Public M&A Regulations – Key Highlights 2023

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This update covers:

The year 2023 saw some significant changes to regulations relating to public M&A transactions. Although there is growing recognition of the need for a more efficient regulatory framework as India matures as a market, the reforms agenda remained somewhat muted. The regulatory focus was primarily on strengthening governance and disclosure rules, some of which also have both direct and indirect consequences for public M&A transactions.

Reflections on the key changes in 2023 to regulations governing public M&A transactions.

The key highlights from the year are:

1 Foreign portfolio investors/financial investors allowed to sell shares through an '*offer-for-sale*'

The Securities and Exchange Board of India (**SEBI**) notified a Comprehensive Framework on Offer for Sale (**OFS**) of Shares through Stock Exchange Mechanism in January 2023, to ease the rules for selling shares through an OFS on the stock exchange.

The OFS route allows shareholders in listed companies to divest significant stakes on the stock exchange through a public bidding process. Earlier, only shareholders holding at least 10% in the listed company could sell their shares through the OFS process. This route is now open to all shareholders, subject to a minimum transaction value of INR 25 crore (~USD 3 million). (To read our detailed update on this amendment, click here.)

This is a positive step towards developing a vibrant secondary market for large stakes in listed companies. For foreign portfolio investors (**FPI**) and other financial investors, in particular, this is good news as the OFS route allows sellers to access a broader market for their shares with more flexibility on pricing, relative to a

negotiated '*block sale*' (which has thus far been the default route for sale of large stakes on-market, but which carries significant constraints on pricing[1]).

2 Shareholders' approval for '*special rights*'

In July 2023, SEBI mandated shareholders' approval (>75% of voting shareholders) for granting any '*special rights*' to a shareholder of a listed company, through an amendment to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015) (**Listing Regulations**). (To read our detailed update on this amendment, click here.)

This approval will remain valid for five years at a time, after which fresh shareholders' approval will be needed. The term '*special rights*' is not defined and is likely to be construed broadly to pick up any rights that are not uniformly available to all shareholders.

The sunset period of five years is at odds with settled principles of corporate and securities laws. Shareholders' rights are typically entrenched in the articles of the company (with shareholders' approval), which remain effective until they are next amended (there is no requirement to refresh the articles after every five years).

This would impact investors with a long-term investment horizon, who would typically wish to rely on a package of rights for the life of the investment – they would now be dependent on shareholders renewing the rights-package after every five-year period. The amendment is silent on the ability of the specific investor (and persons acting in concert) to vote on such resolution.

There is also the question of whether this requirement is intended to extend even to *inter-se* shareholder arrangements, which do not bind the company. One could argue that it should not, insofar as these are not special rights granted by the company but only contractually agreed between the relevant shareholders.

Given these concerns, it may perhaps have been preferable to leave this matter to the commercial incentives of parties in M&A deals. In particular, in the context of financial/minority investments or joint ventures, it is standard practice to make any shareholder rights subject to fall-away shareholding thresholds.

3 Mandatory disclosure of *inter-se* shareholder agreements

In July 2023, SEBI also mandated disclosure of agreements among shareholders of listed companies, which impact "*the management or control of the listed entity*", even if the listed company is not a party to the agreement, through an amendment to Regulation 30 of the Listing Regulations. (To read our detailed update on this amendment, click here.)

The move follows recent instances (such as NDTV), where promoters of listed companies had ceded significant rights to third parties without disclosing such arrangements to the market. As SEBI's market disclosure requirements apply primarily to listed companies (and not to shareholders, except for limited purposes), it was not uncommon until now for shareholders to enter into bilateral arrangements (such as vote-alongs, share-transfer restrictions, and call-put options), which were not always made known to the market.

Many such *inter-se* agreements would now need to be disclosed, depending on whether a particular agreement can be said to impact the management/control of the listed company. This assessment will be transaction-specific, and it remains to be seen how broadly SEBI construes this requirement. For instance,

1 The trading price for a block trade must be within ±1% of the previous day's closing price.

SEBI's general approach towards veto rights (in the context of public takeovers) is that such rights do not amount to *'control'* so long as they are limited to protective/strategic matters and do not extend to business and operating decisions[2] — will the same principle apply here, such that *inter-se* vote-alongs in respect of limited reserved matters need not be disclosed? Another aspect to consider is *inter-se* share transfer restrictions – there would be good basis to argue that such provisions, by themselves, do not impact management or control of the company and hence, need not be disclosed in all cases.

4 Majority-of-minority approval for business transfers

In June 2023, SEBI mandated '*majority of minority*' (i.e., >50% of public shareholders) approval for significant business transfers (i.e., transfer of 20% of the value of an '*undertaking*' of the company, where an undertaking is defined as a business that contributes 20% of income of the company or in which the investment of the company exceeds 20% of its net worth). (To read our detailed update on the amendment to Regulation 37A of the Listing Regulations, click here.)

The majority-of-minority approval requirement for all business transfers is somewhat onerous and at odds with general principles of corporate and securities laws, as ordinarily, such a high threshold for shareholder approval is reserved for exceptional cases, such as related party transactions. Even in the context of a business transfer that occurs as part of a '*scheme*' of demerger under the Companies Act, 2013, majority-of-minority approval is only required in limited cases where, for instance, the business is being divested to the promoter group of the listed company or if the consideration being paid to public shareholders is not in the form of listed equity.[3]

5 Specific confirmation or denial of market rumours

In July 2023, SEBI proposed casting an affirmative duty on large, listed companies (top-250 by market cap) to specifically confirm or deny media reports relating to an "*impending specific material event or information*", through an amendment to Regulation 30(11) of the Listing Regulations. (To read our detailed update on this amendment, click here.)

Until now, most listed companies have taken the approach of largely ignoring media speculation on M&A/PIPE deals that are in the pipeline, even if the deal in question is at a relatively advanced stage of negotiations. This has attracted regulatory censure in recent times (e.g., in the Facebook-Jio transaction).

Whether a particular transaction qualifies as "*an impending specific material event*" will be a fact-specific assessment, depending, for instance, on the materiality of the transaction and the stage of negotiations.

While SEBI's intent is to mitigate informational asymmetries in the market, this amendment is likely to have some significant unintended consequences for public M&A, particularly, on price certainty. For many public M&A deals, the deal price needs to take into account the historic trading price of the stock over a trail period (looking back from deal signing). Premature leaks (in advance of signing) could distort market prices and impact transaction/price certainty for parties.

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2 See SEBI's Consultation Paper on "*Review of the regulatory framework of promoter, promoter group and group companies as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018*" dated 11 May 2021 and the decision of the Securities Appellate Tribunal dated 15 January 2010 in *M/s. Subhkam Ventures (I) Private Limited v the Securities and Exchange Board of India*.

3 See SEBI's circular on "*Schemes of Arrangement by Listed Entities*" of November 2021.

SEBI has proactively responded to this criticism by deferring implementation of this amendment until this issue is addressed and has released a consultation paper in December 2023, proposing certain mechanisms to ensure that the '*undisturbed price*' (i.e., after adjusting for any impact of the premature leak on the stock price) is considered for calculation of the relevant floor prices under the regulations.

6 Proposed reforms to delisting regulations

In a significant move to rationalise the rules relating to take-private transactions, SEBI proposed a new method for delisting at a fixed offer price as an alternative to the existing reverse book building method of price discovery in its Consultation Paper on Review of Voluntary Delisting norms under SEBI (Delisting of Equity Shares) Regulations, 2021 released in August 2023. (To read our detailed update on the consultation paper, click here.)

Market experience suggests that besides being overly complex, the reverse book building method has, more often than not, produced sub-optimal outcomes for stakeholders, with the delisting price often reflecting an exorbitant premium over the regulatory floor price. The proposed fixed-price method promises a significantly more streamlined process and also leaves little room for speculation on the delisting price, which should help insulate the delisting process from bad actors. However, it remains to be seen whether the regulator ultimately follows through with this proposal.

Looking ahead

The year 2023 saw several regulatory changes targeted at bolstering checks and balances (including rights of minority shareholders) in public M&A transactions. It is hoped that the work that has gone into building a strong foundation of governance standards would allow the regulator to move swiftly towards bolder reforms in the coming years. The wish list includes more streamlined rules for public takeovers and take-private transactions, besides more bright-line tests, as far as possible.