Sub: Strengthening corporate governance at listed entities by empowering shareholders - Amendments to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015

1. Objective

1.1. This memorandum seeks approval of the Board to amend the provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR Regulations**" / "**LODR**") to strengthen corporate governance at listed entities by empowering shareholders through the following proposals:

1.1.1. Strengthening disclosure and approval requirements for certain types of agreements binding the listed entities.

1.1.2. Periodic approval for special rights granted to certain shareholders of a listed entity.

1.1.3. Strengthening the extant mechanism for sale, disposal or lease of an undertaking of a listed entity or where the listed entity owns more than one undertaking, of the whole or substantially the whole of any of such undertakings, outside the 'Scheme of Arrangement' framework.

1.1.4. Periodic shareholder approval for any director serving on the board of a listed entity to address the issue of 'Board Permanency'.

2. Background

2.1. Based on recent events observed at a few listed entities and various media reports, certain issues/challenges arising out of the 'Agreements binding listed entities', 'Special rights granted to shareholders', 'Sale, disposal or lease of an undertaking of a listed entity' and the provision for 'Board Permanency' noticed in many listed entities were identified and deliberated in a meeting of the Primary Market Advisory Committee (PMAC) of SEBI.

2.2. Based on PMAC recommendations and further internal deliberations, a Consultation Paper on 'Strengthening corporate governance at listed entities by empowering shareholders – Amendments to the LODR Regulations' (**Annexure 1**)

was issued on February 21, 2023 soliciting comments from the public on the proposals contained therein to address the aforementioned issues/challenges.

2.3. A total number of 48 commenters ranging from listed entities to general public have provided their comments / suggestions on the proposals contained in the Consultation Paper. The different categories to which the commenters belong are tabulated below:

Table 1: Break-up of the types of commenters who have commented on the Consultation Paper

Category	**Number of commenters**
Listed entities	19
Professionals	10
Law Firms	6
Institutions / Societies	5
Industry Associations	3
Proxy Advisors	2
Investors / General Public	2
Market Intermediary	1
Total	**48**

The proposal-wise compilation of public comments is placed at **Annexure-2**.

2.4. The issues identified, proposals made in the consultation paper, public comments thereon, our analysis and the proposals / amendments for Board's consideration are discussed in detail as separate paragraphs in this Board Memorandum.

3. Strengthening disclosure and approval requirements for certain types of agreements binding listed entities

3.1. Issues identified

3.1.1. There is a need to address the issues relating to disclosure and / or approval requirements for agreements that are binding on listed entities which would, directly or indirectly, impact management or control of a listed entity or impose any restriction or liability on a listed entity. These agreements may be

entered into with or without the knowledge and / or consent of the listed entity (including its shareholders).

3.1.2. There have been instances wherein promoters have entered into binding agreements with third parties having an impact on the management or control of a listed entity or such agreements have placed certain restrictions on the listed entity. However, these facts were neither disclosed to the listed entity nor to its shareholders. Non-disclosure of material information creates information asymmetry and results in significant market reaction when it is known to the public at large at a later stage.

3.1.3. In another instance, promoters of the listed entity entered into a shareholder agreement with the listed entity and then entered into an agreement with third parties thereunder placing certain restrictions on the listed entity. These restrictions, particularly when imposed without following due process of approval by the shareholders and without any benefit to the listed entity, cannot be said to be either in the interest of the listed entity or its shareholders.

3.2. **Existing disclosure and approval requirements for agreements binding listed entities**

3.2.1. Disclosure requirements: The LODR Regulations require disclosure of material events or information to the Stock Exchanges by listed entities. In terms of regulation 30(6) read with clause 5 of para A of Part A of Schedule III of the LODR Regulations, agreements which are binding and not executed in the normal course of business have to be disclosed by a listed entity.

3.2.2. The aforesaid requirement includes disclosure of shareholder agreements, joint venture agreements, family settlement agreements (to the extent that it impacts management and control of the listed entity), agreements with media companies etc. Revisions or amendments and termination of such agreements too have to be disclosed.

3.2.3. While the term ‘normal course of business’ is intended to include agreements that are entered into in connection with the business operations of a listed

entity, any agreement that impacts management or control, whether or not entered into in the normal course of business operations, is a material information for the shareholders, hence needs to be disclosed to the public.

3.2.4. Further, if a listed entity is not a party to such an agreement and yet is getting impacted by such an agreement, an obligation must be placed on the promoters or other parties entering into such agreements to inform about the same to the listed entity and to obtain necessary approvals. This would enable the listed entity to disclose such agreements to its shareholders and place it before the appropriate authority of the listed entity to examine it from the point of view of the economic interest of the listed entity.

3.2.5. In terms of clause 5 of para B of Part A of Schedule III of the LODR Regulations, material agreements which are binding and not entered into in the normal course of business have to be disclosed by a listed entity. These include borrowing agreements which are material for a listed entity.

3.2.6. However, there is no explicit provision in the LODR Regulations mandating disclosure of agreements that impose any restriction on a listed entity or create any liability (other than borrowing agreements). These are, however, material information which ought to be disclosed to the shareholders.

3.2.7. Approval requirements: At present, approval of shareholders of a listed entity is required for the following types of agreements:

a) Shareholder Agreements (**SHA**) conferring special rights, obligations, protection etc. upon certain shareholders that are proposed to be incorporated in the Articles of Association (**AoA**) of a company.
b) Agreements with related parties that involve transfer of resources, services or obligations between a listed entity and the related party beyond the threshold for materiality as specified in regulation 23(1) of the LODR Regulations.

3.2.8. However, agreements that bind listed entities directly or indirectly with some obligation and impose certain restrictions or liability on a listed entity, as discussed above, may not require shareholders' approval if they are neither

part of the AoA nor constitute a material related party transaction (RPT) as per the extant provision of the Companies Act, 2013 ("**Companies Act**") and the LODR Regulations. Therefore, the shareholders may not have an opportunity to examine such agreements and express their approval or disapproval of such agreements and there is a likelihood that such types of agreements may be entered into behind the back of the listed entity and its shareholders.

3.3. **<u>Proposals in the consultation paper with respect to disclosure and / or approval requirements for certain types of agreements binding the listed entities</u>**

3.3.1. In order to ensure timely disclosure of certain types of agreements that impact management or control of a listed entity or impose any restriction or liability upon a listed entity, it was proposed to insert a new clause 5A to para A of Part A of Schedule III of the LODR Regulations.

"5A. (i) Agreements which, either directly or indirectly or whose purpose and effect is to, impact the management or control of the listed entity or impose any restriction or create any liability upon listed entity shall be disclosed to the Stock Exchanges, whether or not the listed entity is a party to such agreements.

Provided that revision(s) or amendment(s) and termination(s) of such agreements shall also be disclosed.

Provided further that only such agreements which are binding and entered into by the shareholders, promoters, promoter group, related parties, directors, key managerial personnel, any other officer of a listed entity or of its holding, subsidiary, associate company, solely or jointly with the listed entity or a third party shall be disclosed.

Provided further that agreements, other than those impacting the management or control of a listed entity, entered into by a listed entity in the normal course of business shall not be required to be disclosed.

(ii) Notwithstanding the above, agreements entered in the normal course of business shall be disclosed if they are required to be disclosed otherwise in terms of the provisions of these regulations."

3.3.2. Other proposals in the Consultation Paper with respect to agreements binding the listed entities is tabulated below:

Table 2: Disclosure and / or approval requirements for agreements that are binding and impact management or control or impose any restriction or create any liability upon a listed entity

Parameter	**Future agreements**	**Existing and Subsisting agreements**
Disclosure under reg. 30	Within 12 hours if the listed entity is a party to the agreement; 24 hours if the listed entity is not a party to the agreement.	On or before June 30, 2023.
Parties to the agreement	Shareholders, promoters, promoter group, related parties, directors, key managerial personnel, any other officer of a listed entity or of its holding, subsidiary, associate company, solely or jointly with the listed entity.	Shareholders, promoters, promoter group, related parties, directors, key managerial personnel, any other officer of a listed entity or of its holding, subsidiary, associate company, solely or jointly with the listed entity.
Obligation of the parties to inform the listed entity if it is not a party to the agreement	Within 2 working days of entering into the agreement.	On or before May 31, 2023
Disclosure in the Annual Report	In the Annual Report of FY 2023-24 onwards.	In the Annual Report of FY 2022-23.
Additional requirements applicable only for agreements that are binding and impose any restriction or create any liability upon a listed entity, other than agreements entered by the listed entity in the normal course of business:		
Board's opinion	Opinion along with detailed rationale as to whether such an agreement is in the economic interest of the listed entity.	Opinion along with detailed rationale as to whether such an agreement is in the economic interest of the listed entity.

Parameter	Future agreements	Existing and Subsisting agreements
Shareholder approval	Special Resolution and 'majority of minority'	Special Resolution and 'majority of minority' only for the existing agreements where the listed entity is not a party in the first general meeting (AGM or EGM) held after April 1, 2023.
Effective date	Not effective unless and until shareholders approve such agreements.	If the shareholders do not ratify any existing or subsisting agreement where the listed entity is not a party, the future obligations arising out of such agreements shall not be binding on the listed entity.

3.4. **Public comments**

3.4.1. The responses to the questions posed in the Consultation Paper based on the aforestated proposals are tabulated below:

Table 3: Summary of the responses to the proposals on disclosure and / or approval requirements for certain types of agreements binding listed entities

Sl. No.	Question	Total comments received	Agree	Partially Agree	Disagree
1.	Proposals in the consultation paper with respect to disclosure and approval requirements for certain types of agreements	39	12	20	7
2.	Should there be a requirement to disclose all agreements, including existing and subsisting agreements, that impact management or control of the listed entity or impose any restriction or create any liability on a listed entity?	41	15	17	9

Sl. No.	Question	Total comments received	Agree	Partially Agree	Disagree
3.	Do you agree with the proposed clause 5A to para A of Part A of Schedule III of the LODR Regulations? Do you have any specific comments / suggestions?	42	14	16	12
4.	Should there be a requirement to disclose specific types of binding agreements entered by the listed entity in the normal course of business? If yes, please specify the types of agreements that need to be disclosed.	40	8	2	30
5.	Should there be a requirement of shareholder approval for agreements that impose or have the effect of imposing any restriction or liability on a listed entity?	42	7	20	15
6.	Should the existing and subsisting agreements that impose or have the effect of imposing restriction or liability on a listed entity be subject to ratification by the shareholders in case the listed entity is not a party to it?	40	3	8	29
7.	Should the approval / ratification of shareholders be by way of 'Special Resolution and Majority of Minority'?	41	8	12	21
8.	In the alternative to Sl. No. 7 above, should the approval / ratification of shareholders be by way of Special Resolution in which those shareholders and their relatives / associates who had entered into such agreements are not eligible to vote on such resolutions.	38	11	7	20

3.4.2. Those who have disagreed with the proposals have inter-alia stated the following:

a) The provisions currently under the LODR Regulations, the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 (“**Takeover Regulations**”) provides ample disclosure and compliance requirements and ensure protection of interests of the shareholders.

b) Each and every agreement will impose some kind of restriction or liability on listed entity. It is neither feasible nor desirable for shareholders to approve each and every agreement. 'Stakeholder empowerment' does not mean 'putting everything in public domain', 'being anti majority' and 'ousting promoters (businessmen)'. The minority may not be able to unilaterally undertake a holistic view of the business decision, and may interfere with investments that are in the best interests of the listed entity.

c) Belatedly seeking the opinion of the Board as regards past agreements which have been entered into and implemented may not serve any real purpose.

d) Since the existing agreements are already put into effect and in case the same being disapproved by shareholders, it may have an impact on the activities of the company, which is being carried out basis the said agreements. Hence, ratification of the existing agreements by shareholders need not be mandatory. Only disclosure of the same in the annual report may suffice for the purpose of information to the shareholders.

e) The parties would have acted in furtherance to such existing and subsisting agreements. Non-ratification by shareholders would affect the sanctity of such contracts.

f) The proposal is against the principle of 'separation of ownership and management'. If shareholders have to approve each and every agreement, board of directors and management will be rendered redundant.

g) Disclosure of agreements entered in the normal course of business might affect the commercial advantage and competitive edge of the company in the market. It will also affect the day to day operations of the listed entity.

h) There will be practical difficulties to intimate Stock Exchanges for existing and subsisting agreement due to collation of the data.

i) As disclosures made to the Stock Exchanges will already be in public domain disclosing them again in the Annual report will be an extra burden and cost on the companies.

3.4.3. Those who have partially agreed with the proposals mentioned above have suggested the following modifications:

a) Requirement to disclose agreements having impact on management or control be introduced and shareholder approval for the existing or new agreements be dispensed with.

b) Only prospective agreements to be disclosed which are entered into post amendment of aforesaid proposal.

c) Meaning of 'impacting management and control', 'imposing restriction or creating liability' need to be clarified. Criteria of 'materiality' needs to be applied for the purpose of disclosure requirements. The phrase “Purpose and Effect” should be specifically defined in the regulations.

d) The requirement to disclose the agreements which impact management or control of the listed entity or impose any restriction or create any liability on a listed entity should become applicable w.e.f FY 2024-25. Further, any such agreement subsisting at the end of FY 2023-24 shall be placed for shareholders approval at the first general meeting to be held after April 1, 2024. The listed entities should be given sufficient time to prepare and collate such information including the existing agreements.

e) It is suggested that the proposed Clause 5A should only be made applicable to the shareholders forming part of Promoter(s) & Promoter(s) Group. If public shareholders are to be considered, then a threshold of more than 5% (of the outstanding paid-up capital of the listed entity) must be applied to cover them.

f) Shareholder approval should be subject to only for material restrictions/impacts.

g) SEBI may consider to introduce the concept of "Materiality" for shareholder approval. Shareholder approval must be via ordinary resolution and majority of minority similar to RPTs. The requirements under this proposal appear more stringent as - (i) there are no materiality thresholds applicable and (ii) special resolution of shareholders' is required instead of ordinary resolution under Regulation 23.

h) Instead of ratifying the existing and subsisting agreements, board of directors should consider and approve the same. Requiring ratification of existing agreements, which were validly contracted in accordance with applicable law and regulations at the relevant time, may not be appropriate and there may be legal basis to challenge retrospective applicability to such agreements.

i) It would not be correct to mandate to bring a contract before shareholders for approval when company is not a party to the contract.

3.5. **<u>Analysis</u>**

3.5.1. The concerns raised by the commenters and the modifications suggested by them are analysed below:

a) As against the contention of the commenters, the disclosure requirements under the Takeover Regulations do not cover all the scenarios envisaged here (i.e., all agreements impacting or having the potential to impact the management or control of a listed entity). Any agreement that impacts or has the potential to impact the management or control of a listed entity is a material information for the shareholders and therefore, needs to be disclosed by a listed entity to its shareholders. Some commenters desire to have a definition of 'management' and 'control' for the purpose of effecting the proposed amendments. While the word 'control' will always connote the meaning and explanation as defined under the Takeover Regulations, the term 'management' being a broader term should not be subject to a hard-coded definition and it is desirable to leave the term 'management' to connote the meaning used in common parlance.

b) While some commenters have suggested to introduce materiality threshold for disclosure of agreements that impose any restriction or create any liability on the listed entity, it may be noted that an agreement imposing or have the potential to impose any restriction or create or potentially create any liability other than in the normal course of business of a listed entity, is ipso facto a material information for disclosure to the shareholders. Therefore, it will be undesirable to prescribe a materiality threshold for the purpose of disclosure of such agreements. As regards the suggestions made by some commenters to define the term ‘restrictions’ and ‘liability’, it is viewed that these terms are themselves self-explanatory and any attempt to define them with precise words may lead to unwarranted interpretational issues which should be avoided.

c) Based on the suggestion from commenters, it may be accepted that the subsisting agreements shall be disclosed to the Stock Exchanges and on the website of the listed entity, instead of disclosing them in the Annual Report. However, an executive summary of such agreements, including the number of agreements and the salient features, shall be disclosed in the Annual Report for FY 2022-23 or FY 2023-24 along with a link to the exact webpage where complete details are available.

d) With respect to the parties to the agreement, as noted by the commenters, it is only the shareholders with significant influence (like promoters) who can enter into such restrictive agreements. However, the language of the provision has been kept wide to include various other entities (apart from promoters) so that promoters do not circumvent these provisions by having someone else enter into such binding agreements and escape from their liabilities on the ground that the agreement has not been entered by them. Therefore, no changes are proposed with regard to the proposal on parties to such agreements.

e) The commenters have suggested to introduce the concept of "materiality" for shareholder approval, on the lines of RPTs, for future agreements binding the listed entities. Acceding to the aforesaid suggestion, the following changes are proposed for future agreements that impose any restriction or create any liability upon a listed entity, by broadly aligning the approval requirements with the RPT framework:

i. All future agreements that impose or have the potential to impose any restriction or create or have the potential to create any liability, other than the agreements entered by the listed entity in the normal course of business, shall be placed before the Audit Committee for its approval / recommendations. The Audit committee shall examine and opine on and approve / reject / recommend / not recommend these agreements from the point of view of the economic interest of the listed entity, and more specifically from the point of view of minority shareholders. For agreements above the Materiality Threshold (defined below), the Audit Committee shall provide its recommendations to the shareholders of the listed entity and for agreements below the Materiality Threshold, the Audit Committee shall approve or reject such agreements.

ii. The threshold for shareholders' approval may be linked to the threshold for material RPTs i.e., 1000 crore or 10% of the consolidated turnover of the listed entity, whichever is lower. Any agreement that imposes or has the potential to impose any restriction or create or has the potential to create any liability on a cumulative basis together with other agreements entered during the financial year, exceeding a value of ₹1000 crore or 10% of the consolidated turnover of the listed entity, whichever is lower ("**Materiality Threshold**"), shall be placed before shareholders for approval.

iii. The threshold for shareholder approval may be modified to ordinary resolution and 'majority of minority' as agreements with non-related parties need not be subject to higher requirements

than the RPTs. However, if any shareholder is a party to the agreement, such a shareholder shall not be permitted to vote on such a resolution.

iv. These agreements shall not be effective unless and until they receive the approval of the Audit Committee or the shareholders, as the case may be.

f) While commenters have raised issues regarding disruptions to the subsisting agreements, it may be noted that an agreement to which the listed entity is not a party and yet the said agreement places any restriction or imposes liability on the listed entity, the same has to be done after following due approval process in a listed entity. However, as many commenters have disagreed with the proposal on ratification of subsisting agreements and taking into account the possibility of legal challenges, the Board may take a considered view and decide as to whether such subsisting agreements need to be placed before the shareholders for ratification.

g) If the Board decides to mandate ratification of such subsisting agreements, then the listed entity has to ensure compliance with the following requirements:

(i) All such agreements, irrespective of the materiality, have to be placed before the shareholders, along with the recommendation of the Audit Committee, for ratification (ordinary resolution and 'majority of minority'). The shareholders who are themselves parties to any such agreement shall not be permitted to vote on such a resolution.

(ii) If such agreements are not ratified, the future restrictions or obligations arising out of such agreements shall not be binding on the listed entity.

3.6. Proposal to the Board and amendments to the LODR Regulations

3.6.1. In view of the above, it is proposed to insert a new clause 5A to para A of Part A of Schedule III of the LODR Regulations to ensure disclosure of the following agreements:

"5A. Agreements entered into by the shareholders, promoters, promoter group entities, related parties, directors, key managerial personnel, employees of the listed entity or of its holding, subsidiary or associate company, among themselves or with the listed entity or with a third party, solely or jointly, which, either directly or indirectly or potentially or whose purpose and effect is to, impact the management or control of the listed entity or impose any restriction or create any liability upon the listed entity, shall be disclosed to the Stock Exchanges, including disclosure of any rescission, amendment or alteration of such agreements thereto, whether or not the listed entity is a party to such agreements:

Provided that such agreements entered into by a listed entity in the normal course of business shall not be required to be disclosed unless they, either directly or indirectly or potentially or whose purpose and effect is to, impact the management or control of the listed entity or they are required to be disclosed in terms of any other provisions of these regulations.

Explanation: For the purpose of this clause, the term "directly or indirectly" includes agreements creating obligation on the parties to such agreements to ensure that listed entity shall or shall not act in a particular manner."

3.6.2. The disclosure of the aforesaid agreements as proposed to be included in the new clause 5A of para A of Part A of Schedule III of the LODR Regulations, would be applicable to the subsisting agreements as well as future agreements and the listed entity and / or the parties to such agreements shall ensure compliance with the following requirements as indicated in Table 4A below:

Table 4A: Other compliance requirements for certain types of agreements binding listed entities

Disclosure of agreements which, either directly or indirectly or potentially or whose purpose and effect is to, impact the management or control of the listed entity or impose any restriction or create any liability upon the listed entity (in terms of new clause 5A to para A of Part A of Schedule III)		
Parameter	**Future agreements**	**Subsisting agreements**
Parties to the agreement	Shareholders, promoters, promoter group entities, related parties, directors, key managerial personnel, employees of a listed entity or of its holding, subsidiary, associate company, solely or jointly with the listed entity or solely or jointly with a third party.	Shareholders, promoters, promoter group entities, related parties, directors, key managerial personnel, employees of a listed entity or of its holding, subsidiary, associate company, solely or jointly with the listed entity or solely or jointly with a third party.
Obligation of the parties to inform the listed entity if it is not a party to the agreement	Within 2 working days of entering into the agreement or agreeing to enter into such an agreement.	On or before July 31, 2023
Disclosure under reg. 30 by the listed entity	Within 12 hours of signing of the agreement or approval to sign the agreement if the listed entity is a party to the agreement; 24 hours if the listed entity is not a party to the agreement.	All the subsisting agreements shall be disclosed to the Stock Exchanges and on the website of the listed entity on or before August 14, 2023 i.e., within two weeks of receipt of complete information about the agreements where the listed entity is not a party.
Disclosure in the Annual Report	In the Annual Report of FY 2023-24 onwards.	An executive summary of such agreements, including the number of agreements and the salient features, shall be disclosed in the Annual Report for FY 2022-23 or FY 2023-24 along with a link to the exact webpage where the complete details are available (if companies are

		unable to disclose the executive summary in the Annual Report of FY 2022-23, the same shall be disclosed in the next financial year i.e., FY 2023-24).

3.6.3. The listed entity shall ensure compliance with the approval requirements as specified in Table 4B below for future agreements binding listed entities. However, if subsisting agreements are required to be ratified by the shareholders, as referred in para 3.5.1(g) above, then the listed entity has to ensure compliance with the requirements specified in Table 4B below:

Table 4B: Approval requirements for certain types of agreements binding listed entities

Approval requirements for agreements which, either directly or indirectly or potentially or whose purpose and effect is to, impose any restriction or create any liability upon the listed entity, other than agreements entered by the listed entity in the normal course of business:		
Parameter	**Future agreements**	**Subsisting agreements where the listed entity is not a party**
Audit Committee's approval / recommendation	Any such future agreement. The Audit Committee shall examine and opine on and approve / reject / recommend / not recommend these agreements from the point of view of the economic interest of the listed entity, and more specifically from the point of view of minority shareholders.	All such subsisting agreements where the listed entity is not a party. The Audit Committee shall examine and opine on and recommend / not recommend these agreements from the point of view of the economic interest of the listed entity, and more specifically from the point of view of minority shareholders.
Shareholder approval	Any agreement that imposes or has the potential to impose any restriction or create or has the potential to create any liability on a cumulative basis	All such subsisting agreements where the listed entity is not a party shall be placed be placed before the shareholders, along with the recommendations of the

	together with other agreements entered during the financial year, exceeding a value of ₹1000 crore or 10% of the consolidated turnover of the listed entity, whichever is lower, shall be placed before shareholders, along with the recommendations of the Audit Committee, for approval by way of resolution to be passed at a general meeting. Approval of shareholders shall be by way of Ordinary Resolution and 'majority of minority'. However, if any shareholder is a party to such an agreement, such a shareholder shall not be permitted to vote on such a resolution.	Audit Committee, for ratification by way of an Ordinary Resolution and 'majority of minority' in a general meeting. However, if any shareholder is a party to such an agreement, such a shareholder shall not be permitted to vote on such a resolution.
Effective date	Not effective unless and until it receives the approval of the Audit Committee or the shareholders, as the case may be.	If the shareholders do not ratify any subsisting agreement where the listed entity is not a party, the future restrictions or obligations arising out of such agreements shall not be binding on the listed entity. Shareholder ratification shall be obtained on or before December 31, 2023.

3.6.4. The proposed amendments to the LODR Regulations are placed at **Annexure 3** (sub-regulations II, V and VI of regulation 3 of the amendment regulations). The proposal to insert new regulation 30A(3) to the LODR Regulations (ratification of subsisting agreements) shall be subject to the Board's decision as mentioned at para 3.5.1(f) above.

4. Periodic approval for special rights granted to certain shareholders of a listed entity

4.1. Issues identified

4.1.1. SHAs granting special rights to certain shareholders are drafted in such a way that those special rights would continue to be available to those shareholders even after a significant dilution of their holding in those listed entities. Such SHAs permit certain shareholders to enjoy such special rights perpetually, which is against the principle of rights being proportional to one's holding in a company.

4.2. Existing provisions and the practice

4.2.1. Generally, to attract investments in a company prior to listing, special rights are offered by the company to its pre-IPO investors and the promoters. These special rights are included in the SHAs executed between the company and the pre-IPO investors / promoters.

4.2.2. The nature of these special rights varies across companies and depends on the specific requirement of the investor(s). Some of the common types of special rights granted by companies are Nomination Rights, Veto Rights / Affirmative voting, Information Rights, Anti-Dilution Rights, Right of First Refusal, Tag Along Rights, Divestment Rights, etc.

4.2.3. In terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**ICDR Regulations**"), an issuer is required to provide a statement that the shares allotted in the public issue are equal in all respects, including dividends, with the existing shares issued by the company prior to the public issue, excluding SR (Superior Rights) equity shares. The underlying principle is that the shares issued in the Initial Public Offer (IPO) shall rank equally with the existing shares and any right which is not available to the shareholders after allotment of shares in the IPO, shall not be permitted to survive for any pre-IPO shareholders after listing of the company.

4.2.4. In view of the above, for a company coming up with an IPO, all the existing SHAs are cancelled or modified to the extent that special rights available to certain pre-IPO shareholders, except nominee / nomination rights and information rights, are terminated before listing. Further, such nomination and information rights are subject to approval of shareholders in the first general meeting of the listed entity conducted after listing of its shares.

4.3. <u>**Need for periodic approval for the special rights granted to certain shareholders**</u>

4.3.1. As per the principles specified in regulation 4 of the LODR Regulations, every listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders.

4.3.2. However, if any shareholder enjoys special rights and privileges, the same should have been agreed upon by all the other shareholders of a company. Further, such rights and privileges must be in proportion to one's holding in the company.

4.3.3. Once a public company gets listed, the special rights available to shareholders (Nomination and Information Rights) are put up for approval of the shareholders in the first general meeting, post-listing. On a review of the voting pattern of public shareholders and the commentaries available in public domain around such special rights accorded by certain recently listed companies, especially by the new-age tech companies, it is observed that the public institutional shareholders are increasingly voicing their concerns against any such special rights being conferred upon the promoters / founders / certain body corporates of those companies.

4.3.4. It is also observed that the SHAs are drafted in such a way that those special rights (nomination rights) would continue to be available to those shareholders even after significant dilution of their holding in those entities. Such a practice permits the shareholders to enjoy such special rights

perpetually and irrespective of their holdings, which is against the principle of rights being proportional to one's holding in a company.

4.3.5. It may be noted that even superior voting rights granted to promoters / founders have a sunset clause (maximum of 10 years after listing) as per the provisions of the LODR Regulations.

4.4. Proposal in the Consultation Paper

4.4.1. In order to address the issue of certain shareholders enjoying special rights perpetually, it was proposed that any special right (existing / proposed) granted to a shareholder of a listed entity shall be subject to shareholder approval once in every 5 years from the date of grant of such special rights.

4.4.2. Further, the existing special rights already available to any shareholders shall be renewed within a period of 5 years from the date of notification of the amendments to the LODR Regulations.

4.5. Public comments

4.5.1. The response to the questions posed in the Consultation Paper are tabulated below:

Table 5: Summary of the responses to the proposals on periodic approval for special rights granted to certain shareholders

Sl. No.	Question	Total comments received	Agree	Partially Agree	Disagree
1.	Should there be periodic shareholder approval for any special rights (existing / proposed) granted to shareholders?	38	17	6	15
2.	Do you agree with the proposal that such special rights should be subject to shareholder approval once in every 5 years?	37	13	7	17

3.	Should the special rights, if any, granted to a public financial institution be subject to shareholder approval once in every 5 years, as proposed above?	35	13	6	16

4.5.2. From the table above, it may be observed that the opinion of the commenters on the aforesaid proposals is divided. While many have favoured periodic approval of special rights granted to shareholders, there also equal amount of opposition to the said proposal by other commenters. Those who have disagreed with the proposals have inter-alia stated the following:

a) In case of existing special rights already approved by the shareholders, no periodic review is required. For newly listed entities, the special rights may be highlighted in the prospectus.

b) While the rights linked to same class shares of a listed entity are pari-passu, in reality, the shareholders among themselves are not at pari-passu. Promoter shareholders are not the same as other public shareholders, as they carry with them additional regulatory obligations.

c) Special rights are essential for institutional investors to undertake an investment in any entity consistent with global market practice. If the availability of such basic rights becomes uncertain (since this would be contingent on approval by the shareholders), this would drastically disincentivize investments by such investors in listed Indian entities and encourage a tendency to view investments in the Indian securities market unfavorably.

d) Granting of special rights to any specific shareholder generally arises out of long-term strategic decisions. Periodical approval of such rights by shareholders will jeopardise the long-term intent.

e) The public shareholder base keeps changing on a daily basis and it may not be commercially prudent to require special rights granted to certain shareholders to undergo ratification on a periodic basis by a different set of shareholders.

f) Often in contracts, failure on the part of the party to make available these rights in the target listed entity, is treated as Material Adverse

Effect which leads to indemnity being invoked. As investments were made in the company basis the agreement over such rights, subjecting them now to repeated shareholders approval may result in unreasonable consequences for both the listed entity and the promoters/party to the agreement.

g) Bringing in an additional ratification every 5 years will only increase the compliance burden. Sunset clause must be extended to nomination and information rights too.

h) All such entities whose majority shareholding is with Government should not be subject to shareholder approval as proposed, irrespective of whether they are included as 'public financial institution' under the Companies Act or not (eg., banks/ insurance companies).

4.5.3. The commenters who have partially agreed to the proposals have suggested the following modifications:

a) Exemption should be provided from seeking shareholders' approval every five years, if such rights are provided in the Articles of Association of the listed entity and specific thresholds with respect to shareholding have been provided for exercising such rights.

b) Special rights to promoters and investors holding over a prescribed threshold (for eg. 5%) should not be subject to any periodic approval / ratification. For shareholders holding less than 5%, sunset clause may be introduced.

c) Listed entities with identified promoters should be grandfathered from this proposal.

d) Specific shareholder rights granted to banks / insurance companies to appoint directors to listed companies in furtherance of Section 161(3) of the Companies Act, 2013 or provisions of the statute governing the such banks/insurance companies should be exempt as such directors are required to ensure preservation of the public money (the deposit-holder/policy-holder funds) invested in the debt or equity of a listed company. Special rights granted as part of loan / financing agreements may be excluded.

e) Approval of shareholders may be mandated only for amendment / modification of special rights already granted.

f) Considering the fast-changing dynamics, 5-year period is a relatively longer period. The period should be reduced to 3 years from the proposed 5 years.

g) A distinction may be made between the nomination rights by a Lender public financial institution and Investor public financial institution and the restriction as mentioned above shall be made applicable only to the Investor public financial institution.

4.6. **Analysis**

4.6.1. The idea behind the proposal was to introduce a sunset clause for the special rights, on similar lines of superior voting rights, enjoyed by certain shareholders. It was observed that the special rights are drafted in such a way that they continue forever.

4.6.2. While a sunset clause, on the lines of superior voting rights, may lead to non-availability of the special rights after a specified period, it was rather proposed to have a provision of periodic approval of such special rights once in 5 years so that the listed entity can grant, if it wishes to, in its own interest, special rights but subject to shareholders' consent and approval once in every 5 years. Further, the existing special rights was proposed to be ratified within a period of 5 years from the date of notification of the amendments to the LODR Regulations, thereby giving sufficient time to the listed entity to get shareholders' approval.

4.6.3. Commenters, who have disagreed or partially agreed, have highlighted the need to differentiate between (i) Existing special rights and the special rights that may be granted in future and ii) Special rights incorporated in the AoA with a prescribed threshold vis-à-vis rights not incorporated in the AoA of a company.

4.6.4. It may be noted that grandfathering all the existing special rights would amount to identifying the problem as discussed above and leaving it unaddressed. While the shareholders base of a listed entity keeps changing, permanency of rights that were granted to certain shareholders by the

company sometime in the distant past enables a particular set of shareholders to enjoy certain rights over others, perpetually without any regard to the wishes of the changing shareholders from time to time. Therefore, incorporation of special rights in the AoA or otherwise, which continues forever, goes against the spirit of regulation 4(2)(c) of the LODR Regulations which requires a listed entity to ensure equitable treatment of all the shareholders.

4.6.5. However, the shareholders having special rights in a listed entity can continue to enjoy the said special rights, if the other shareholders existing at a particular point of time agree to it.

4.6.6. With respect to the suggestion on exemption to banks and insurance companies, it may be noted that the special rights granted to such institutions are generally incorporated as part of the lending agreements or the debenture trust deed agreement entered into with the listed entity. The proposal in the Consultation Paper and the one being discussed in this Memorandum intends to cover only those special rights granted to a shareholder of a listed entity and does not intend to cover the rights granted to the lenders under a financing or a trust deed agreement. Therefore, the aforesaid suggestion of commenters seeking exemption of special rights granted as part of lending agreements to the lenders do not hold relevance. However, if such lending institution or a debenture trustee becomes a shareholder of the listed entity and enjoys certain special rights by virtue of the lending agreements or the debenture trust deed, then the requirement of obtaining periodic shareholders' approval of such special rights, may be dispensed with.

4.7. **Proposal to the Board and amendments to the LODR Regulations**

4.7.1. In view of the above, in order to address the issue of special rights being enjoyed perpetually by certain shareholders disproportionate to their holding in the listed entity, it is proposed to insert a new regulation 31B to the LODR Regulations as given below:

“**Special rights to shareholders**

31B (i) Any special right granted to the shareholders of a listed entity shall be subject to the approval by the shareholders in a general meeting by way of a special resolution once in every five years starting from the date of grant of such special right:

Provided that the special rights available to the shareholders of a listed entity as on the date of coming into force of this regulation shall be subject to the approval by shareholders by way of a special resolution within a period of five years from the date of coming into force of this regulation:

Provided further that the requirement specified in this regulation shall not be applicable to the special rights made available by a listed entity to a financial institution registered with or regulated by the Reserve Bank of India under a lending arrangement in the normal course of business or to a debenture trustee registered with the Board under a subscription agreement for the debentures issued by the listed entity, if such financial institution or the debenture trustee becomes a shareholder of the listed entity as a consequence of such lending arrangement or subscription agreement for the debentures.”

5. Strengthening the extant mechanism for sale, disposal or lease of an undertaking of a listed entity or where the listed entity owns more than one undertaking, of the whole or substantially the whole of any of such undertakings, outside the ‘Scheme of Arrangement’ framework

5.1. Issue Identified

5.1.1. Presently, sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings (hereinafter for sake of brevity is referred to as “Sale, lease or otherwise disposal of an undertaking”), may happen either through Scheme of Arrangement (as prescribed under Companies Act and/ or under the LODR

Regulations and the circulars issued by SEBI) or "Outside the Scheme of Arrangement" framework, generally through agreement referred to as Business Transfer Agreement or slump sale.

5.1.2. SEBI, vide its Master Circular on Scheme of Arrangements by Listed Entities dated November 23, 2021 (hereinafter referred to as "Master Circular"), has prescribed a framework which has to be complied with by listed entities while undertaking scheme of arrangement. Further, SEBI has also ensured that minority shareholders are adequately protected by mandating that a scheme of arrangement, which, inter-alia, involves transfer of whole or substantially the whole of the undertaking of the listed entity and where the consideration for such transfer is not in the form of listed equity shares is to be acted upon only if the votes cast by the public shareholders in favour of the proposal are more than the number of votes casted by the public shareholders against it ("Majority of Minority").

5.1.3. In terms of the Master Circular, in case any listed entity undertakes such sale, lease or otherwise disposal of an undertaking, through a scheme of arrangement route, it is required to enumerate and explain to the shareholders the rationale, need, impact on the shareholders etc. of such sale, lease or disposal. Further, such listed entity is also required to submit a valuation report from a registered valuer (other than cases where there is no change in shareholding pattern of the listed company/resultant company) and the registered merchant bankers have to provide a fairness opinion on the valuation done by the valuer. These requirements ensure greater transparency and dissemination of information for the benefit of the shareholders and helps them to take an informed decision on the proposal.

5.1.4. However, in case any sale, lease or otherwise disposal of an undertaking is being undertaken "outside the scheme of arrangement" framework, it is observed that the notice to the shareholders pertaining to passing of a resolution to that effect is often bereft of adequate disclosures. Further, presently there is an inconsistency in the approval process as such a proposal requires approval by way of only special resolution if undertaken "outside the scheme of arrangement" framework, as against the requirement

of seeking majority of minority approval in case a sale, lease or otherwise disposal of an undertaking is being proposed through a scheme of arrangement. Moreover, it is observed that a resolution for effecting a sale, lease or otherwise disposal of an undertaking outside the scheme of arrangement framework passes through easily where the promoter shareholding is significant, which proves to be disadvantageous to the minority shareholders as it does not fully protect their interests when such business arrangements are transacted outside the regulatory framework of "scheme of arrangement".

5.2. Existing provisions

5.2.1. Sub-section 1 of Section 180 of the Companies Act confers on the Board of Directors of a company to exercise power with respect to selling, leasing or otherwise disposing of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings, only with the consent of the company by a special resolution. The relevant section from the Companies Act is reproduced herein below-

180. Restriction on powers of Board. — (1) The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely: —

(a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.

Explanation. —For the purposes of this clause, —

(i) "undertaking" shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent. of the total income of the company during the previous financial year;

(ii) the expression “substantially the whole of the undertaking” in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year;

5.2.2. The scheme of arrangements governed under Sections 230 to 232 of the Companies Act, 2013 provides for companies to approach National Company Law Tribunal (NCLT) to obtain its sanction to such schemes of arrangement before they can take effect. Further, LODR Regulations places obligations with respect to schemes of arrangement on listed entities, which inter-alia involves filing the draft scheme with Stock Exchange(s) and SEBI for obtaining their no-objection letter. SEBI, vide its Master Circular, has specified that where the scheme involves transfer of whole or substantially the whole of the undertaking of the listed entity and where the consideration for such transfer is not in the form of listed equity shares, it can be acted upon only if the votes cast by the public shareholders in favour of the proposal are more than the number of votes cast by the public shareholders against it.

5.2.3. Presently, LODR Regulations do not prescribe any requirements with respect to sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of the listed entity or where the listed entity owns more than one undertaking, of the whole or substantially the whole of any of such undertakings, if it is done “outside the scheme of arrangement”.

5.3. **Proposals in the Consultation Paper:**

5.3.1. In order to strengthen the extant framework of ‘slump sale’ executed by entering into an agreement outside the scheme of arrangement framework and to safeguard the interest of minority shareholders as well as to bring these transactions in alignment with the regulatory requirement, as applicable to the scheme of arrangement, the following proposals are made:

a) Introducing provisions in LODR Regulations for sale, disposal or lease of whole or substantially the whole of the undertaking of the listed company

or where the company owns more than one undertaking, of the whole or substantially the whole of any one or more of such undertakings;

b) Mandating disclosure of the objects and commercial rationale for such sale, disposal or lease, to the shareholders;

c) Such sale, disposal or lease of whole or substantially the whole of the undertaking, of the listed company or where the listed company owns more than one undertaking, of the whole or substantially the whole of any of one or more such undertakings can be acted upon only if the votes cast by the public shareholders in favour of the proposal are more than the number of votes cast by the public shareholders against it. This shall be in addition to the requirement to pass a Special Resolution as provided in the Companies Act.

5.4. **Public Comments**

5.4.1. The response to the questions posed in the Consultation Paper are tabulated below:

Table 6: Summary of the responses to the proposals on sale, disposal or lease of an undertaking of a listed entity outside the 'Scheme of Arrangement' framework

Sl.No.	Question	Total comments received	Agree	Partially Agree	Disagree
1.	Should new provisions, as proposed in the Consultation Paper, be introduced in LODR Regulations to safeguard the interests of minority shareholders in case of sale, disposal or lease of whole or substantially the whole of the undertaking of the listed company or where the company owns more than one undertaking, of the whole or substantially the whole of any one or	38	14	10	14

	more of such undertakings?				
2.	If yes, do you agree with the proposal of mandating disclosure of objects and commercial rationale for such sale, disposal or lease, to the shareholders?	35	22	4	9
3.	Do you agree with the proposal of obtaining 'majority of minority', in addition to special resolution, for such sale, disposal or lease of an undertaking?	37	12	6	19

5.4.2. The commenters have highlighted that seeking approval of majority of the public shareholders, in addition to an approval by way of Special Resolution, would be onerous for listed entities and will add to the compliance obligation.

5.4.3. Some commenters have asserted that Ministry of Corporate Affairs (MCA) has already prescribed regulations for these types of transactions. One commenter has also stated that the said provisions are covered under the Companies Act, which are subject to National Company Law Tribunal (NCLT) approval process.

5.4.4. Further, some commenters have also submitted that in case such transactions are being undertaken with related parties, Section 188 of the Companies Act as well as Regulation 23 of LODR regulations restrict the related party from voting in such resolution. Moreover, if the transactions are being undertaken with an unrelated party, it has been stated that there would be no conflict of interest between the promoter and the counter party and seeking majority of public shareholders' approval may not serve any purpose in such cases.

5.4.5. Few commenters have also raised apprehension that implementation of the said proposals may lead to possibility of genuine proposals being defeated, causing delay in business decisions and may also adversely impact the business operations of the listed entities as the same would limit the ability of

the board of directors to effectively manage companies in the best interests of all shareholders. It has also been submitted that promoter/majority shareholders are adequately equipped to analyze and evaluate as to whether the proposal is in the best interest of the entity or not.

5.4.6. Some commenters have also offered their suggestions on the said proposals. These include providing exemption for disposal of undertaking to a wholly owned subsidiary, sale of an undertaking by virtue of a covenant covered under an agreement with lender (by way of mortgage, etc), specifying the thresholds for which approval would be required, disclosing the use of sale proceeds and also prohibiting public shareholders who, directly or indirectly, have interest in such transaction from voting in such resolution.

5.5. **Analysis**

5.5.1. With respect to commenter's concern that seeking approval of majority of the public shareholders, in addition to an approval by way of Special Resolution, would be onerous and will add to the compliance burden, it is clarified that there shall be a unified voting process and thus, there would be no requirement of undertaking separate voting for seeking approval by way of special resolution and for majority of minority approval of the public shareholders. This unified voting mechanism is also being currently followed in case of scheme of arrangements and other relevant requirements under LODR Regulations.

5.5.2. With respect to commenters' assertion that MCA has prescribed regulation for these types of transactions, it is stated that under section 180 of Companies Act, requirement is only to seek approval by way of special resolution of the shareholders. However, the additional requirement of majority of minority approval is proposed to protect the interests of minority shareholders, more so in cases where the promoter's shareholding is significant. Further, with respect to commenter's contention that such transactions are subject to NCLT process, it is clarified that the proposed provision of majority of minority shareholder approval will be applicable for transactions which are now proposed to be dealt with are outside the scheme of arrangement framework, hence do not fall under the scrutiny of NCLT.

5.5.3. With respect to commenter's reasoning that in case the transactions are being undertaken with an unrelated party, there would be no conflict of interest between the promoters and the counter party and thus obtaining majority of minority approval may not be essential in such scenarios, it is stated that these proposals are aimed at strengthening the approval process irrespective whether the counter party is related or unrelated to the promoters as the shareholders need to know and agree to the objectives and rationale behind such business transactions being undertaken outside the framework of scheme of arrangements. Further, such a requirement is already applicable to transactions that are undertaken through scheme of arrangement route, hence, it is proposed to harmonize the said requirements for the transactions undertaken "outside the scheme of arrangement" framework as well.

5.5.4. With respect to the apprehension raised regarding possibility of genuine proposals getting defeated, it is stated that it is a mere apprehension expressed and if the proposal is in the interest of public shareholders there is a high probability that majority of minority shareholders will approve it. However, if majority of the public shareholders have expressed their disapprobation with the proposal, it may be appropriate to infer that the proposal is not in the interest of the minority shareholders.

5.5.5. In respect of the suggestions provided by the commenters with respect to providing exemption for transfer of undertaking by a listed entity to its wholly owned subsidiary, the said suggestion can be accepted provided such a transfer to a wholly owned subsidiary should not be done with an intention for further sale, lease or disposal of the said undertaking to a third party or to subsequently dilute the shareholding of the holding listed entity in the wholly owned subsidiary so as to deprive its shareholders of the economic benefits of the said undertaking. Ideally, a sale, lease or disposal of a business undertaking made to listed entity's wholly owned subsidiary will not cause any economic loss to the shareholders of the listed entity as they continue to be the ultimate beneficiary of that business undertaking through the wholly owned subsidiary. However, in order to eliminate the possibility of any misuse of such business arrangement/transactions as expressed above, it is

proposed to mandate that if such wholly owned subsidiary decides to sell, lease or dispose of the said undertaking in any manner in future, the same can be done only by passing of a special resolution along with obtaining majority of minority approval from the shareholders of the holding listed company who had originally transferred the said undertaking to the wholly owned subsidiary. Similarly, the holding listed company shall be required to pass a special resolution along with obtaining majority of minority approval from its shareholders before deciding to dilute its shareholding below 100% of the wholly owned subsidiary.

5.5.6. Further, the suggestion with respect to sale of an undertaking by virtue of a covenant covered under an agreement with financial institution(by way of mortgage, etc) may also be accepted and exemptions with respect to seeking shareholders approval may be provided in such cases too subject to condition that the lenders in such cases should be regulated by or registered with Reserve Bank of India or that Debenture Trustee representing debenture holders of the listed entity should be registered with Securities and Exchange Board of India. Furthermore, specifying a threshold for the purpose of seeking shareholders' approval is taken into consideration by referring the expression "undertaking" and "substantially the whole of the undertaking" with the definitions provided in the Section 180(1)(a)(i) and Section 180(1)(a)(ii) of the Companies Act, respectively.

5.5.7. Further, suggestion with respect to prohibiting public shareholders who, directly or indirectly, have interest in such transaction, from voting in such resolution and disclosure of use of sale proceeds, may also be accepted.

5.6. **Proposal to the Board and amendments to the LODR Regulations**

5.6.1. Keeping in view the above discussions, in order to strengthen the extant mechanism for sale, disposal or lease of an undertaking of a listed entity or where the listed entity owns more than one undertaking, of the whole or substantially the whole of any of such undertakings, outside the 'Scheme of Arrangement' framework, it is proposed to insert a new regulation 37A to the LODR Regulations as given below-

"37A. Sale, lease or disposal of an undertaking outside Scheme of Arrangement

(1) A listed entity carrying out sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of such entity or where it owns more than one undertaking, of the whole or substantially the whole of any of such undertakings, shall -

(a) take prior approval of shareholders by way of special resolution;

(b) disclose the object of and commercial rationale for carrying out such sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of the entity, and the use of sale proceeds arising therefrom, in the statement annexed to the notice to be sent to the shareholders.

Provided that such a special resolution shall be acted upon only if the votes cast by the public shareholders in favour of the resolution exceed the votes cast by such public shareholders against the resolution:

Provided further that no public shareholder shall vote on the resolution if he is a party, directly or indirectly, to such sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of the listed entity.

Explanation. —For the purposes of this regulation, the terms "undertaking" and "substantially the whole of the undertaking" shall have the same meaning as assigned to them under clause (a) of sub-section (1) of section 180 of the Companies Act, 2013.

(2) The requirement as specified in sub-regulation (1) shall not be applicable for sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking by a listed entity to its wholly owned subsidiary whose accounts are consolidated with such listed entity.

Provided that prior to such wholly owned subsidiary selling, leasing or otherwise disposing of the whole or substantially the whole of the undertaking received from a listed entity, whether in whole or in part, to any other entity, such listed entity shall comply with the requirements specified in sub-regulation (1).

Provided further that the listed entity shall comply with the requirements specified in sub-regulation (1) before diluting its shareholding below hundred percent in its wholly owned subsidiary to which the whole or

substantially the whole of the undertaking of such listed entity was transferred.

Explanation: The provisions of this regulation shall not be applicable where sale, lease or otherwise disposal of the whole or substantially the whole of the undertaking of a listed entity is by virtue of a covenant covered under an agreement with a financial institution regulated by or registered with the Reserve Bank of India or with a Debenture Trustee registered with the Board."

6. Periodic shareholder approval for any director serving on the board of a listed entity to address the issue of 'Board Permanency'

6.1. Issues identified

6.1.1. Recently, the issue of a few promoters of listed entities enjoying permanency on the board, thereby enjoying an undue advantage, prejudicial to the interest of the public shareholders, was highlighted in the media. It was stated in the media report that "A permanent seat on the company's board can be detrimental to investor interest. When the companies' performance deteriorates, promoters hang on to their seats making it harder for investors to effect management change, and arrest value destruction….."

6.1.2. Other instances of promoter-directors continuing on the board even after substantial dilution of their stake and after ceding the control of the company, were also reported in the media.

6.1.3. Permanent seat on a board is generally secured through two ways viz., (i) by having a clause inserted in the Articles of Association (AoA) of a company enabling appointment of a permanent director, and / or (ii) by getting appointed on the board as a director not liable to 'retirement by rotation' and without any defined tenure.

6.1.4. Such directors are not subject to periodic shareholders' approval. Consequently, the shareholders of listed entities do not get an opportunity to evaluate the performance of such directors appointed in the aforesaid manner. This allows them to serve on the board of a listed entity as long as

they desire, thereby enjoying “board permanency”, disregarding the intent of shareholders on continuation of such directors on the board of a listed entity.

6.2. **Existing provisions and practices**

6.2.1. Directors serving on the board of a listed entity can be classified into two categories viz., Executive and Non-Executive.

6.2.2. Executive Directors i.e., a Whole-time Director (WTD) or a Managing Director (MD) appointed in terms of section 196, 197 and other applicable provisions of the Companies Act, have a fixed tenure specified at the time of appointment. Therefore, after completion of the tenure (maximum of 5 years), such a person can be re-appointed to the board subject to the approval of shareholders of the company. Further, such directors may also be subject to ‘retirement by rotation’ (discussed below) as determined by the company at the time of appointment or re-appointment.

6.2.3. Non-Executive directors are generally classified into two categories viz., Independent Directors (IDs) and other than Independent Directors (directors who hold a non-executive position and do not fulfil the criteria of independence specified in regulation 16(1)(b) of the LODR Regulations).

6.2.4. The Companies Act has certain provisions relating to mandatory retirement of a specific percentage of directors every year through rotation. The rationale behind having the concept of ‘retirement by rotation’ is to limit the service lengths of board members and have them vacate their positions at the Annual General Meeting (AGM), unless such directors are proposed for re-appointment in the AGM. Therefore, this provision relating to ‘retirement by rotation’ and subsequent re-appointment only with shareholders’ approval, gives an opportunity to the shareholders to evaluate the performance of such directors and thereafter vote either in favour of or against their re-appointment.

6.2.5. Section 152(6) of the Companies Act states that, unless the AoA provides for retirement of all directors at every AGM, at least 2/3rd of the total number of directors shall be persons whose period of office is liable to determination by

'retirement by rotation' and out of the said 2/3rd, at least 1/3rd of directors shall retire from office every year through rotation. Certain categories like Independent Directors, small shareholder directors etc. are excluded from the said 'retirement by rotation'.

6.2.6. Though the concept of 'retirement by rotation' does not apply to Independent Directors, the tenure of such directors on the board is fixed (a term of maximum 5 years) and there is a mandatory requirement of shareholders' approval for their re-appointment.

6.2.7. However, there is a possibility that those directors who are non-executive directors (NEDs), other than independent directors, may be appointed to the board of a company as a director not liable to 'retirement by rotation' and without any defined tenure. Therefore, such non-independent NEDs would not be subject to periodic shareholders' approval, unlike other categories of directors.

6.2.8. A combined reading of the provisions of the Companies Act and the extant practices being followed by companies, leads to the following conclusion on appointment of directors:

a) Not all directors serving on the board of listed entity may be subject to 'retirement by rotation'.

b) There may be some directors who are appointed to the board of a listed entity without a defined tenure and not liable to 'retirement by rotation'.

c) In addition to the above, by virtue of the provisions of the AoA of a company, a person can be appointed as a director on a "permanent-basis". Such director, so appointed on the basis of the provisions of AoA, serves as a "permanent-director" on the board of the company.

6.3. **<u>Proposal in the Consultation Paper</u>**

6.3.1. In the interest of good corporate governance at listed entities, all directors appointed to the board of a listed entity need to go through periodic shareholders' approval process, thereby providing legitimacy to the director to continue to serve on the board.

6.3.2. On the lines of what is followed in the appointment / re-appointment of MD / WTD and IDs, it is necessary that the directorship of any individual serving on the board of a listed entity should be subject to periodic shareholders' approval at least once in every five years from the date of his / her first appointment to the board.

6.3.3. Keeping in view the need for a glide-path for compliance, it was proposed to implement the following measures:

a) As on March 31, 2024, if there is any director serving on the board of a listed entity without his / her appointment or re-appointment being subject to shareholders' approval during the last 5 years i.e., from April 1, 2019, the listed entity shall take the proposal for shareholders' approval in the first general meeting to be held after April 1, 2024, for his / her continuation on the board of the listed entity.

b) From April 1, 2024, subject to the other applicable provisions of law, the listed entity shall ensure that the directorship of all directors serving on the board or appointed to the board is put up to shareholders for approval at least once in every 5 years.

The aforesaid provisions would not be applicable to those cases where the director is appointed pursuant to the orders of a Court or a Tribunal.

6.4. Public comments

6.4.1. The responses to the questions posed in the Consultation Paper are tabulated below:

Table 7: Summary of the responses received to the proposals on periodic shareholder approval for any director serving on the board of a listed entity to address the issue of 'Board Permanency'

Sl. No.	Question	Total comments received	Agree	Partially Agree	Disagree
1.	Should there be a requirement of periodic shareholders' approval for all categories of directors serving on the board of a listed entity?	38	16	13	9
2.	If yes, do you agree with the proposals mentioned at para 9.3.4 of the Consultation Paper?	35	13	9	13

6.4.2. While majority of the commenters have agreed with the proposals to address the issue of 'Board Permanency', few have disagreed. Those who have disagreed with the proposals have inter-alia stated the following:

a) If the terms of appointment of any director has already been approved by the shareholders, no periodic approval shall be required.

b) The proposal would become an additional burden on the companies as approaching shareholders again and again is neither feasible nor desirable.

c) If shareholders do not want any director to continue, they can always remove him / her by following the procedure laid down in the Companies Act.

d) The proposal would create a conflict with the provisions of the Companies Act as it recognizes the merit of Permanent Directors. The rationale behind not having all directors with term liable to retire by rotation is such that board members should be structured to retain valuable skills, maintain continuity of knowledge and experience, while gradually attempting to introduce people with new ideas and expertise.

e) Permanent Directors are generally deemed to be the pillars of the company whose guidance and knowledge is important for the functioning of the company, hence they shall not be required to undergo periodic shareholder's approval.

6.4.3. Other commenters who have partially agreed with the proposal have suggested the following modifications:

a) Nominee Directors should be exempt from the proposed requirement of periodic shareholder approval.

b) Directors appointed or nominated by the Government or regulatory authorities to the board of a listed entity should also be excluded.

c) Directors appointed by banks / insurance companies in furtherance of any specific law in force in India including Section 161(3) of the Companies Act, 2013 should be excluded as such directors are required to ensure preservation of the public money (the deposit-holder/policy-holder funds) invested in the debt or equity of a listed company.

d) Lending institutions are provided with rights of nominating a director to protect their interests as they have invested/lent significant amount in/to the Company. Review of appointment of Directors nominated by such institutions/investors every 5 years would be futile. This has the effect of removal of nominee directors when the loan obligations are still pending.

e) Permanent Board seats should be linked to shareholding in the company.

f) The applicability of obtaining shareholder approval once in every five years be restricted only to directors that are (i) promoters or promoter group members, (ii) relatives of promoters or members of the promoter group, or (iii) nominees of promoters and promoter group members.

g) Directors representing the promoter or promoter group may be exempt by linking the exemption to their holding and the market capitalization of the company.

h) All non-executive directors may be subject to periodic ‘retirement by rotation’.

i) Suggestion to clarify that rotation and re-appointment under section 152(6) of the Companies Act during the last 5 years will suffice proposed requirement. Further, few have also stated that the periodic

shareholder approval requirement should not be applicable to Independent Directors and Executive Directors who have a fixed tenure.

6.5. **Analysis**

6.5.1. The proposals mentioned in the Consultation Paper are aimed to address the issue of directors continuing perpetually on the board of a listed entity which is not a good corporate governance practice. It may be noted that the Executive Directors and Independent Directors are already subject to periodic shareholder approval. Further, other Non-Executive Directors may also be subject to 'retirement by rotation' by companies and therefore, extending it to the remaining non-retiring Non-Executive Directors may not result in any substantial increase in the compliance responsibility as contested by the commenters. If continuation of any director is critical for the company due to the "valuable skills" or "continuity of knowledge and experience", then shareholders would also appreciate continuation of such directors on the board. Therefore, reappointment of "meritorious" directors on the board of a company would not be a problem.

6.5.2. Removal of directors, especially promoter-directors, from the board of a listed entity may not be feasible or practicable in all cases. The recent events relating to removal of directors at a few listed entities highlighted the difficulties faced by public shareholders in unseating promoter-directors.

6.5.3. On the suggestions to exclude nominee directors from the requirement to obtain periodic shareholder approval, it may be noted that the apprehension that shareholders may not approve their reappointment is unfounded. A recent analysis by a proxy advisory firm on the resolutions put to vote in 2022 reveals that less than 3% of the resolutions got defeated at NIFTY-500 companies. If a nominee director has professional experience and expertise which would benefit the listed entity, his / her re-appointment should not be a concern either for the nominating institution or for the listed entity.

6.5.4. With respect to directors appointed or nominated by the Government or regulatory authorities, it is observed that the tenure for such directors is

generally less than 5 years and therefore, there may not be any conflict with the aforesaid proposal.

6.5.5. As far as the right of banks / insurance companies or lending institutions to nominate directors on the board of a listed entity is concerned, it is observed that the covenants provide for appointment of nominees of lending institutions to the board in the event of a default by the borrower. Therefore, these institutions do not have their nominees on the board of a company under normal circumstances. However, in case a financial institution regulated by or registered with RBI or a Debenture Trustee registered with SEBI has its nominees pursuant to a financing arrangement or subscription to debentures issued by the listed entity, as the case may be, such nominee directors may be exempted from the proposed requirement of periodic approval of shareholders.

6.5.6. It is also clarified that the proposal is intended to mainly cover those Non-Executive Directors who do not have any fixed tenure and are not liable to 'retirement by rotation'. It is proposed to make suitable modifications to the proposals made in the Consultation Paper, for clarity.

6.6. **Proposal to the Board and amendments to the LODR Regulations**

6.6.1. In view of the above, to address the issue of 'Board Permanency' at listed entities, it is proposed insert new-sub regulation (1D) to regulation 17 of the LODR Regulations as given below:

"(1D) With effect from April 1, 2024, the continuation of a director serving on the board of directors of a listed entity shall be subject to the approval by the shareholders in a general meeting at least once in every five years from the date of their appointment or reappointment, as the case may be.

Provided that the continuation of the director serving on the board of directors of a listed entity as on March 31, 2024, without the approval of the shareholders for the last five years or more, shall be subject to the approval of shareholders in the first general meeting to be held after March 31, 2024:

Provided further that the requirement specified in this regulation shall not be applicable to the Whole-Time Director, Managing Director, Manager, Independent Director or a Director retiring as per the sub-section (6) of

section 152 of the Companies Act, 2013, if the approval of the shareholders for the reappointment or continuation of the aforesaid directors or Manager is otherwise provided for by the provisions of these regulations or the Companies Act, 2013 and has been complied with:

Provided that the requirement specified in this regulation shall not be applicable to the director appointed pursuant to the order of a Court or a Tribunal or nominated by a financial institution registered with or regulated by the Reserve Bank of India under a lending arrangement in its normal course of business or nominated by a Debenture Trustee registered with the Board under a subscription agreement for the debentures issued by the listed entity."

7. Proposed amendments to the LODR Regulations

7.1. In view of the above, it is proposed to amend the LODR Regulations as specified in paras 3.6, 4.7, 5.6 and 6.6 above.

7.2. Draft amendments to the LODR Regulations is placed as **Annexure 3**. The amendments to the LODR Regulations, except the proposal at para 5.6 above, shall come into effect on the 30th day of notification in the Official Gazette.

8. Proposal to the Board

8.1. The Board is requested to consider and approve the proposals as in the Memorandum and authorize the Chairperson to make consequential and incidental changes and take necessary steps to give effect to the decisions of the Board.

Annexure 1

(The Consultation Paper is available on the SEBI Website)

Annexure 2

(This has been excised for reasons of confidentiality)

Annexure 3

(The amendments notified in the Official Gazette shall also be available on the SEBI website)