Voluntary Delisting

The current situation caused by the COVID-19 pandemic is unprecedented and several listed companies have seen a reduction in their value due to the sharp fall in stock prices compared to the beginning of 2020. The recent weeks have also seen delisting announcements by certain widely held companies including those on the NIFTY-50 and subsidiaries of global corporations.

Voluntary delisting is essentially a strategic move where a promoter (controlling shareholder) of a listed company and the listed company seek to delist the shares from the stock exchanges in India and is primarily governed by the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, as amended (the "**Delisting Regulations**").

This note discusses the legal framework and process for voluntary delisting under the Delisting Regulations and certain key issues involved in delisting.

RATIONALE FOR VOLUNTARY DELISTING

While there could be many reasons for delisting, the uncertain business environment and market volatility caused by the current pandemic and the continued cost and effort of regulatory compliance have catalyzed voluntary delisting as an option for some promoters. There may be other advantages, such as seeking to purchase the shares at an attractive value with a view to enhance investment in private hands or preventing any future takeover bids.

Maintaining a listing status generally involves various ongoing costs of compliance that a company has to incur under the listing regulations of the Securities and Exchange Board of India (the "**SEBI**") and the stock exchanges, including those relating to financial reporting requirements, on-going disclosures and the increased demands on management to develop a good relationship with analysts and investors. Delisting may also provide companies the strategic and financial freedom to undertake certain restructuring to tackle the current business environment, utilize cash-flows for group-

level activities without increased scrutiny from public shareholders and generally ensure quick decision making.

PROCEDURE FOR VOLUNTARY DELISTING

The procedure for voluntary delisting varies depending on whether the company chooses to selectively delist from certain stock exchanges or from all stock exchanges. The primary difference would be providing the public shareholders with an exit opportunity when the company completely delists its securities from all the stock exchanges. A company has to meet certain qualifying conditions prior to initiating the delisting process, failing which, neither can the company apply for delisting nor can the relevant stock exchanges approve such delisting of equity shares. Such conditions include:

(i) the delisting should not be pursuant to a buyback of equity shares by the company or pursuant to a preferential allotment made by the company;

(ii) a period of three years should have elapsed since the listing of that class of equity shares on any recognized stock exchange (only applicable in case of delisting from all stock exchanges);

(iii) no instruments issued by the company, which are convertible into the same class of equity shares that are sought to be delisted, are outstanding (only applicable in case of delisting from all stock exchanges);

(iv) no promoter or promoter group can propose delisting of equity shares of a company, if any entity belonging to the promoter or promoter group has sold equity shares of the company during a period of six months prior to the date of the meeting of the board of directors (the "**Board**") in which the delisting proposal is sought to be approved (discussed below); and

(v) no company can apply for and no recognized stock exchange can permit delisting of convertible securities.

If a listed company proposes to voluntarily delist itself from all stock exchanges, the Delisting Regulations require it to, *inter alia,* comply with the following key steps:

(i) A voluntary delisting offer from the promoters should be presented to the Board to obtain the approval of the Board. While approving the delisting proposal, the Board is required under Regulation 8(1B) of the Delisting Regulations to certify (a) compliance of securities laws by the listed company and the promoters and (b) that the delisting is in the best interest of the company.

(ii) Even prior to granting its approval above, the Board is required to inform the stock exchanges about the proposed delisting proposal and appoint a merchant banker under Regulation 8(1A) of the Delisting Regulations for carrying out due diligence. The merchant banker then has to conduct due diligence and submit a report (the "**Merchant Banker Report**") to the Board to certify that the trading in shares carried out by the promoter and its related entities in the past two years have been in accordance with the provisions of securities laws, the promoter and the promoter group have not carried out any undisclosed buy or sell transactions in the past two years, and that the promoter, promoter group, persons acting in concert with them and related entities have not carried out any transaction to facilitate the success of the delisting offer which is in contravention of Regulation 4(5) of the Delisting Regulations (which prohibits such persons/entities to (a) employ any device, scheme or artifice to defraud any shareholder or other person, (b) engage in any transaction or practice that operates as a fraud or deceit upon any shareholder or other person, or (c) engage in any act or practice that is fraudulent, deceptive or manipulative in connection with any delisting sought or permitted or exit opportunity given or other acquisition of shares made under these regulations).

(iii) Obtain shareholders' approval for the delisting by way of a special resolution through postal ballot, with the number of votes cast by public shareholders (i.e., not including the promoter and promoter group) in favor being at least twice those against it.

(iv) Apply to the stock exchange for in-principle approval accompanied by an audit report as required under Regulation 76 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018, as amended, in respect of the equity shares sought to be delisted, covering a period of six months prior to the date of the application. In addition to the specific requirements provided under the Delisting Regulations, the stock exchanges have their respective checklists of actions and documents that are required to be completed prior to granting in-principle approval and the merchant banker typically coordinates this with the stock exchanges.

(v) Make a public announcement after obtaining in-principle approval containing specified information about the delisting process in accordance with Regulation 10 of the Delisting Regulations. Before making such a public announcement, the promoter is required under Regulation 11 of the Delisting Regulations to open an escrow account and deposit therein the total estimated amount of

consideration calculated on the basis of floor price and number of equity shares outstanding with public shareholders.

(vi) Issue a letter of offer in accordance with Regulation 12 of the Delisting Regulations to the public shareholders containing all disclosures made under the public announcement and such disclosures as may be required by the shareholders to make an informed decision.

Bidding and determination of offer price for purchase of equity shares from the public shareholders through a "reverse book-building process" of discovering price. Through this process, the final offer price is determined as the price at which equity shares accepted through eligible bids takes the shareholding of the promoter along with the persons acting in concert to 90% of the total issued equity shares ("**Offer Price**"). However, the promoter is not required to accept such Offer Price.

(vii) As an optional step to accepting the Offer Price determined under the reverse book-building process described above, the promoter may make a counter offer for the price in accordance with Regulation 16 of the Delisting Regulations, which cannot be lower than the book value of the company as certified by the merchant banker.

(viii) The delisting offer is deemed successful only if (i) the post-offer promoter shareholding (together with persons acting in concert) is at least 90% of the issued shares and (ii) at least 25% of the public shareholders approving the delisting proposal participate in the process (this 25% requirement is not required if the acquirer and merchant banker demonstrate that the letter of offer has been delivered to all shareholders through specified means).

(ix) Make a public announcement of success or failure of delisting offer in accordance with Regulation 18 of the Delisting Regulations.

(x) Final application to stock exchange for delisting, which must be made within one year from the date on which the special resolution for delisting is adopted by the shareholders.

It is important to highlight that a company that is successful in delisting its equity shares is not permitted to apply for listing its equity shares for a period of five years from such delisting.

ROLE OF PUBLIC SHAREHOLDERS

The Delisting Regulations provide for a high threshold for a successful delisting and public shareholders enjoy substantial rights under the Delisting Regulations to control the delisting process. Among other requirements, Regulation 17 of the Delisting Regulations provides that an offer for purchase of equity shares will be considered successful only if the post-offer promoter shareholding along with persons acting in concert reaches 90% of the total issued shares. Also, the requirement of the approval of the majority of minority public shareholders means that public shareholders have an important role in determining whether or not the delisting process should proceed at all.

The public shareholders also play a key role in price discovery in any voluntary delisting offer. The price discovery process under the Delisting Regulations only prescribes a floor price (calculated with reference to Regulation 8 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as amended (the "**Takeover Code**")) and not a maximum price, which may result in other factors that could influence the delisting price. The reverse book-building price discovery process provides the ability to public shareholders (especially entities with large positions) to have a say in determining the relevant delisting Offer Price. In the past, as a result of these restrictions, companies have faced the consequences of an unsuccessful delisting. A recent amendment by the SEBI provides the promoter with an option to counter the Offer Price of the public shareholders, provided it is not less than the book value of the company. Although these amendments have made the process slightly easier, companies need to consider upfront whether or not large public shareholders will be supportive of such transaction.

MANIPULATION OF DELISTING PROCESS

Engagement with third parties, including public shareholders, may result in allegations of collusion and manipulation by the regulators. In the recent past the SEBI has penalized companies indulging in such practices. In April 2020, following an investigation in the matter of trading in the shares of ECE Industries Limited ("**ECE**"), the SEBI pursuant to a settlement order imposed a fine of Rs.2.5 million on each of the promoters (and entities connected with the promoters) on the basis that ECE had delisted with the help of external parties who had driven down the price discovery pursuant to the bidding process. In its order, the SEBI noted that ECE made buyback and delisting offers during 2016. It was observed by the SEBI that the entities connected to the promoters of ECE funded the purchase of shares of ECE, a bulk of which was subsequently sold under the buyback offer of ECE and thus contributed

towards making the buyback offer successful. The SEBI alleged that the applicants who were the acquirer in the delisting offer participated at various stages in a manipulative and fraudulent scheme wherein misleading appearance of trading was created to first make the buyback offer successful and thereafter depressing both the cutoff price under delisting as well as the scrip price to make the delisting offer also successful.

In another recent order issued on June 5, 2020 relating to a proposed delisting of shares of AstraZeneca Pharma India Limited ("**AZPIL**"), the SEBI censured AstraZeneca Pharmaceuticals AB Sweden, the promoters of AZPIL, and the Elliot Group for attempting to employ a similar scheme. The SEBI in its order held that AstraZeneca Pharmaceuticals AB Sweden and the Elliott Group colluded with each other to get the shares of AZPIL delisted and influence the delisting price of such shares without considering the interests of the retail shareholders of AZPIL and that there was a "meeting of minds" before the delisting announcement (*see here* https://www.snrlaw.in/sebi-order-astrazeneca-pharma-and-the-elliott-group/ *our Insight on the SEBI order in the AstraZeneca case*).

ROLE OF THE BOARD OF DIRECTORS

Regulation 8(1B) of the Delisting Regulations requires the Board to certify that the delisting is in the interest of the shareholders which, it may do by referring to the Merchant Banker Report. Unlike the Takeover Code that requires a committee of independent directors to provide reasoned recommendations on an acquisition offer, the Delisting Regulations do not impose such requirement on the independent directors. The Merchant Banker Report is not required to confirm that the delisting offer is fair.

However, directors have fiduciary duties towards the shareholders. Given that a voluntary delisting offer involves an offer by the promoters, the directors and in particular the independent directors, should consider the interest of minority shareholders at the time of approving any voluntary delisting offer from the promoters.

ROLE OF THE MERCHANT BANKER

Under Regulation 10 of the Delisting Regulations, the promoters are required to appoint a merchant banker registered with the SEBI and such other intermediaries as are considered necessary for carrying out the delisting process. The merchant banker is required to ensure compliance with the provisions of Delisting Regulations, specifically with provisions regarding exit opportunity to the public shareholders. The merchant banker appointed by the Board to conduct due diligence and issue the

Merchant Banker Report may also act as the manager to the delisting offer. However, if the promoter is appointing a merchant banker, such merchant banker cannot be an associate of the promoter.

DELISTING MAY NOT SQUEEZE OUT ALL MINORITY SHAREHOLDERS

A successful delisting at the end of which promoter holds more than 90% of the share capital may not completely squeeze out all minority shareholders and the promoters may need to take additional steps such as selective buyback or the recently introduced method of minority squeeze out under the Companies Act, 2013, as amended (*see here* https://www.snrlaw.in/a-new-method-of-minority-squease-out/ *our Insight on the new method of minority squeeze out*). Such steps to squeeze out the remaining minority shareholders may add to time and cost of completing the process to privatize the company.

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