.

Impact: The condition applied on the merger of an unlisted listed with a listed company in (a) (i) above, that is, only if the listed entity is listed on a stock exchange having nationwide trading terminals (and not regional stock exchanges), will restrict the scope for such mergers. This would lead to either de-listing of such listed entities from the regional stock exchanges or such listed entities will have to mandatorily list the securities on a stock exchange having nationwide trading terminals. SEBI could have relaxed this condition and the resulting enhancement of the scope could have benefited the unlisted or entities not listed on exchanges (with nationwide terminals) which are looking for synergic opportunities for their growth.

■ **Processing of draft scheme by SEBI-**

Upon receipt of the ‘No-Objection’ letter from the relevant stock exchange, SEBI provides its comments on the draft scheme of arrangement the stock exchange within 30 (thirty) days from:

- (a) date of receipt of satisfactory reply on clarifications, if any, sought from the listed entity by SEBI; or
- (b) date of receipt of opinion from an independent chartered accountant, if sought by SEBI; or
- (c) date of receipt of ‘No-Objection’ letter from the stock exchange; or
- (d) date of receipt of copy of in-principle approval for listing of equity shares of the company seeking exemption from Rule 19(2)(b) of SCRR on the designated stock exchange, in case the listed entity is listed solely on a regional stock exchange;

whichever is latest. These comments are then forwarded to the designated stock exchange for necessary action and resolution by the listed entity.

CONCLUSION :

While collating the previous master circulars into this 2023 Circular seems to be an attempt in the right direction to provide ease of reference, it does not substantially modify the already existing regulatory and compliance framework in relation to a scheme of arrangement. Given that SEBI has been actively overhauling the existing framework in relation to listed entities otherwise, it is left to see if some of the difficulties faced by listed companies while undergoing the process of approval of a scheme of arrangement will now be solved for and the process is simplified.

– Sach Chabria , Santosh Gangavati & Harshita Srivastava

You can direct your queries or comments to the authors.

¹[https://www .businesssto day.in/maga zine/corpor ate/story/ how-madhab i-puri-buch -is-transf orming-seb i-371559-2 023-02-27](https://www.businesssto day.in/maga zine/corpor ate/story/ how-madhab i-puri-buch -is-transf orming-seb i-371559-2 023-02-27)

²Including the upload of relevant information such as the ‘report on complaints’ and the ‘compliance report’

³As per the format provided in Annexure-II of the 2023 Circular.

⁴A person, registered as a valuer, having such qualifications and experience and being a member of an organization recognized, as specified in Section 247 of the Companies Act, 2013 read with the applicable Rules issued thereunder.

⁵Accounting standards under Section 133 of the Companies Act, 2013 read with the rules framed thereunder or the Accounting Standards issued by ICAI, as applicable, and other generally accepted accounting principles, unless an applicable sectoral regulator has prescribed specific norms in this regard, which shall prevail.

⁶https://www.seb i.gov.in/ legal/cir culars/ja n-2022/sc hemes-of -arrangem ent-by-l isted-en tities-c larifica tion-w-r -t- timin g-of-sub mission- of-noc-f rom-the- lending- schedule d-commer cial-ban ks-finan cial-ins titution s-debent ure- tru stee_55 166.html

⁷Twenty per cent or more of value of the company in terms of consolidated net worth or consolidated total income during previous financial year as specified in Section 180(1)(a)(ii) of the Companies Act, 2013.

⁸In the format specified for abridged prospectus as provided in Part E of Schedule VI of the ICDR Regulations.

⁹On a fully diluted basis.

¹⁰Certain broad scenarios for this have been illustrated in Part 1 (12) (a) of the 2023 Circular.

¹¹Such as the applicable provisions of the Companies Act, 2013 including the provisions related to creation and maintenance of Capital Redemption Reserve/Debenture Redemption Reserve; all the provisions of Chapter II and other applicable provisions of the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ("ICDR Regulations") etc.

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