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M&A UPDATE

NEW RULES FOR TAKEOVER OF UNLISTED COMPANIES & CONSEQUENT MINORITY SQUEEZEOUT

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Introduction

Section 230 of the Companies Act, 2013 ("**Companies Act**") sets out the process for a scheme of arrangement between a company and its creditors and shareholders ("**Scheme**"). Such Schemes have to be approved by the National Company Law Tribunal ("**NCLT**").

A Scheme can include a proposal for a merger or a demerger of a company, in which case the procedure in section 232 of the Companies Act would also have to be followed. Can a Scheme provide that a shareholder or any person will acquire the shares of other shareholders of the company? This issue was addressed when the Companies Act was enacted in 2013, and a provision[1] was included which permitted a Scheme to include a takeover offer. The rules for such a takeover offer were to be notified. It is on February 3, 2020 that the Government of India notified the said provision and also prescribed rules in this regard by issuing the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2020 ("**Rules**") which amend the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

This paper provides an overview of the new Rules for takeovers and analyses their impact.

Applicable to unlisted companies

The new Rules are applicable when a takeover offer is proposed to be made for acquiring shares of an unlisted company.

For listed companies, the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SEBI Takeover Regulations**") are applicable which sets out the process for a takeover offer of shares of a listed company and, *inter alia*, requires an acquirer to make an open offer to acquire the shares of the company if the acquirer acquires shares of the company (whether by way of a primary infusion or a secondary acquisition) above a specified percentage.

The new Rules will not apply to any transfer or transmission of shares through a contract, arrangement or succession, as the case may be, or any transfer made in pursuance of any statutory or regulatory requirement. Hence a voluntary arrangement between parties for transfer of shares will continue to be governed by the agreed contractual terms between the parties.

Who can make a takeover offer

Pursuant to the Rules, a shareholder of a company can make an application to NCLT for a takeover offer only if such shareholder along with any other shareholder holds at least three-fourth of the equity shares carrying voting rights or any securities, such as depository receipts, which entitles the holder thereof to exercise voting rights, in the company.

Thus, a takeover offer can only be made by an existing shareholder, unlike in case of listed companies where an open offer can be made by an acquirer proposing to acquire shares in the company which would entitle the acquirer and persons acting in concert to exercise 25% or more of the voting rights in the company.

What is a takeover offer – deciphering the scope

'Takeover offer' is not specifically defined. However, the Rules provide that a shareholder (satisfying the threshold described above) can file an application for a takeover offer for acquiring any part of the remaining shares of the company. Hence, there seems to be flexibility for the acquiring shareholder

[1] Sub-sections (11) and (12) of section 230 of the Companies Act.

regarding the number of additional shares that the shareholder can acquire as well as the shareholders from whom the additional shares can be acquired. However, since the term 'shares' has been defined in the Rules as equity shares and any securities carrying voting rights, it seems that a takeover offer cannot be for preference shares or non-voting shares. One can foresee this aspect being closely scrutinized by courts to decide whether the application of the restrictive definition of shares should be limited to calculating the holding of a shareholder who wishes to make a takeover offer or should it even extend to determining what kinds of shares such a shareholder can acquire.

Pricing

Since a takeover offer would essentially involve acquisition of the shareholding of the minority shareholders, it is imperative that the price offered be fair and the interests of the minority shareholders be protected. Towards this objective, the Rules provide that a report of a registered valuer ("**Valuation Report**") is required to be obtained disclosing the details of the valuation of the shares proposed to be acquired after taking into account the following factors:

a. the highest price paid by any person or group of persons for acquisition of shares during last 12 (twelve) months; and

b. the fair price of shares of the company to be determined by the registered valuer after taking into account valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple vis-à-vis the industry average, and such other parameters as are customary for valuation of shares of such companies.

Since the highest price paid by any person for acquisition of shares during the last 12 (twelve) months has to be taken into consideration, a peculiar issue that may arise is what happens if a miniscule number of shares are transferred for a considerable high price (significantly higher than the fair value of the shares) during the preceding 12 (twelve) months? In such a scenario, would the shareholder making the takeover offer be obligated to pay such higher price?

Interestingly, the Rules merely provide that an application for a takeover offer should contain the Valuation Report which discloses the details of the valuation of the shares proposed to be acquired after taking into account the factors set out above. The Rules do not explicitly provide what the minimum offer price should be. This is unlike the SEBI Takeover Regulations which expressly provide the minimum price at which shares can be acquired under an open offer.

Deposit of price

The Rules provide that an application of arrangement for takeover offer should contain details of a bank account, to be opened separately, by the member wherein a sum of amount not less than one-half of total consideration of the takeover offer is deposited. Thus, it appears that an acquirer has to upfront deposit half of the consideration proposed to be paid in a bank account in cash. It would have been welcome if instead of only cash, an acquirer was given alternatives such as deposit of a bank guarantee.

Approval of the takeover offer and its binding nature

Since the takeover offer has to be part of a Scheme, the provisions of section 230 of the Companies Act has to be followed. Under section 230, an application has to be made to NCLT. Typically, NCLT orders a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be. A notice of the meeting is also required to be sent to the Central Government, income-tax authorities, Reserve Bank of India, Securities and Exchange Board of India, Registrar of Companies, stock exchanges, the Official Liquidator and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement.

If in the meeting mentioned above, majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by NCLT by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be. Hence, once a Scheme containing a takeover offer is approved

by NCLT, it would be binding on all shareholders including the minority shareholders whose shares are sought to be acquired under the Scheme.

An order of NCLT approving a Scheme could provide for a variety of matters, including an exit offer to dissenting shareholders, as are in the opinion of NCLT necessary to effectively implement the terms of the compromise or arrangement.

Role of creditors

Under section 230(1) of the Companies Act, a Scheme can be proposed between a company and its creditors or any class of them, or between a company and its members or any class of them. In case of a Scheme involving a takeover offer it maybe argued that the Scheme will not affect the interests of the creditors of the company and hence the Scheme would be a Scheme only between the relevant company and its shareholders. This argument may be relevant to determine whether consent of creditors should be required.

Differentiation amongst minority shareholders

As mentioned above, a shareholder is permitted to make a takeover offer for any part of the remaining shares of the company. Hence, the takeover offer can be for only some of the shares held by the minority shareholders as the acquiring shareholder determines. The Rules are silent as to whether the offer has to be made to all minority shareholders on a proportionate basis. Hence, effectively, a selective minority squeeze out can be attempted under the new Rules.

Purchase of minority shareholding

It is interesting to read the new Rules alongwith section 236 of the Companies Act which was notified on December 7, 2016. Under section 236(1) of the Companies Act, in the event an acquirer, or a person acting in concert with such acquirer, becomes the registered holder of 90% or more of the issued equity share capital of the company, or in the event of any person or group of persons becoming 90% majority or holding 90% of the issued equity share capital of the company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, is obligated to notify the company of their intention to buy the remaining equity shares. The minority shareholders of the company can also offer to the majority shareholders to purchase the minority equity shareholding of the company.

The price offered to minority shareholders has to be determined on the basis of valuation by a registered valuer.

Thus, minority shareholders whose shareholding is not acquired under a takeover offer, can have recourse to section 236 of the Companies Act provided that pursuant to the takeover offer, the acquiring shareholder and persons acting in concert with such acquirer becomes the registered holder of 90% or more of the issued equity share capital of the company.

Recourse available to aggrieved minority shareholders

An aggrieved party can make an application to NCLT in the event of any grievances with respect to the takeover offer and NCLT can pass such order as it may deem fit. The scope of the provision is quite wide in as much as any party (and not necessarily only the shareholder whose shares are being acquired) can make an application and such person can have a grievance on any ground. The scope of NCLT's powers is also very wide under this provision. One can guess that most of the grievances would revolve around pricing and that the forceful exits are unfair and detrimental to the interests of the minority shareholders.

Going forward

The Rules appear nebulous in certain aspects and there are several issues which are required to be addressed. Pending any changes to the Rules, one can foresee the courts and tribunals being called upon to interpret various provisions. Nevertheless, the new Rules are significant and will surely be explored by many companies looking to 'restructure' minority shareholding.

One thing is certain that since takeover offers will be under the umbrella of Schemes, the jurisprudence which has evolved over the decades concerning Schemes would apply to takeover offers – the most basic principle being that Schemes should be just and fair to all interests affected and should not be against public interest.

This update has been contributed by Adity Chaudhury (Partner), Deeya Ray (Associate) and Ishita Malhotra (Associate).