

Capital Markets Hotline

September 29, 2009

PROPOSED CHANGES TO SECURITIES LAWS: IRONING OUT THE CREASES

The Securities and Exchange Board of India ("SEBI") has, in its Board Meeting dated September 22, 2009 ("Board Meeting"), proposed certain amendments to re-align the takeover norms with recent market developments and to bring parity between various legislations governing Indian capital markets. We've summarized the key proposals and our initial reactions to the same below:

I. Anchor investors for Indian Depository Receipts

Quite recently SEBI had introduced the novel concept of an anchor investor in Initial Public Offerings (IPOs) by Indian companies. Anchor Investors are qualified institutional buyers who commit to invest a fixed amount¹ and are roped in by the issuers to boost the confidence of the investors in the offering. In an attempt to encourage the issuance of Indian Depository Receipts (IDRs) and listing of foreign companies on the domestic bourses, SEBI has proposed to extend this facility of anchor investors to issuance of IDRs by foreign companies.

The anchor investor with its brand power and upfront fiscal commitment is expected to serve as a catalyst to ensure the success of IDR offerings.

It is also proposed to reserve not less than thirty percent of the issue size of the IDRs for retail investors. A move that is significant in enhancing the liquidity of such issuances.

II. Open offer requirements applicable to GDRs / ADRs

Under regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ("Takeover Code"), acquisition of ADRs / GDRs are currently exempted from open offer requirement under Chapter III of the Takeover Code until the time of conversion into the underlying equity shares. It was generally understood that this position would remain unchanged even when customary voting arrangements are entered into between depositories and ADR / GDR holders.²

Under Chapter III of the Takeover Code, acquisition of 15% or more of shares carrying voting rights or acquisition of control over a listed company, would trigger the open offer requirement and would mandate the acquirer to make an offer to acquire at least an additional 20% of the voting shares from the public shareholders.

It is now proposed by SEBI that such exemption from open offer would be available only as long as ADR / GDR holders remain passive investors without any kind of voting arrangement with the depository banks on the underlying equity shares. The proposal does not speak of the consequences on earlier ADR / GDR issues or the potential for a two-time trigger of the Takeover Code. This is a development that will be keenly watched by all public market participants.

III. Takeover Code: Creeper reigned in

Under Regulation 11(1) of the Takeover Code an acquirer is allowed to make a creeping acquisition of 5% per financial year when its holding ranges between 15% and 55% of the equity shares of the target company. The current laws are silent on whether an acquirer can exceed the 55% threshold using this creeper route. For example, assuming that an acquirer is holding 52% in a target company, can the acquirer acquire an additional 5% in a financial year under this route such that his post acquisition shareholding becomes 57%? SEBI proposes to now clarify this position by providing that the creeping acquisition limit of 5% under Regulation 11(1) of the Takeover Code would be permissible provided post-acquisition, the shareholding / voting rights of the acquirer together with persons acting in concert does not exceed 55% of the equity capital of the target company.

One significant issue with respect to this change, which needs SEBI clarification, is whether acquisition of the creeping entitlement of 5% under this route is to be calculated on a gross basis (i.e. is only acquisition), or can be netted off against sales during the financial year.

IV. Disclosures extended

Under Takeover Code any acquisition or divestment of shares / voting rights aggregating 2% or more of the share capital of the target company is required to be disclosed to the target company and the stock exchanges where the shares of the target company are listed.

Such a requirement existed for situations where the acquirer is acquiring shares between 15% and 55% of the share capital of the target company. SEBI during the Board Meeting has proposed to extend such disclosure requirements to acquirers holding shares / voting rights between 15% and 75%. This move is likely to be aimed at providing more disclosure and transparency with respect to public market deals.

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V. Accounting Standards

SEBI has proposed that every scheme of arrangement or corporate restructuring exercise undertaken by a listed company will require a certificate from an auditor certifying that the accounting treatment and financial statements are in compliance with the applicable accounting standards. An amendment is proposed to the listing agreement to effectuate the above.

Moreover, the recently issued SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 are proposed to be amended, whereby an unlisted company undergoing a corporate restructuring exercise and proposing to make an initial public offer will be required to make appropriate disclosures in terms of Accounting Standard-14 (*Accounting for Amalgamations*) in the draft red herring prospectus.

Conclusion

SEBI has come up with a mixed bag of proposals. While initiatives like introduction of anchor investors for IDRs would be a welcome step, the proposed open offer requirement for ADRs / GDRs (in the circumstances mentioned above) could remain contentious and may tend to deter foreign investors and make such offerings harder to complete for companies, thereby restricting their ability to mobilize foreign capital.

The above proposals are still to be notified by SEBI. Source: [Press Release dated September 22, 2009](#) issued by SEBI.

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¹As per Reg. 2(c) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 an 'anchor investor' must make a minimum commitment of Rupees Hundred Million in an IPO.

² It was affirmed by SEBI in an informal guidance given in the month of June, 2009 in proposed transaction between Bharti and MTN

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