

## **Disinvestment: Lessons from the Past and the Road Ahead**

Recently in the budget speech delivered by the Finance Minister for 2021-22, the Government announced a new policy on Disinvestment which marked a significant shift from the position that has prevailed thus far. The policy statement made a distinction between sectors that are “strategic” and “non-strategic” from the Government’s perspective.

The following sectors were identified in the policy statement as “strategic” sectors: (a) atomic energy, space and defense, (b) transport and telecommunications, (c) power, petroleum, coal and other minerals, and (d) banking, insurance and financial services.

The Government announced that in strategic sectors, there will be “bare minimum” presence of public sector enterprises. The remaining public sector enterprises in the strategic sector will be privatized or merged or made subsidiaries of other public sector enterprises or closed.

With regard to non-strategic sectors (i.e., sectors other than those identified above), the Government stated that public sector enterprises will be privatized or closed.

Specifically, the Government announced that it will be completing transactions relating to Bharat Petroleum, Air India, Shipping Corporation of India, Container Corporation of India, IDBI Bank, Bharat Earth Movers, Pawan Hans and Nilanchal Ispat Nigam among others in 2021-22. It was further stated that other than IDBI Bank, the Government proposed to take up the privatization of two public sector banks and one general insurance company, as well as the initial public offering of LIC, in 2021-22.

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While the Government has issued perhaps the strongest ever statement on the need for privatization and set out a clear policy without any caveats, it is also a fact that successive governments in the past have been unable to complete, or indeed progress, such disinvestment transactions to any meaningful extent.

It would be instructive to consider the reasons for this, to draw lessons for execution of the policy statement issued by the Government.

## **TRANSACTION STRUCTURE**

Past experience indicates that transactions in which the Government sells a majority or controlling interest, but retains a minority interest, are problematic for three reasons.

First, they are unlikely to fetch optimal value for the Government at the initial stage. Second, retention by the Government of a minority stake will inevitably mean that the Government has some minority rights associated with such residual shareholding – as a practical matter, this hampers quick decision making after the sale, restricts future funding and slows down the growth of the company. Third, the eventual exit of the Government by a sale of its residual shareholding is likely to be contentious.

In keeping with the Government's policy, the more sensible approach would be to consider transactions involving a 100% sale of the Government's interest where the Government does not retain any residual interest.

The government may also consider maximizing value by separating different parts of the business of a public sector enterprise and inviting bids for each such unit or division. For instance, in the case of a Bharat Petroleum, a possible three-way split is between its refining, retailing and overseas businesses.

## **TIMELINES; PROCESS**

As is often the case with auction situations in a private context, the Government will need to consider setting more aggressive timelines for completion. There are several examples of Government transactions where delayed timelines have led to extraneous factors coming into play which have derailed the transaction.

To a certain extent, this can be addressed through preparatory work to be done even before expressions of interest are invited. As would be the norm in a private context, the Government should consider preparing vendor due diligence reports

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(financial, legal and technical) in advance so that time taken by multiple bidders in due diligence is minimized. The Government's advisors need to proactively prepare for potential questions from bidders, and get responses cleared from the Government, so that the time period for management discussions and responding to questions from bidders can be minimized.

In terms of transaction documents, the principal document will be a share purchase agreement (assuming a 100% sale of the government's interest). From the Government's perspective, it would be good to develop a standard form of this document so that Government's position on key aspects such as conditions to closing, regulatory approvals, closing matters, post-closing adjustments, operations between signing and closing, representations and warranties, indemnities, continuation of certain arrangements post-closing and dispute resolution is clear from the start of the process. There will obviously be transaction specific issues to address, however, there would be merit in formulating a clear and consistent position for the Government on these aspects so that there is no need to reinvent the wheel for every transaction.

Equally, the message for bidders has to be that timelines must be respected at all costs, to the point of disqualification of bidders if there are delays.

## **EMPOWERING QUICK DECISION MAKING BY THE GOVERNMENT**

Adequate delegation is required to the government officers running the process so that the Government's reactivity to bidder questions and concerns can be improved.

One central point in this regard, which has surfaced in the context of earlier rounds of disinvestments, is to provide government officers running the disinvestment process the assurance that they will not be subjected to a witch hunt at a later date due to a regime change or for other collateral reasons. This may be easier said than done, but will be critical to the success or failure of execution of the Government's disinvestment program.

## **MANAGING STAKEHOLDERS**

In running a disinvestment process, it will be important to keep the stakeholders aligned, whether it be the relevant state governments or employee unions.

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Past experience shows that it will be difficult, if not impossible, to steamroll opposition from such stakeholders. The disinvestment process therefore needs to be proactively managed keeping in mind competing concerns of the different stakeholders, involving them in consultations from the beginning and ensuring that they have clarity about the process at each step.

## **LITIGATION RISK**

There will inevitably be the risk of litigation being initiated by one or more stakeholders, whether for genuine reasons or otherwise, which will have the effect of stalling the disinvestment process. Previously, the Vedanta group's purchase of a stake in Hindustan Zinc was stayed by the Supreme Court on account of a petition alleging that such sale was illegal under the Metal Corporation (Nationalisation and Miscellaneous Provisions) Act, 1976. The petition also questioned the government's earlier sale of its majority stake in Hindustan Zinc to Sterlite Industries at a purportedly undervalued price, resulting in losses to the exchequer.

Such risks need to be proactively managed and addressed so that valuable time, energy and resources which could be better utilized in execution of disinvestment transactions do not need to be diverted in managing court litigations.

## **REGULATORY AND CONTRACTUAL CONSIDERATIONS**

The Government may also need to amend sector specific laws or regulations to allow the disinvestment process to be completed. For instance, when the government sought to sell its stake in Bharat Petroleum and Hindustan Petroleum in 2003, the proposal was disallowed by the Supreme Court since it found such proposal to be contrary to the laws through which such companies were nationalized. These laws have since been repealed, paving the way for the government to sell its stake.

There may also be contractual matters to be considered. For example, financing or other agreements may require the government to retain majority ownership in certain cases – for instance, in response to the proposals to sell the National Thermal Power Corporation, the Power Grid Corporation of India and the Power Finance Corporation, the Ministry of Power raised an issue that bond covenants required the government to retain more than 50 per cent ownership.

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## CLARITY ON WHETHER CONCESSIONS WILL CONTINUE, IN WHAT SHAPE AND FOR HOW LONG

One key feature of public sector enterprises is that they benefit from various concessions offered by the Government or other public sector enterprises. This could be in the form of land leased on concessional rates or access to public utilities at preferential rates. These may or may not be formally documented. An analogy to this in the private M&A context is related party transactions. Bidders need to know early on whether, in what shape, and for how long these arrangements will continue. If this work can be done in advance, that it would save valuable time at the stage of negotiations with bidders.

For example, the Container Corporation of India's ("CONCOR") inland depots operate on land leased to it by the Indian Railways. The Government's approach with respect to continuation of such lease agreements could well be a critical issue in the disinvestment of CONCOR.

In summary, while implementation of the Government's disinvestment policy will pose significant challenges, however the clear enunciation of such policy in the budget speech indicates greater conviction and holds promise of better success with implementation.

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