

Discussion Paper on “Exit Offer to Dissenting Shareholders”

Background

1. Section 13 and Section 27 of Companies Act, 2013 have prescribed that dissenting shareholders shall be given an exit opportunity by promoters and shareholders having control over the company in accordance with the regulations to be specified by SEBI. Both these sections have come into force w.e.f. April 01, 2014.
2. The relevant extract of Act is reproduced below for ease of reference:

Section 13(8) of Companies Act, 2013:

Alteration of memorandum

“A company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and—

- a. the details, as may be prescribed, in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;*
- b. the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.”*

Section 27 of Companies Act, 2013:

Variation in terms of contract or objects in prospectus.

- (1) *A company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of special resolution:*

Provided that the details, as may be prescribed, of the notice in respect of such resolution to shareholders, shall also be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation:

Provided further that such company shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

(2) The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

3. Accordingly, SEBI is in the process of framing regulations under the aforesaid provisions of the Companies Act, 2013. In this regard, public comments are being sought on the following related issues:

ISSUES FOR DISCUSSION

1) APPLICABILITY OF THE PROVISION:

The provisions may be made applicable on a prospective basis since the provisions of the Act have been made applicable on a prospective basis. This would also take care of the apprehension of the inability of the promoters to bring in additional cash in a short span of time.

Also, the provision should be made applicable to such contracts which may substantially affect the main line of business or revenue generation of the company.

It has been suggested that the requirement of providing exit to dissenting shareholders may affect fresh capital raising as well as capital availability. Thus, the regulations may provide that if an offer is dissented by a specified percentage, say 10% of shareholders, the company may provide exit offer. This will require suitable changes in Companies Act as well.

2) ELIGIBILITY OF SHAREHOLDERS FOR AVAILING THE EXIT OFFER

It is presumed that investors in the secondary market take an informed decision of investing in the equity shares of the company after doing a full background check on the same. This includes the objects of the company for which the company has raised money from the market. Thus, investors who invested in the company through secondary market should also be given a fair opportunity of exiting the company in case they do not agree to the change in objects of the company.

Therefore investors who are holding shares as on the date on which the proposal to change the objects becomes public should be allowed to exit under this provision.

3) OFFER PRICE FOR THE EXIT OFFER

Reliance on a historical price distorts the value of the shares and such a price may not be reflective of the prevailing market price. Further, a higher exit price than the prevailing market price may significantly influence the decision making of the investor in favour of achieving short term gains vis-à-vis evaluating exit in the context of long term potential of the company. Thus, the exit price should be based on the existing market value of the stock. The exit price may be based on price determined in case of exit offer given to the existing shareholders in terms of SEBI (Substantial Acquisition of Shares and Takeovers), Regulations, 2011 which, in cases of frequently traded shares, is the highest of the following:

- (i) Volume weighted average price paid during fifty two weeks immediately preceding the date of the announcement.*
- (ii) Highest price paid for any acquisition during the twenty six weeks immediately preceding the date of the announcement.*
- (iii) Volume weighted average market price for a period of sixty trading days immediately preceding the date of the announcement.*

4) CARVE OUTS FOR COMPANIES WITH NO IDENTIFIABLE PROMOTERS OR SHAREHOLDERS HAVING CONTROL

Since the exit offer has to be given by promoters or shareholders having control, whether companies with no identifiable promoters or shareholders having control can be exempted from this requirement. This will require suitable changes in Companies Act as well.

5) EXIT OFFER IN CASES WHERE A HIGH PERCENTAGE OF AMOUNT RAISED FOR THE ISSUE HAS ALREADY BEEN UTILIZED

There may be instances wherein a company has already utilized higher percentage of the amount raised and intends to change the objects to some extent due to certain reasons. In such cases, the promoters or persons in control should give exit opportunity only if the amount utilized is less than a specified percentage of the total amount raised for the objects of the issue, e.g. 75%. This will require suitable changes in Companies Act as well.

6) EXEMPTION FROM MANDATORY TRIGGER OF OPEN OFFER REQUIREMENTS

There may be instances wherein the promoters or shareholders in control may trigger open offer obligations owing to shareholding increasing beyond 25% or through creeping acquisition. Such increase in shareholding due to mandatory requirement of law should be exempted from open offer obligations. Further regulation 3(2) of SEBI (Substantial Acquisition of Shares and Takeovers), Regulations, 2011 does not allow any person to acquire the shares voluntarily in case the shareholding pursuant to the acquisition exceeds maximum permissible public shareholding. In cases where promoters are already holding 75%, they should be allowed to acquire further shares.

In the event shares accepted in the offer are such that the aggregate shareholding of the promoter exceeds 75% of the total paid up capital of the company, the promoter shall comply with the stipulation mentioned under rule 19A read with rule 19(2)(b) of Securities Contracts (Regulation) Rules, 1957 i.e. bring their shareholding to 75% in one year.

7) MANNER OF PROVIDING EXIT OPPORTUNITY TO DISSENTING SHAREHOLDERS

a) The notice proposing the passing of the special resolution for changing the objects of the issue and variation in terms of contract or objects in prospectus shall also contain information about the exit offer to the dissenting shareholders.

b) In addition to the disclosures required under section 102 of the Act read with rule 32 of Companies (Incorporation) Rules, 2014 and rule 7 of Companies (Prospectus and Allotment of Securities) Rules, 2014 and or any other applicable law, a

statement to the effect that the promoters or controlling shareholders shall provide an exit opportunity to the dissenting shareholders shall also be disclosed in the explanatory statement to the notice for passing special resolution. The regulatory requirements in this regard is placed as Annexure to this Discussion Paper.

- c) After passing of the special resolution, voting results as specified in regulation 44(3) of SEBI (Listing Obligations and disclosure requirements) regulations, 2015 including the list of dissenting shareholders would be communicated to the Stock Exchanges.*
- d) The issuer shall also intimate the Stock Exchanges on which the securities of the company are listed about the offer of promoters or shareholders having control to dissenting shareholders and the price at which the exit offer is being given. The Stock Exchanges shall immediately on receipt of such intimation disseminate the same to public within one working day.*
- e) The promoters or shareholders in control shall appoint a Merchant Banker registered with SEBI and finalise the exit price in accordance with the regulations specified in this regard.*
- f) To ensure security for performance of their obligations, promoters or shareholders having control shall create an escrow account and deposit the aggregate consideration in the account at least two working days prior to opening of the tendering period.*
- g) The tendering period shall start not later than seven working days from the passing of the special resolution and shall remain open for ten working days.*
- h) The promoters or shareholders having control shall facilitate tendering of shares by the shareholders and settlement of the same through the Stock exchange mechanism as specified by SEBI vide Circular No. CIR/CFD/ POLICYCELL/1/2015 dated April 13, 2015*
- i) The promoters or shareholders having control shall, within a period of ten working days from the last date of the tendering period, make payment of consideration to the shareholders who have accepted the exit offer.*

- j) *Within a period of two working days from the payment of consideration, the listed company shall make a disclosure to the Stock Exchange giving details of aggregate number of shares tendered, accepted, payment of consideration and the post offer shareholding pattern of the promoters and a report by the merchant banker that the payment has been duly made to all the shareholders who offered their shares to exit from the company after dissenting to the proposal.*

Public comments:

4. Considering the implications of the said matter on the market participants including listed companies and investors, public comments on the policy framework proposed above are solicited. Specific comments/suggestions as per the format given below would be highly appreciated:

Name of entity / person :			
Name of organization (if applicable):			
Sr. No.	Pertains to paragraph (1 to 7)	Proposed changes / suggestions	Rationale

5. Such comments may please be e-mailed on or before December 23, 2015, to issueobject@sebi.gov.in or sent by post, to:-

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Annexure

Disclosures required under section 102(1) of the Companies Act, 2013:

A statement setting out the following material facts concerning each item of special business to be transacted at a general meeting, shall be annexed to the notice calling such meeting, namely:—

- a. the nature of concern or interest, financial or otherwise, if any, in respect of each items of—
 - i. every director and the manager, if any;
 - ii. every other key managerial personnel; and
 - iii. relatives of the persons mentioned in sub-clauses (i) and (ii);

- b. any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Disclosures required under Rule 32(1) of Companies (Incorporation) Rules, 2014:

Where the company has raised money from public through prospectus and has any unutilised amount out of the money so raised, it shall not change the objects for which the money so raised is to be applied unless a special resolution is passed through postal ballot and the notice in respect of the resolution for altering the objects shall contain the following particulars, namely:-

- (a) the total money received;
- (b) the total money utilized for the objects stated in the prospectus;
- (c) the unutilized amount out of the money so raised through prospectus,
- (d) the particulars of the proposed alteration or change in the objects;
- (e) the justification for the alteration or change in the objects;
- (f) the amount proposed to be utilised for the new objects;
- (g) the estimated financial impact of the proposed alteration on the earnings and cash flow of the company;
- (h) the other relevant information which is necessary for the members to take an informed decision on the proposed resolution;
- (i) the place from where any interested person may obtain a copy of the notice of resolution to be passed.

Disclosures required under Rule 7 of Companies (prospectus and allotment of securities) Rules, 2014:

Variation in terms of contracts referred to in the prospectus or objects for which prospectus was issued. —

(1) where the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a special resolution through postal ballot and the notice of the proposed special resolution shall contain the following particulars, namely: —

- (a) the original purpose or object of the Issue;
- (b) the total money raised;
- (c) the money utilised for the objects of the company stated in the prospectus;
- (d) the extent of achievement of proposed objects(that is fifty percent, sixty percent, etc);
- (e) the unutilised amount out of the money so raised through prospectus,
- (f) the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued;
- (g) the reason and justification for seeking variation;
- (h) the proposed time limit within which the proposed varied objects would be achieved;
- (i) the clause-wise details as specified in sub-rule (3) of rule 3 as was required with respect to the originally proposed objects of the issue;
- (j) the risk factors pertaining to the new objects; and
- (k) the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.