

SEBI relaxes pricing guidelines and open offer obligations for preferential issues by companies having stressed assets

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1 Introduction

Securities and Exchange Board of India (SEBI) has introduced amendments to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) and the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Code) on 22 June 2020. The amendments aim to provide a mechanism to identify companies which have stressed assets, determine the pricing for preferential issues by such companies and provide related exemption from open offer requirements under the Takeover Code for such preferential issues.

2 Background

On 22 April 2020, SEBI had issued a consultation paper in connection with pricing of preferential issues by companies having stressed assets and an exemption from making an open offer for acquisitions in such companies. It had observed that companies having stressed assets face difficulty in accessing capital markets and experience steep fall in their share prices. A lack of capital at this stage may prove detrimental to the operations of the company.

SEBI identified that the prevailing pricing norms were hindering access to capital for these companies because the price in the preferential issue was to be calculated over a 26-week period. For a company in deteriorating financial condition and falling share prices, this led to a wide gap between the price at the beginning of such period and at the time funds were proposed to be raised. The price at the beginning of the 26-week period would invariably be higher, consequently making it more expensive for any potential investor to participate in a preferential issue by a company having stressed assets.

Accordingly, SEBI proposed certain changes in the pricing framework for companies with stressed assets to make it easier for such companies to access capital markets and invited public comments to such proposed changes. Considering the comments received, SEBI has now introduced a new regulation 164A (Regulation) in the ICDR Regulations for pricing of preferential issues by companies having stressed assets (Stressed Issuer) and consequent amendments to the Takeover Code to exempt such preferential issues.

3 Amendments introduced to the ICDR Regulations

3.1 Pricing for Frequently Traded Shares

| Other Issuer | Stressed Issuer |
|---|--|
| The pricing framework in a preferential issue for frequently traded shares is the higher of the average weekly high and low of the volume weighted average price during either (i) 26 weeks, or (ii) 2 weeks preceding the relevant date. | The price of equity shares in a preferential issue by a Stressed Issuer will be at least the average weekly high and low of the volume weighted average price of the equity shares on a stock exchange during the 2 weeks preceding the relevant date. |

SEBI has amended its ICDR Regulations in relation to pricing of preferential issues by companies having stressed assets. Consequent amendments have also been made to the Takeover Code exempting such issues from the open offer requirements under the Code.

3.2 Eligibility

| Other Issuer | Stressed Issuer |
|---|---|
| <p>The issuer must not have any promoter or director who is a fugitive economic offender.</p> | <p>In addition to the existing conditions applicable to Other Issuers, additional eligibility conditions have been prescribed for a Stressed Issuer. A Stressed Issuer must meet any two of the following additional conditions:</p> <ul style="list-style-type: none"> (i) it has disclosed all defaults relating to the payment of interest, repayment of principal amount on loans from banks, financial institutions or other financial companies and listed or unlisted debt securities, and such payment default is continuing for at least 90 calendar days after the occurrence of such default; (ii) there is an inter-creditor agreement (ICA) in terms of Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019 (Directions)^[1]; or (iii) the credit rating of the financial instruments, credit instruments or borrowings of the Stressed Issuer has been downgraded to "D". |

3.3 Who cannot subscribe

| Other Issuer | Stressed Issuer |
|--|--|
| <p>The preferential issue cannot be made to:</p> <ul style="list-style-type: none"> (i) any person who has sold or transferred any equity shares of the issuer during 6 months preceding the relevant date; or (ii) any person belonging to the promoter or promoter group who has previously subscribed to warrants of the issuer and failed to exercise for a period of 1 year from the date of expiry of tenure of warrants, or the date of cancellation of warrants. | <p>While the existing restrictions on who cannot subscribe to a preferential issue continue to apply, the following additional restrictions have been prescribed for a Stressed Issuer:</p> <ul style="list-style-type: none"> (i) its promoter or promoter group; (ii) undischarged insolvent; (iii) wilful defaulter; (iv) a person disqualified to act as director; (v) a person debarred by SEBI; |

^[1] Under the Directions, when a borrower is reported to be in default by any of the specified lenders and a resolution plan is to be implemented, all lenders to such borrower are required to enter into an ICA. The ICA will provide for finalisation and implementation of a resolution plan and must specify that any decision made by lenders representing 75% of total outstanding credit and 60% of lenders by number shall be binding on all lenders. The ICA may also inter alia provide for rights and duties of majority lenders and protection of rights of dissenting lenders.

| Other Issuer | Stressed Issuer |
|--------------|--|
| | <p>(vi) a fugitive economic offender;</p> <p>(vii) a person convicted for any offence punishable with imprisonment; and</p> <p>(viii) a person who has executed a guarantee in favour of a lender of the Stressed Issuer and such guarantee has been invoked by the lender and remains unpaid in full or part.</p> |

3.4 Shareholders' Resolution

| Other Issuer | Stressed Issuer |
|--|---|
| <p>The shareholder's resolution approving the preferential issue does not require any minimum number of votes from 'public' category or otherwise.</p> | <p>The votes cast in favour of the proposal for preferential issue by shareholders in the 'public' category must exceed the votes cast against the proposal. Proposed allottees in the preferential issue who already hold specified securities of the Stressed Issuer will not be included in the 'public' category.</p> <p>If there is no identifiable promoter, the votes cast in favour of the proposal must be at least 3 times the number of votes cast against it.</p> |

3.5 Use of Proceeds

| Other Issuer | Stressed Issuer |
|---|---|
| <p>There is no restriction on the use of proceeds of the issue.</p> | <p>The issue proceeds cannot be used for repayment of loans taken from promoters, promoter group or group companies.</p> <p>The proposed use of proceeds is required to be disclosed to the shareholders of the Stressed Issuer, in the explanatory statement to the notice calling the general meeting to pass the shareholder resolution for the issue.</p> |

3.6 Monitoring the Use of Proceeds

| Other Issuer | Stressed Issuer |
|--|---|
| <p>There are no requirements for monitoring the use of proceeds.</p> | <p>A monitoring agency must be appointed and is required to provide quarterly reports until 95% of proceeds are utilised.</p> <p>The audit committee of the Stressed Issuer must also monitor issue proceeds.</p> |

3.7 Lock-in

| Other Issuer | Stressed Issuer |
|--|---|
| Promoters and promoter group are subject to a lock-in of 3 years and the remaining allottees 1 year, from the last date of trading approval. | The lock-in requirements for all allottees is 3 years from last date of trading approval. |

3.8 Certification of Compliance

| Other Issuer | Stressed Issuer |
|---|---|
| Statutory auditors must provide a certificate confirming that the issue is in accordance with the ICDR Regulations, at the general meeting considering the proposed preferential issue. | Statutory auditors as well as the audit committee of the Stressed Issuer must certify that the conditions of the Regulation have been met at the time of: <ul style="list-style-type: none"> (i) dispatching the notice for the general meeting for passing the special resolution; and (ii) allotment of specified securities in the preferential issue. |

4 Amendments introduced to the Takeover Code

Consequent to the introduction of the Regulation, SEBI has amended the Takeover Code exempting any acquisition of shares or voting rights in a preferential issue by a Stressed Issuer in compliance with Regulation 164A of the ICDR Regulations, from the obligation to make an open offer under the Takeover Code.

This exemption is also applicable to target companies having infrequently traded shares who meet the conditions under the Regulation. The pricing norms to be followed for such companies, however, will continue to be the pricing framework for infrequently traded shares.

5 Analysis and Conclusion

The amendments introduced by SEBI relax the pricing norms for preferential issues by companies with stressed assets only and not for other companies. The Regulation provides that in order to qualify as a stressed company and take advantage of the relaxed pricing guidelines, a company is required to meet a minimum of two of the three prescribed conditions (described above). Compliance with these conditions could however get onerous and SEBI should consider relaxing this requirement. For instance, there may be a delay by the creditors while entering into an ICA or a delay by the credit rating agency in downgrading the credit rating of the company. In such cases, the company may have already defaulted and be in urgent need of raising capital but may be unable to meet the two conditions criteria of qualifying as a 'stressed' company under the Regulation.

Additionally, while the objective criteria for identifying 'stressed' entities is appreciated, many cash starved listed companies which do not qualify as 'stressed' under the Regulation would not benefit from the relaxed pricing requirements for raising capital from investors. Given the wide disruptions caused by the Covid-19 pandemic, SEBI may consider further relaxing the pricing norms for all companies, to encourage additional modes of fund raising. This will ensure capital infusion before a company goes into financial distress and becomes a 'stressed company'.

UPDATES

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