APPLICATION OF SECURITIES LAW REGULATION TO MERGER IN INDIA: A CRITICAL STUDY OF LEGAL REGIME REGULATING SUCH RESTRUCTURING AND ROLE OF REGULATORY AUTHORITIES IN TRANSACTION

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Abstract

Under 1992, Securities Exchange Board of India Act came to give statutory power to SEBI which was established in 1988. This Board was established to protect the interest of investors. This Article aims to establish role of SEBI in Mergers in India and how SEBI acts like a watchdog in Indian legal regime and ensure the proper disclosures when a company wants to get merger with other company. The Role of SEBI becomes important because in Merger, which is a form of corporate restructuring one or more company in that merger get dissolved. As a consequence of that it becomes important to ensure proper disclosure of various details which SEBI does through SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 at the same it pricing of share and determination of Share Transfer Ratio also become important which is determined by SEBI(ICDR) Regulations . Role of SEBI becomes more crucial when it comes to merger of listed company with an unlisted company. In this article Researcher has explored various angles where role of securities laws becomes important in Merger and what kind of role does SEBI play in this kind of corporate restructuring.

I. INTRODUCTION

"An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto"[1]

This is the Aim of Securities and Exchange Board of India Act, 1992 was created, which was created with an intention to establish a board that protect the interest of shareholder and also regulate the securities market in India. Security and Exchange Board of India was established

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[1] SEBI ACT,1992

in 1988 but Statutory power to this Board were conferred on 30 January 1992. SEBI performs various functions of quasi -legislative, quasi- judicial and quasi- executive which means the Board can formulate certain regulation, it can conduct investigation and also enforce those regulation along with related provisions of various Acts. In this project the researcher will try to explain how securities law regulations are applied to mergers in India and what is the role of Securities and Exchange Board of India in regulating such restructuring of the company.

Following the liberalization, privatisation and globalisation policy in India from the year 1991 the boom of industry is self- evident in various sectors not going far away 2018 was a big year for mergers in India. Various top deals such as merger of Vodafone-Idea, merger of three banks i.e. Bank of Baroda, Vijaya bank and Dena bank, Tata steel and Bhushan steel and many other mergers happened. Now after looking these example a question arises that what is the importance of merger as corporate restructuring and how does SEBI regulates these mergers is it regulates through certain special regulation or is there any provision is given under Companies Act 2013 itself and if SEBI regulates then what is the need for SEBI to regulate such corporate restructuring.

Before going to the concept of merger it is very important to explain the concept of corporate restructuring. In the words of J. D.Y Chandrachud-

"Corporate restructuring is one of the means that can be employed to meet the challenges and problems which confront business. The law should be slow to retard or impede the discretion of corporate enterprise to adapt itself to the needs of changing times and to meet the demands of increasing competition. The law as evolved in the area of mergers and amalgamations has recognised the importance of the Court not sitting as an appellate authority over the commercial wisdom of those who seek to restructure business."[2]

Therefore, corporate restructuring is considered to be one of the accepted strategies of expansion.

Concept of Merger and Amalgamation is not directly explained in Companies Act, 2013 or Income tax Act, 1961 and even the rules of 2016 related to Scheme of arrangement, amalgamation also do not include the definition. Merger and Amalgamation is often used interchangeably but their procedures are different. 'Merger' is the fusion of two or more

[2] Ion Exchange (India) Ltd, Re(2001) 105 Comp Cases

company where identity of one or more company who is participating in that merger is diminished. In merger there is one transferor company and other is transferee company.

Transferor company and the transferee company has to be a company within the meaning of Section 2(20), that is company incorporated under Companies Act of 2013 or previous Companies Act[3]. In Andhra Finance ltd. v. Andhra Bank[4] it was held that "It is apparent from a perusal of the provision that the transferee company shall invariably be a company within the meaning of the Act. However, the transferor company includes a "body corporate". Therefore, for the purpose of section 394 the transferee does not include any company other than a company within the meaning of the Act." (This case is related to Companies Act 1956, so sections used can be interchanged by sections of Companies Act 2013).

In merge when one or more participant company loses its "sperate entity", so it becomes very important to look into the rights of various stakeholders such as investors of securities more likely shareholders, creditors, employees etc. As in the above-mentioned stakeholders' shareholders interest is crucial because they are large in numbers as well as they are unsecured people also their loss might shake the public trust. Therefore, it becomes very important to have some regulatory approach towards protecting the rights of shareholders.

Therefore, as a result SEBI pitch in as a gatekeeper and watchdog and ask from Companies to give proper disclosure of their Scheme of arrangement.

II. PROCEDURE FOLLOWED IN MERGER UNDER COMPANIES ACT 2013 AND ROLE OF SEBI

Compliance of securities law becomes very important in all the three level of the company whether it be at entry level , existing level or at exiting level because company do not exist in vacuum they exist in public market therefore in order to regulate capital market and securities which is involve in company securities laws has to govern and regulate the participation in public market.

In the year 2013 SEBI has vide the circular dated February 4, 2013 which streamlined the requirement to be fulfilled by the listed companies although these guidelines were in

[3] Section 2(20), The Companies Act, 2013.
[4] (2003) 47 SCL 513 (520)

consonance with Companies Act 1956 but it become important to analyse the regulatory approach of SEBI and how SEBI tried to streamlined its situation with the then Companies Bill 2012. SEBI introduced Listing, equity shares with differential rights and warrants that are stapled with non-convertible debenture in the scheme of arrangement to be comply with Rule 19(2)(b) of the Securities Contracts (Regulation) rules, 1957. Now rest merger of two listed companies, merger of one listed and one unlisted company is discussed in further part of paper is largely based upon the disclosure given by the company.

In Indian law regime under The Companies Act of 2013, Chapter XV under section 230 and 232 gives the detail procedure as to how to formulate the scheme of arrangement and how we need to go about getting the scheme approved by central government, competition commission of India, Security Exchange Board of India, and various other sectoral regulators or authorities.

Important for this project is to see how Security Exchange Board of India plays a role in Scheme of arrangement which is for merger of listed companies. Section 230 subsection 2 provides to have certain disclosures with tribunal by affidavit. Subsection 3 requires to send the notice of meeting along with proposed scheme of arrangement and relevant documents along with explaining the effect of that scheme on creditors, promoters, managerial personnel etc. to creditors or class of creditors, members or class of members etc. However, that such notice along with other document has to put on website. When the company who is proposing the scheme is listed company then such disclosure has to be made to Security Exchange Board of India.

In meeting is any objection is raised by person holding 10 percent of share or 5 percent of debt then notice shall be also be send to SEBI in case of listed company.

Under Section 232, which gives an exclusive procedure about how to proceed with "Merger and Amalgamation of Companies" Subsection (3) of this section provides that where transferor company is a listed company and transferee company is unlisted company, this researcher will deal in next part of this paper.

These disclosure by companies are regulated by *Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015*. Regulation 11 of this Regulations provides a mandatory provision where listed entity shall ensure any scheme arrangement/amalgamation/merger/reconstruction/reduction of capital which is to be present to tribunal does not in any which way violating, override or limit the provision of securities

laws or requirement of stock exchange.[5] This regulation proves that how important is to uphold shareholder's interest and indirectly public interest by ensuring transparency and credibility.

Regulation 28 ask approval from the recognised stock exchange where the company is listed and seek no objection certificate before getting further with scheme of arrangement.

The most immediate goal of the securities law provisions is to focus on providing better disclosure environment. This happen when supported by an active market where every competing company want to have proper disclosure of the company with whom it is going to merge. A well-functioning disclosure system increases market's "informational efficiency".

Disclosure of information becomes very important when Security regulators want to prevent Insider trading. Securities and Exchange Board of India Act, 1992 along with (Prohibition of Insider Trading) Regulations, 2015 gives an extensive provision to combat with insider trading. Although Insider trading by disclosing unpublished price sensitive information is less seen in schemes of Merger. *In the Merger of Vodafone and Idea* SEBI gave a conditional approval to the $23 billion merger, in this merger SEBI has investigated whether Pilani investment acquiring Idea share just few days before the merger violates insider trading rules as Pilani investors were one of the promoters of Idea Cellular.

In tandem with a prohibition on Insider trading, a more information especially which is undisclosed might lead to undue advantage of those who knows more about the issuer's prospects. Therefore, participation of Securities market will be broader, with positive effect on market liquidity.

In all jurisdiction imposition of disclosure duties on companies with securities traded on domestic public training markets do not allow companies to make disclosures of their own choice rather different jurisdictions may differ in quantity and content of information that they require company to disclose which may differs from minimal to extensive. However, merger is although scheme of arrangement which is result of mutual decisions but certainly there are some areas which researcher have stated where SEBI needs to look into.

In 1998, SEBI issued a circular stating " When two or more corporate broking firms merge leading to creation of a new entity, the SEBI registration granted to the extinguishing entity

[5] Regulation 11 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015

does not automatically devolve upon the emerging entity and the new entity has to fulfil the eligibility criteria and apply afresh for registration and pay the registration fees.

It is generally seen that while the application comes to SEBI after the court has approved the scheme of amalgamation/ merger, the existing entity is required to seek prior approval from SEBI in case of any change in its constitution, in terms of Rule 4(c) of SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992. Therefore, you are advised that as soon as the application for merger is filed before the High Court, the extinguishing broking entity should approach SEBI through the Stock Exchange for obtaining prior permission, to the scheme of merger/ amalgamation giving all necessary details of the proposal.

It is also seen that some of the Stock Exchanges would be inclined to disconnect the trading terminal of the extinguishing entity, on the approval of the scheme of the merger by the High Court until SEBI grants registration to the new emerging entity. As this may cause hardship to the business interests of the emerging entity, it is suggested that the emerging entity may be allowed to trade on the registration of the extinguishing entity for a period of say 45 days. However, the emerging entity should apply to SEBI at the earliest and give an undertaking to be liable for the act of the extinguishing entity and such applications in any case should be made not later than 30 days of the registration granted by the Registrar of companies to the emerging entity. In view of the above, you may consider amending the Bye-laws/ trading rules suitably."[6]

The above circular shows that even the company is of any nature, SEBI pitches in where investors interest is involved. The most critical area where SEBI plays a very important role is merger of listed company with unlisted company which is also known as reverse merger.

III. MERGER OF UNLISTED COMPANY WITH LISTED COMPANY

Section 232 (3) (h) of Companies Act enshrined the provision where transferor company is a listed company and the transferee company is unlisted company, -

(A) In this case the transferee company will continue to be an unlisted company until it becomes a listed company.

[6] Merger and Amalgamation of trading member, SEBI circular18/98 issued on July 09 1998

(B) this part provides that, if shareholders of transferor company which is listed decide to opt out of the transferee company which is unlisted, the provision shall be made for payment of the value of share held by transferee company and other benefits in accordance with the price formula which is pre-determined or according to the valuation made and the arrangement under this provision may be made by the Tribunal.

However, the amount of payment or the valuation of any share under this clause shall not be less than what has been specified by SEBI.

However, if the transferor company dissolves then if any fee paid by the transferor company on its authorised capital shall be consider as set – off against any fee which is payable by transferee company on its authorised capital subsequent to the merger.

SEBI is mindful of corporate governance problem which arises in merger of two entities which are not on same standing, there the situation of one company which is not at good position tries to take advantage of other which holds a better position. To curb the overzealous promoters drafting their own scheme of arrangement where the big unlisted company want to acquire the small listed company in order to facilitate its listing on stock exchange, SEBI made certain changes in listing agreements requiring stock exchange to preapprove all the schemes involving listed company as per SEBI's LODR guidelines. But then SEBI realised that there was certain imperfection in implementing those guidelines. Pursuant to the notification of the SEBI(Listing Obligation and Disclosure requirement) regulations, 2015 new guidelines were issued with following salient features-

1. **Pricing of shares**

Issuance of shares under scheme of arrangement where shares are to be allotted to a select of shareholder or shareholder of unlisted companies are subject to Issue of capital and disclosure Regulations which were applied in case of preferential allotment of shares. However the circular does not specify the date when the price of these share is to be computed but it mentioned that such calculation will be from "relevant date", relevant date for this purpose will be date on which board meeting of such company passing the scheme of arrangement.[7]

[7] http://www.sebi.gov.in/cms/sebi_data/attachdocs/1490268460576.pdf(Last seen Dec 14,2019)

Therefore by this circular SEBI has intervene as to what shall be the fair value of the share involved.

In this provision a little clarity on "shares are allotted to a select group of shareholders" is required. SEBI intent may to be to ensure balance between the shareholders and this provision can be interpreted to mean that there can be significant impact on flexibility while drafting the scheme of arrangement.

The circular provides for pricing norms in case where shares are allotted to the shareholder of unlisted companies, however there is no guidance on whether on whether pricing will be applicable on shares of listed company.

So, there is lot of confusion about pricing norms as to whom they will be applicable and what is the intention of SEBI while issuing them.

2. **Scheme of arrangement between listed and unlisted companies**.

There is certain requirement which have been specified when the scheme of arrangement is between listed and unlisted companies.

2.1 Abridge Prospectus- The listed company is required to provide information with regards to unlisted company in the format specified for abridged prospectus in the explanatory notice, then this notice to be sent to shareholders while for seeking their approval.

2.2 Qualified Institutional Buyers- The percentage of shareholding of pre scheme public shareholder of listed company and qualified institutional buyer of the unlisted entity shall not be less than 25% post-merger.

2.3 Unlisted companies can be merged with the listed company having nation wide trading terminals.

3. **Submission of documents**

In addition to the document submitted to fulfil the requirement of Section 230 and SEBI guidelines i.e draft of scheme of arrangement, valuation report, auditor's report etc. Listed company in the given merger also has to submit detailed self-compliance report which will be

certified by Company secretory, Chief financial officer and managing director and this report shall confirm the regulatory and accounting compliance.

4. **Approval of scheme by shareholders through e-voting**

The listed companies must ensure that the Scheme of arrangement which is submitted to the Tribunal, provides for e- voting by public shareholders. The purpose behind introducing this mechanism is to ensure that there is no interference by promoter in terms of voting mechanism.

5. **Processing of Scheme by SEBI**

SEBI can ask information about the scheme from any person in relation with the scheme and it can also seek an opinion from an independent chartered accountant when scrutiny is done by SEBI. Even in practice it is evident that certain changes in the draft scheme to be filled before tribunal after SEBI has made its observant in letter. Therefore, SEBI has provided in circular that is any changes are to be made in the Scheme after specific written consent of SEBI.

6. **Merger of a listed entity into unlisted entity**

Rule 19 of Securities Contract Regulation Rules provides the procedure to be followed by a public company in order to get their shares listed on recognised stock exchange in India. Many a time unlisted companies sought approval to the merger with listed companies and an approval to such scheme of merger would have enable the shares of unlisted company to get listed on the stock exchange without having complied with strict vetting which is placed under SCRR. SEBI with a view to maintain the faith of public market had often issued letters to the entity which circumvent the enforcement of Securities Contract Regulation Rules. However, there was need felt to have a properly constructed mechanism. Therefore, SEBI issued certain eligibility criteria-

6.1 Unlisted company sought to list their equity shares in pursuant to the scheme of arrangement.

6.2 At least 25% of the paid-up share capital of resulting company from the merger shall comprise of share allotted to the public shareholder of earlier listed entity.

6.3 There shall be no further issuance or re issuance of shares that have not been covered under the scheme of arrangement.

6.4 The Lock- in period is applicable to the shares of listed entity, those shares will be transferred to the company which will form as a result of merger and those transferred share will be subject to lock- in for the significant remaining period.

Recently the Security Exchange Board of India has issued a circular[8] amending the existing circular of 2017 and in recent one they have provided framework for the listed companies which are involved in the Scheme of arrangement. The amendments were made regarding the lock in norms and also misuse to bypass the regulatory authority. This amendment is in line with ease of doing business. The *inter-se* transfer between the promoters and of the locked- in shares and allowing to pledge these locked-in shares for raising fund.

With is circular SEBI has attempted to strike a balance between need to protect the interest of investors and also the integrity of public market as against the commercial and economical reason of business community. Moreover, the recent amendment to various regulation and the decisions taken by SEBI is in light to encourage the practice of good corporate governance, The SEBI intent to ensure the place for corporate governance in listed company while also intent to ensure that shareholders of listed company to be protected.

If we see the above mechanism from the commercial prospective then although certain flexibility is diluted in transaction of merger between listed and unlisted companies. However there has to be more clarity as a Securities regulator regarding merger of listed and unlisted companies.

CONCLUSION

After discussing various angles of application of Securities laws to merger in India the question which appears Is the role of SEBI is only of regulator in India or do ‘s legal regime follows the Gatekeeper control in relation to SEBI?

Gatekeeper control is one of the most traditional and important approach to ensure the compliance with securities regulation. Either by way of voluntary or in compliance of legal

[8] 1 CFD/ DIL3/ CIR/ 2018/ 2 dated 3 January, 2018

regulation the transferor and transferee companies in the scheme of arrangement has to make a credible disclosure.

In both accounting standards and securities regulation there is a case where disclosures has to be in line with legal requirements. Securities laws have often assimilated such kind of practice by providing certain kind of initial check for listed companies even before they enter into the scheme of arrangement of merger. In listed companies large amount of investor's stake is involved which becomes important to be protected so if the SEBI take ex ante approach and ask respective participants of Scheme of arrangement to disclose the valuable information. If SEBI will apply ex post approach then by that time if the scheme is potential to cause damage then by that time enough damage must have occurred to investors interest.

Importance of SEBI is correctly recognised in our legal regime by providing certain disclosures which are to be made under Section 230 and Section 232. These sections prove the point that when the company works in public market at that time it becomes very important to keep the interest of inventors at paramount. SEBI's ICDR regulation ensures that pricing of shares in the scheme should be according to the pricing standard and formula not at the whims and fancies of the promoters of company where as SEBI's LODR regulations ensure proper disclosures of the information which is in relation to the scheme of arrangement. Above we have also discussed SEBI's guidelines about Prevention of Insider trading which prohibits from illegal disclosure of undisclosed information.

In the legal regime of India the role of SEBI is very much crucial especially when corporate restructuring is involved. SEBI adopts a gatekeeper approach in the Scheme of Merger where it ask to disclose all the relevant information related with the scheme of arrangement at the very initial stage of proposed scheme without waiting for any adverse effect.