

## NOTE ON PROPOSED OVERHAUL OF SEBI (DELISTING OF EQUITY SHARES) REGULATIONS, 2021.

The Securities and Exchange Board of India (“**SEBI**”) recently issued a Consultation Paper proposing changes to the SEBI (Delisting of Equity Shares) Regulations, 2021 (“**Delisting Regulations**”) to improve the delisting process, as outlined in a consultation paper.<sup>1</sup> Mr. Keki Mistry led a sub-group, which included members from the Primary Market Advisory Committee (PMAC), and they came up with consultation paper. One key proposal is to replace the reverse book building (RBB) method with a fixed-price approach for voluntary delisting. The proposed changes in regulations is aimed at preventing possible manipulation of exit prices.

This shall not be the first time that SEBI has tried to overhaul the Delisting Regulations. In 2021, SEBI came out with the current Delisting Regulations, replacing the SEBI (Delisting of Equity Shares) Regulations, 2009 (“**2009 Regulations**”)<sup>2</sup> to increase efficacy of the delisting process. The Delisting Regulations were notified on June 10, 2021, maintaining continuity with the 2009 Regulations but bringing in changes to streamline the delisting process. The notable amendments in voluntary delisting offers included a clearer distinction of responsibilities between the Acquirer and the Company, with the Acquirer and associated entities being accountable for compliance.<sup>3</sup> The Board of Directors assumed an independent role in the delisting process, appointing a company secretary for due diligence and forming a committee of independent directors to provide recommendations.<sup>4</sup> The regulations provided for the disclosure of an indicative price by the Acquirer, specified the success threshold (90%), and retained the concept of a counter offer.<sup>5</sup> Additional provisions covered subsidiary companies, rights of public shareholders, and payment considerations. Noteworthy was the expanded role of the Manager to the Offer, including obligations for diligence, fair disclosure, and protecting the interests of remaining shareholders. Cooling-off periods were shortened, and strict timelines were set for various stages of the delisting process, promoting a quicker completion.<sup>6</sup>

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<sup>1</sup> SEBI Consultation dated August 08, 2023: [https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-review-of-voluntary-delisting-norms-under-sebi-delisting-of-equity-shares-regulations-2021\\_75335.html](https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-review-of-voluntary-delisting-norms-under-sebi-delisting-of-equity-shares-regulations-2021_75335.html).

<sup>2</sup> SEBI (Delisting of Equity Shares) Regulations, 2009: <https://www.sebi.gov.in/legal/regulations/jun-2009/sebi-delisting-of-equity-shares-regulations-2009-last-amended-on-march-6-2017-34625.html>

<sup>3</sup> Same as above; Regulation 4(4) of Delisting Regulations.

<sup>4</sup> Same as above; Regulation 10(2) of Delisting Regulations.

<sup>5</sup> Same as above; Regulation 2(1)(o) of Delisting Regulations.

<sup>6</sup> Amendments in SEBI Delisting Regulations (2021): [https://corporate.cyrilamarchandblogs.com/2021/06/sebi-delisting-regulations-2021/#:~:text=The%202021%20regulations%20also%20expressly,\(and%20not%20the%20Company\).&text=Unlike%20the%202009%20Regulations%2C%20where,to%20the%20Board%20of%20Directors.](https://corporate.cyrilamarchandblogs.com/2021/06/sebi-delisting-regulations-2021/#:~:text=The%202021%20regulations%20also%20expressly,(and%20not%20the%20Company).&text=Unlike%20the%202009%20Regulations%2C%20where,to%20the%20Board%20of%20Directors.)

The Consultation has proposed the following changes:

### **1. Revised of threshold for counter-offer mechanism for acquirer:**

As per the current Delisting Regulations, the acquirer is only able to make a counter-offer upon reaching 90% post-offer shareholding.<sup>7</sup> However, even if the 90% threshold is not reached, the majority of the public shareholders are willing to delist. In such a case under the current counter-offer framework, the acquirer is not able to provide a counter-offer to the public shareholders to reach the 90% post-offer shareholding threshold and the delisting fails. The Consultation Paper proposes that the acquirer will have the ability to make a counter-offer to reach the 90% threshold if the bids received are higher of:

- a) the difference between the acquirer's shareholding and 75% of the total issued shares of the company; and
- b) 50% of the public shareholding.

### **2. Review of Floor Price under Delisting Regulations:**

The floor price refers to the minimum price that the acquirer is bound to pay the public shareholders for the shares tendered. Under the Delisting Regulations, the floor price must be computed in accordance with Regulation 8 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations").<sup>8</sup>

In this context, the Paper identifies the specific parameters under Regulation 8 of the Takeover Regulations that will apply while determining the floor price of frequently and infrequently traded shares. Additionally, the Paper also proposes to introduce 'adjusted book value' as an additional parameter to protect the interest of shareholders, by accounting for the fair market value of a company's assets while computing the floor price. The manner of calculating the adjusted book value has also been discussed at length. The definition of adjusted book value is as under:

The adjusted book-value of the company shall mean: **A + B + C + D – L**, where,

**A** = Book value of all the assets (other than jewellery, artistic work, shares & securities and immovable property) in the balance sheet as reduced by any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

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<sup>7</sup> Regulation 21 of SEBI (Delisting of Equity Shares) Regulations, 2021

<sup>8</sup> Regulation 8(1): The open offer for acquiring shares under regulation 3, regulation 4, regulation 5 or regulation 6 shall be made at a price not lower than the price determined in accordance with sub-regulation (2) or sub-regulation (3), as the case may be.

**B** = Price which jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

**C** = fair market value of unquoted/infrequently trade shares and securities as determined considering the internationally accepted valuation methods by the registered valuer. If the shares and securities are quoted and frequently traded on any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange as on the valuation date;

**D** = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property. In case immovable property is located outside India, market value of the property shall be determined by the independent registered valuer;

**L** = book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

- i. the paid-up capital in respect of equity shares;
- ii. the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
- iii. reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;
- iv. any amount representing provisions made for meeting liabilities, other than ascertained liabilities;
- v. any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

### **3. Fixed Price Delisting as an alternative;**

Under the current Delisting Regulations, to delist a company, the acquirer must provide an exit opportunity to all public shareholders of the company at a price discovered using the reverse book building process ("**RBB**").<sup>9</sup>

The RBB process begins with the calculation of a floor price in accordance with the Regulations. The acquirer can also provide an indicative price, which must be higher than the floor price. Second, public shareholders are required to tender their shares in favor of the acquirer through stock exchanges. If the shareholding of the acquirer does not cumulatively reach 90% (acquirer's shareholding + shares tendered by the public shareholders in the acquirer's favour), then the delisting is failed. Third, if the cumulative shareholding of the acquirer does reach 90% then a

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<sup>9</sup> Regulation 20(1) of SEBI (Delisting of Equity Shares) Regulations, 2021

discovered price is determined based on eligible bids by the public shareholders. Fourth, the acquirer has the option to either accept (which would mean that the acquirer has agreed to buy the shares at the discovered price) or reject the discovered price. If the acquirer rejects the discovered price, then it can give a counteroffer at a price not less than the floor price. Fifth, the shareholders are allowed to tender their shares at the counter-offer price. If the post-counter-offer shareholding of the acquirer reaches 90%, then the delisting is successful.<sup>10</sup>

India is the only country that follows the RBB process.<sup>11</sup> The RBB process was adopted in 2003. It was felt that the exit price offered under the fixed-price process then did not justify company fundamentals and its true worth. Moreover, minority shareholders felt compelled to sell their shares at the offered exit price, even if it was not attractive enough, or else they held a potentially illiquid stock. Thus, the RBB process was adopted – to harmonize the interests of the acquirers and shareholders. However, the RBB process has been far from successful prompting SEBI to keep making amendments to the delisting regulations from time to time.

The Consultation Paper has proposed to provide an option to delist equity shares at a fixed price instead of the RBB process, subject to the following conditions:

- a) the option is available only to those companies whose shares are *frequently traded shares*<sup>12</sup>;
- b) the fixed price offered will not be lower than the floor price; and
- c) the delisting offer shall be successful if the post-offer shareholding of the acquirer along with the shares tendered by the public shareholders, at the price offered by the acquirer, reaches 90% of the total issued shares of the company.

#### 4. Change of reference date for determination of Floor Price:

Under the Delisting Regulations, the floor price is calculated based on a reference date, i.e., the date on which the exchanges are required to be notified of the board meeting in which the delisting proposal was approved.<sup>13</sup> In this context, the paper notes that the interval between the public

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<sup>10</sup> Same as above; Schedule II of SEBI (Delisting of Equity Shares) Regulations, 2021.

<sup>11</sup> SEBI Discussion Paper on Delisting of Equity Shares (2018): [https://www.sebi.gov.in/sebi\\_data/attachdocs/jul-2018/1532603980878.pdf](https://www.sebi.gov.in/sebi_data/attachdocs/jul-2018/1532603980878.pdf)

<sup>12</sup> **Regulation 2(1)(j) of SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011:** “frequently traded shares” means shares of a target company, in which the traded turnover on any stock exchange during the twelve calendar months preceding the calendar month in which the public announcement [is required to be made under these regulations], is at least ten per cent of the total number of shares of such class of the target company:

<sup>13</sup> Regulation 20(3) of SEBI (Delisting of Equity Shares) Regulations, 2021.

announcement of the delisting proposal by the acquirer or prior intimation to exchanges in promoter led delisting, and the date on which exchanges are notified, carries the risk of abnormal trading activity which may disturb the calculation of the floor price.

To tackle this issue, the paper makes a case for calculating the floor price as on the date when information related to the proposed delisting is publicly disclosed for the first time, or based on an '**undisturbed price**'. Accordingly, the reference date is proposed as the date of the initial public announcement or the date on which prior intimation is given to the exchanges, as applicable.

## **5. Proposed Delisting method for Investment Holding Companies.**

An investment holding company (IHC) is basically a company that mainly holds investments in other companies, whether they're listed on the stock exchange or not. Sometimes, these IHCs might also have other assets like property or real estate. Interestingly, the shares of an IHC tend to be priced lower than the actual value of the investments it holds. One main reason for this is that the people who own and support these companies typically see their investments as long-term, and the market doesn't expect them to sell these shares anytime soon. Right now, the Delisting Regulations don't have a specific set of rules for taking listed IHCs off the market, so they have to follow the general delisting rules. However, the issue is that the current market price and the floor price determined in the delisting process might not truly represent the actual value of the investments and assets. This is particularly tricky because the nature of these investments makes their valuation quite complex. So, a sub-group thought about this and discussed the idea of having a separate delisting mechanism just for these listed IHCs. It is proposed in the consultation paper to delist IHC through Scheme of Arrangement (selective capital reduction under Section 66 of Companies Act) by way of -

- a) transfer of shares held by a listed IHC in other listed companies to the public shareholders of such IHC *pro-rata* their shareholding;
- b) cash payments to the public shareholders of the listed IHC for investments made by such IHC in unlisted companies and other assets;

## **Analysis of the Proposed Changes:**

The changes to the counter offer mechanism and introduction of fixed price delisting needs to be discussed in more depth as the changes such as addition of adjusted book value to price determination and change of reference rate for price determination seem more or less justified. The alternative process involving setting a fixed price is meritorious as the discovered price under the RBB process may not be suggestive of the price the Company is willing to pay. In the RBB process, the only reference points for the shareholders are the floor price and/or the indicative price. It is important to understand that neither of these prices is an actual representation of the price the acquirer is willing to pay for the strategic value of the company. This was also acknowledged by SEBI in the form that delisting without the knowledge of what the acquirer is willing to pay

leads to a lot of speculation.<sup>14</sup> This lack of information is a double-edged sword as it creates a scenario where the shareholders can either squeeze out the maximum price from the acquirer based on the idea that the acquirer might be willing to pay more, or it results in exploitative amounts of premium being sought. The uncertainty also causes the public shareholders to not tender their shares at all.

Several instances of unsuccessful delisting due to substantial premium prices have been observed. For instance, in cases such as Brady and Morris Engineering Company, the price determined through the RBB process exhibited a substantial 1128.70% premium over the floor price. Similarly, Vedanta in 2020 saw demand for a 267% premium, and Linde India in 2019 at 517%.<sup>15</sup> A report by SEBI analyzing data from 2015 to 2018 reveals that 53% of companies voluntarily delisted through the RBB process were delisted at premiums with a median value of 125%.<sup>16</sup>

SEBI envisions that with the fixed price mechanism in place, companies will be enabled to fix price for delisting of shares at a realistic value and the prohibition on fixed to be not lower than that of floor price shall be adequate protection for interest of public shareholders. The paper also mentions that the companies will also have an additional incentive for fixing a fair price of shares so as to ensure that the delisting offer does not fail to reach the 90% threshold because the proposed fixed price mechanism shall not have a counter-offer mechanism. Therefore, if the delisting offer fails, the company shall have to start the process from the start. In addition to that the proposed framework for determination of the counter-offer price along with the proposal to lower the threshold for a counter offer could potentially result in more successful delisting offers. However, it should be noted that the revised threshold is applicable only in relation to a counter offer. Accordingly, once a counter offer is made, the post-offer shareholding of the acquirer along with the shares tendered in the reverse book-building process will be required to reach 90% of the total issued shares of the company.

In conclusion, the outlined amendments hold the potential to lead to more successful delisting offers. The reduction in the threshold for a counter offer shall lead to a better review of public expectations of the proposed counter-offer price by acquirers. The proposed changes in the determination of the reference date seek to establish a mechanism that guards against the influence of the impending delisting offer in calculating the floor price. Lastly, the introduction of the fixed-price route for delisting is poised to streamline the delisting process, offering a level of certainty that stands to mutually benefit both acquirers and public shareholders. But we shall need to wait for them to be approved and brought in as an amendment to realize the practical effects of the proposed amendments.

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<sup>14</sup> See page 7 of the Consultation Paper.

<sup>15</sup> Report-on-Delisting-Deals-Current-Trends (2020): <https://www.cyrilshroff.com/wp-content/uploads/2020/11/Report-on-Delisting-Deals-Current-Trends.pdf>

<sup>16</sup> SEBI Discussion Paper on Delisting of Equity Shares (2018): [https://www.sebi.gov.in/sebi\\_data/attachdocs/jul-2018/1532603980878.pdf](https://www.sebi.gov.in/sebi_data/attachdocs/jul-2018/1532603980878.pdf)