

Background

The Securities and Exchange Board of India (SEBI) has recently issued a regulatory framework for streamlining mergers/schemes of arrangement involving listed companies in India. The underlying purpose of the framework is to ensure that interests of public shareholders are protected, by regulating mergers of large unlisted companies with small listed companies. The framework also addresses mergers/schemes of arrangement of an unlisted wholly-owned subsidiary company with its listed parent entity.

Previously, SEBI had amended the listing agreements to require stock exchanges to grant prior approval for schemes of arrangement involving listed companies. During a review of these proposals, SEBI raised concerns over such mergers, including dilution of public shareholding and increase in promoter shareholder through share swaps, inflated valuation of unlisted companies increasing and substantial acquisition of voting rights. The salient features of SEBI's proposal to address these concerns are:

Conditions for merger of an unlisted company with a listed company

- **Post-scheme shareholding pattern** – The shareholding of pre-scheme public shareholders of the listed company and that of qualified institutional buyers of the unlisted company must not fall below 25% in the merged company proposed to be listed.
- **Stock exchange** – An unlisted company is required to merge with a listed company that is listed on a stock exchange having nationwide trading terminals.

Merger between wholly-owned subsidiary and parent

Schemes which provide for merger of a wholly-owned subsidiary with its parent will no longer be required to be filed with or require approval from SEBI and will be required to be filed only with the stock exchanges for the limited purpose of disclosures.

Public shareholder approval for merger/scheme of arrangement through e-voting

For the following schemes, approval of the public shareholders through e-voting is required to ensure greater public participation:

- Merger of an unlisted company that will result in a reduction in the voting share percentage of pre-scheme public shareholders by more than 5% of total capital of the merged entity.

- Transfer of whole or substantially the whole of a listed company's undertaking where consideration for such transfer is not in the form of listed equity shares.
- Merger of unlisted subsidiary with listed holding company where the shares of the unlisted subsidiary have been acquired by the holding company directly or indirectly from the promoters/promoter group.

Disclosure requirement and compliance

- **Abridged prospectus** – The unlisted company will be required to mandatorily disclose all material information in the form of an abridged prospectus prior to its merger with a listed company.
- **Compliance report** – Companies will be required to submit a compliance report confirming compliance with Accounting Standards duly certified by the company secretary, CFO and managing director.

Pricing formula

To ensure that the issue of shares is not restricted to a select group of shareholders, and that all classes of shareholders are able to participate, the listed company must mandatorily follow the pricing formula set out in the prescribed regulations.

Key Takeaways

The framework not only establishes SEBI's jurisdiction over mergers/schemes involving listed companies, but also takes cognizance of the fact that several unlisted companies were surpassing disclosure and listing obligations by getting listed on stock exchanges by merging with smaller listed companies.

Following its implementation, the framework is also expected to make unlisted companies cautious of merging with listed companies, in an attempt to protect the interests of public shareholders. That said, SEBI has also eased the requirements for mergers between parent entities and wholly-owned subsidiaries.

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