Framework for protection of interest of public equity shareholders of listed cos. undergoing CIRP : SEBI Consultation Paper dated Nov 10, 2022

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- We are a team of qualified company secretaries, chartered accountants, lawyers and managers.

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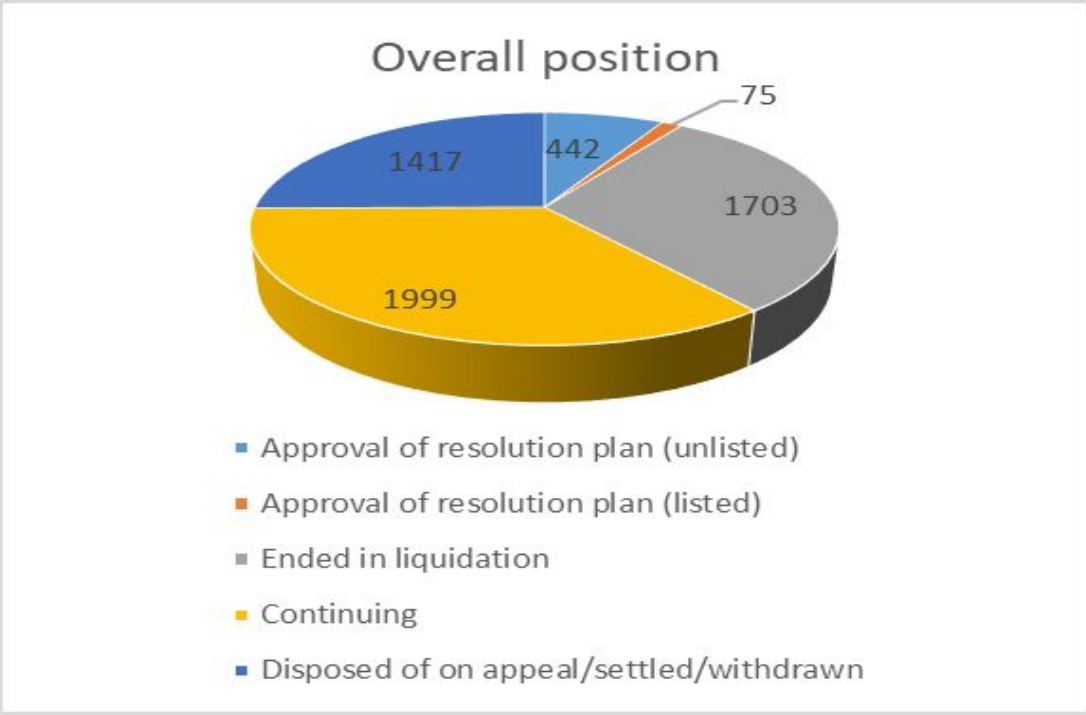
Background- Objective behind the proposal

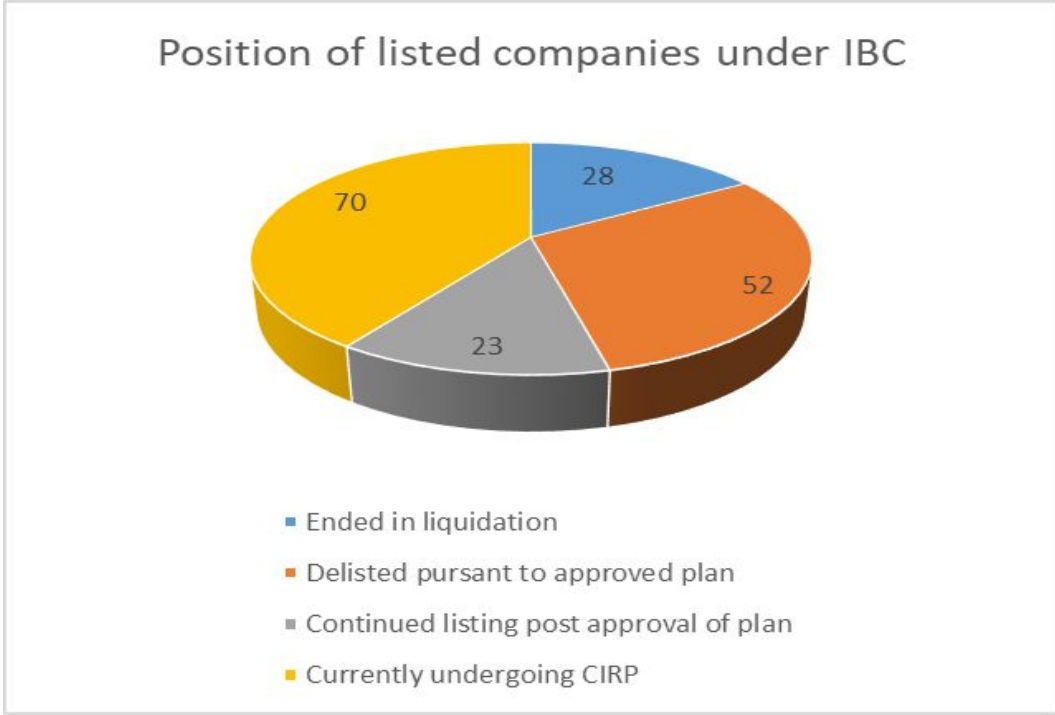
- Present treatment of equity shareholders under resolution plan-
  - Payments under resolution plan to follow sec 53 of IBC, read with reg. 38 of CIRP Regulations; min. payments tied to liquidation value
  - Equity Shareholders acquire the last position in waterfall mechanism
  - Usual approach is to extinguish existing shareholding which leads to which leads to zero value overnight
  - Hence, question of protection of minority shareholders

- Existing provisions under Delisting Regulations [Reg. 3(2)(b)]:
  - Exemption from the provisions of Delisting Regulations in case of delisting pursuant to approved resolution plan and where exit opportunity is provided to existing public shareholders at specified price
    - Specified price means a price not less than the price at which promoter/promoter group is provided the exit opportunity
  - Effective benefit of the regulation may not be there, as equity holders would only be entitled to 'liquidation value' which would be zero. Hence, the provision does not really help

Hence, SEBI's Consultation Paper, with the proposal to provide an option to public shareholders to become shareholders of the new CD post approval of resolution plan ("**New CD**") - discussed in further slides.

Statistics





Source: SEBI Consultation Paper

Relevant provisions

- CIRPs mostly result into delisting - the equity shares are reduced to zero value and the CD goes for a capital write off.
  - Only 23 out of some 100 odd cases of CIRP of listed entities, the listing status has been continued
- There is an exemption from Delisting Regulations in case of CIRP if approved resolution plan approved provides for [Reg. 3(2)(b)]:
    - delisting of shares;
    - exit opportunity is given to public shareholders at same price at which the promoter/promoter group shareholders are given.
- There is also an exemption under SAST Regulations
  - Reg. 10(1)(da) exempts CD under IBC from the requirement of making public offer in case acquisition made pursuant to approved resolution plan

Consultation Paper dated November 10, 2022

- Para 10(E) of the Consultation Paper proposes for revisiting the carve out provided in Delisting Regulations to make the exemption available only in following cases-
  - CD has to undergo liquidation pursuant to CIRP;
  - Where RA fails to raise 5% of the diluted equity and the CD goes into mandatory delisting.

Overview of proposals

- Applicable only to **listed companies** undergoing CIRP
  - Will this be a part of CIRP Regs or LODR Regs?
- **Mandatory offer** to public shareholders to acquire shareholding in new CD, max upto 25%
- **Minimum level of acceptance** required to remain listed = 5%
- **Exemption from Delisting Regulations**, if delisting happens pursuant to not obtaining minimum acceptance (as above)
- Essentially:
  - Priorities under sec. 53 have not been tinkered
  - However, public shareholders , allowed to participate in the resolution process and have the potential benefit from the shares of New CD

Consultation Paper dated November 10, 2022

- to protect the interest of all stakeholders including minority public shareholders
- proposes new avenues for raising funds for the corporate debtor
- without compromising the speed and efficiency of CIRP process.

"Para 11 of the Consultation Paper states: In brief, the proposal aims to provide an opportunity to minority shareholders to participate in the resolution process on the same pricing terms as available to the resolution applicant (up to a maximum of 25%)"

Mandatory offer by RA to public shareholders

- To acquire equity of the fully diluted capital structure of the new entity
- Limit: to the extent of max. 25%
  - The intent may be limit public funding of the RA to the extent of 25%, and ensure sec. 29A
  - In case RA doesn't write down existing equity of CD to the extent of 100%, then, the 25% threshold will include the existing public shareholders (including promoter shareholding re-classified as public)
- Offer to be made in an equitable manner (proportionate):
  - seems like a rights offer
- Offer to be given to 'public shareholders'
  - For identifying public equity shareholders, a negative list has been provided which propose to include the following:
    - Promoter and Promoter Group
    - Shares held by associate companies and subsidiaries
    - Family members of Promoter and Promoter group not covered under definition of promoter group
    - Trusts managed by Promoter and Promoter group
    - Directors and Director's Relatives
    - KMPs of the Company
    - Public shareholder representing member on Board
- How much offer will be given to public shareholders?
  - Assume public holding is 60%
  - New CD to offer 25%
  - Hence, public holders will get 25%/60%*respective holding of the shareholder

Pricing of the public offer

- The pricing of the public offer shall be the same price at which shares have been offered to the RA in the New CD
  - The New CD is a new entity
  - The combination of equity/debt in the new CD is typically determined by the RA
  - However, whatever be the equity, the shares may be acquired by the RA in the New CD at their fair value
  - Can be the fair value be more than par or less than par
    - provisions of sec. 56 (2) (viib) do not apply to listed cos.
    - However, it will be counter intuitive to expect shares to be in the New CD being offered at more than fair value
  - Hence, public shareholders of the CD will have to infuse further funds to remain in the game
    - Feasible? - a question of trust on incoming RA

Minimum acceptance to be achieved to maintain listing status

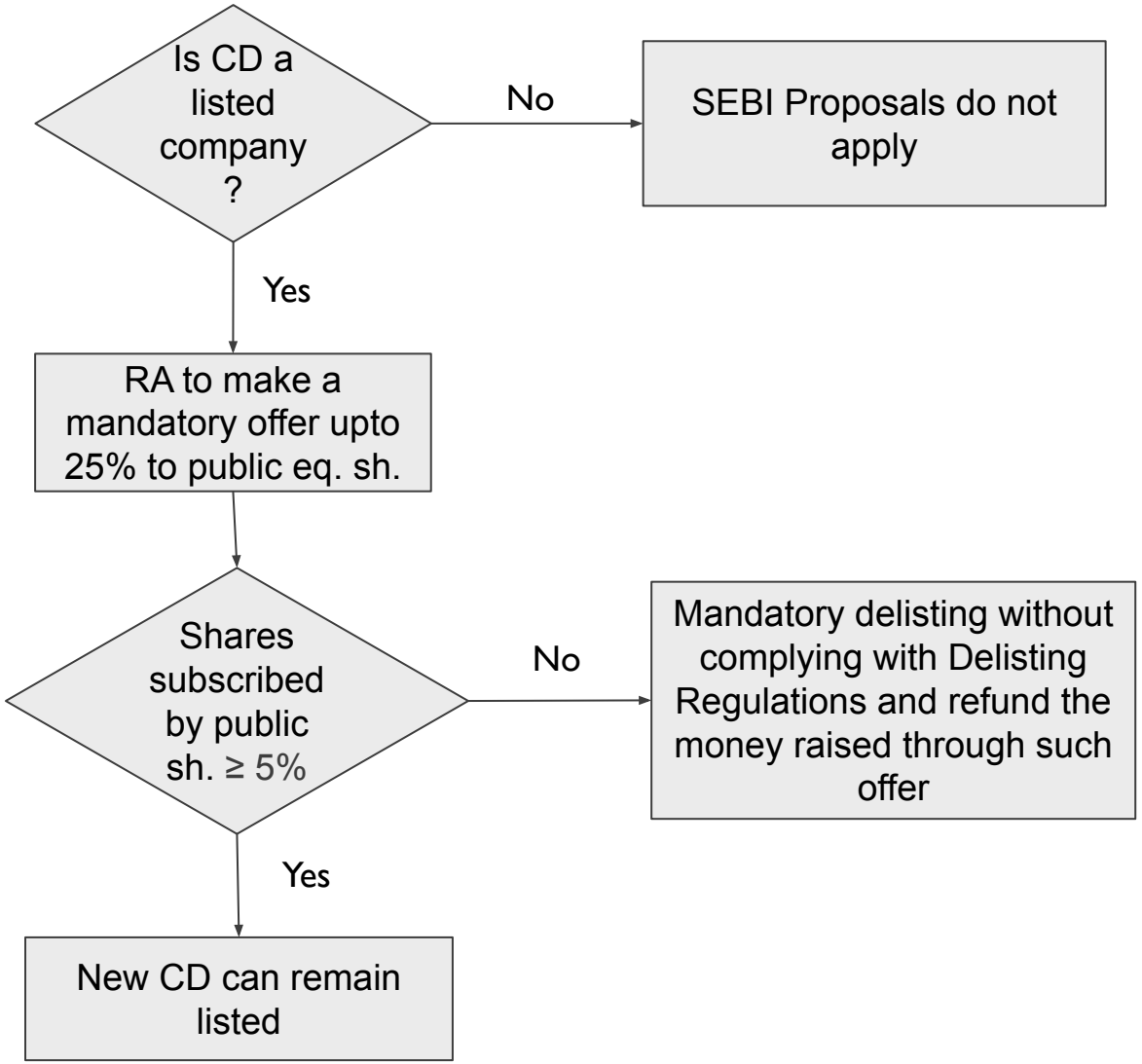
- At least 5% of the fully diluted capital structure of the new CD
  - rule 19A(5) of SCRR - company to maintain a min. 5% public shareholding pursuant to implementation of resolution plan
- If not received then:
  - New CD will get delisted, pursuant to "cancellation of offer"
    - Exemption from Delisting Regulations
  - Refund the money received from public shareholders pursuant to the offer
    - before proceeding further with CIRP
      - ideally, this should be before proceeding further with the implementation of the resolution plan; as, CIRP culminates with the approval of resolution plan
- What about MPS of 25%? No conditions and timelines prescribed; hence rule 19A of SCRR
  - Rule 19A(5): If public shareholding falls below 25% pursuant to implementation of resolution plan, max. period of 3 years (from the date of such fall) allowed
    - If falls below 10%, should be brought to 10% within 12 months from the date of such fall

- **No specification for scenarios where the RA intentionally wants to delist the CD**
  - No such option with RA
  - In case acceptance is above 5%, and RA wants to delist, RA will have to follow Delisting Regulations for New CD.
- **When should the offer be given?**
  - Provision in the resolution plan; proposals say "The above mechanism shall form an integral part of the resolution plan"
  - Further, RA may not be in a position to upfront specify the percentage of public shareholding, as a part of resolution plan
  - However, resolution plan may specify that that the entity may be permitted to continue as a listed entity only if 5 % of the fully diluted capital structure of new entity is with the public shareholders
  - Hence appears that such offer be given after approval of resolution plan (and subject to the condition of minimum acceptance)

Specific concerns and possible solutions/arguments

- The proposals do not clarify the scenario where the RA would not want to keep the CD listed
  - May be clarified that, in such case, Delisting Regulations will have to be followed
- Very often, the CD is subsequently taken for restructuring i.e., merge into another entity or demerge into several entities or acquired by SPVs, which then get various upstream investors
  - In each of these cases, the principle will be - whatever be the company acquiring the CD, the acquiring company will have to ensure public participation
- The timeline within which the process of raising money to be concluded is nowhere provided
  - Basically, the CoC cannot wait forever to receive the money that is due
  - Since the fate of the CIRP process is determined by the CoC, the timeline for making payment should also be at sole discretion of CoC
  - Alternatively, RA may be called upon to put the entire equity on table, and then go for public offer as offer for sale (OFS)
- RA may try reducing the equity ratio in resolution amount to reduce the quantum of offer
  - this may raise questions of fairness before AA
- Offer to public for equity participation - will it be seen as new issuance of securities/offer for sale?
  - What about compliances w.r.t issuance of securities? Also, whether would be considered as public offering or preferential issue (since offer is to identified public shareholders)
  - Suitable carve-out/clarification may be provided to avoid interpretational gaps
- Concerns as to default by RA in implementation of resolution plan
  - Infusion of funds by public shareholders is at their own risk, hence, the loss shall be borne by such shareholders
- How will the proposals be legislated?
  - may be either through LODR Regulations, and/or SEBI Delisting Regulations

Proposal w.r.t making mandatory offer (In gist)



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