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October 12, 2012

SEBI GIVES EXEMPTION FROM OBLIGATION OF OPEN OFFER

INTRODUCTION

The Securities and Exchange Board of India ("**SEBI**") in its order dated September 24, 2012 in the matter of Proposed Acquisition Of Shares of IFCI Limited – Application Filed Under Regulation 11(3) of The SEBI (Substantial Acquisition Of Shares And Takeovers) Regulations, 2011,[1] has exempted the Government of India ("**GOI**") from making a mandatory open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**") for its proposed increase in stake in IFCI Ltd ("**Target**") from 0.0000011% to 55.57%.

FACTS

The Industrial Finance Corporation of India ("**IFCI**") was initially established as a statutory corporation on July 1, 1948 under the IFCI Act, 1948 and subsequent to the repeal of the IFCI Act, 1948, IFCI was converted into a public limited company incorporated under the Companies Act, 1956 on March 1993 pursuant to which, the name of IFCI was changed to IFCI Ltd. In 2001, GOI, foreseeing the possibility of IFCI defaulting on its liabilities, infused Rs. 400 crores as unsecured convertible debentures ("**UCDs**") with an interest rate of 9.75% so as to avoid a systemic risk to the economy with IFCI's credit default. The terms of the UCDs inter alia were such that they could be converted wholly or partly into fully paid equity shares of the Target, at par, at any time during the currency of UCDs (i.e. 20 years) subject to compliance with the provisions of SEBI guidelines in respect of preferential allotment. Subsequently, in December 2002, as part of a financial assistance package, GOI subscribed to 523 optionally convertible debentures ("**OCDs**") of the Target at a very nominal coupon rate of 0.1%.

On August 23, 2012 the Union Cabinet approved the conversion of UCDs and OCDS (collectively the "**Debentures**"). The proposed conversion of UCDs would have raised GOIs shareholding in the Target from 0.0000011% to 35.15% and thereafter, upon conversion of OCDs, would have raised to 55.57%. Foreseeing the obligation to make a mandatory open offer under Regulation 3(1), 3(2) and 4 of the Takeover Code, the GOI through the Ministry of Finance, Department of Financial Services, vide letter dated August 29, 2012 filed an application with SEBI under Regulation 11(3) of the Takeover Code to seek an exemption from complying with the open offer requirements.

Pursuant to Regulation 11(5) of the Takeover Code, SEBI referred the said application of GOI to a panel of experts ("**Panel**") for making recommendations to the application. The Panel after considering the facts, briefly made the following observations:

1. The authorised share capital of the IFIC Ltd. was not sufficient to accommodate the allotment of equity shares on conversion of Debentures into equity at par and hence, would require shareholders resolution for reclassifying/ increasing the authorised share capital of IFCI Ltd.

2. Although, the terms of OCDs approved by the IFCI's board were silent on the pricing on resultant equity shares, the conversion of Debentures pursuant to Section 81(3)2 of the Companies Act can be done at par value since SEBI pricing formula under Regulation 76 of Issue of Capital & Disclosure Requirements Regulations, 2009 is not applicable to preferential issue of equity shares pursuant to conversion of loan or option attached to convertible debt instruments in terms of Section 81(3) of the Companies Act.[3]

3. The very motive behind conversion of IFCI from being a company under the IFCI Act into a company incorporated under the Companies Act was to make it a Government Company to which the entire business and functions as well as assets and liabilities of IFCI would be transferred to.

4.The conversion of IFCI into a public limited company would provide additional safeguard to the larger public funds that have been infused by the GOI in IFCI from time to time.

REGULATORY FRAMEWORK

Under the Takeover Code an acquirer is under an obligation to make a mandatory open offer for acquisition of 26% of the total shares of the target company if it acquires shares or voting rights entitling the acquirer to exercise 25% or more of voting rights in the target company[4] or it acquires additional shares or voting rights entitling the acquirer to exercise more than 5% of voting rights in a financial year if it already holds 25% or more of the capital in the target company;[5] or if the acquirer acquires direct or indirect control over the target company.[6]

SEBI, by virtue of being the securities market regulator is empowered to grant exemption to acquirers from the obligation of making open offer under the Takeover Code on a case to case basis.[7] For availing the exemption granted by SEBI, the acquirer or the target company, as the case may be, need to file a specific application[8] with

SEBI together with a non-refundable fee of INR 50,000.[9] SEBI can then pass a reasoned order on the application, after affording reasonable opportunity of being heard to the applicant and after considering all the relevant facts and circumstances.[10] Further, SEBI is empowered to constitute a panel of experts and refer the matter to such panel for recommendations.[11]

SEBI'S DECISION

Considering the interest of safeguarding public funds and the recommendations of the Panel, SEBI exempted GOI from the obligation to make the mandatory open offer under the Takeover Code. However, the said exemption is subject to the acquisition being made in accordance with the relevant provisions of the Companies Act and that the Target and GOI shall observe due compliance towards the statements, disclosures and undertakings made in the application and subsequent correspondence with this matter.

ANALYSIS

This exemption is the first exemption given by SEBI under the Takeover Code. The purpose behind the regulation of takeovers is to protect the interest of the public shareholders of a company, by providing them an option to exit if there is a change in control of the company. In the case at hand, the SEBI has found it befitting to grant the exemption to the GOI on account of two reasons: (i) upon conversion of the convertible debentures, the Target would become a government company thereby increasing public accountability, (ii) since public funds were pumped in at a time that the Target needed financing and this was done at a discounted interest rate, shareholders of the Target have already benefitted as this funding conserved the cash outflow of the Target. Keeping this in mind, the added protection of giving shareholders of the Target the opportunity to exit might not have been warranted.

It could be argued that since no pricing norms applied to the conversion of the debentures held by the GOI in the Target, on account of the provisions of Section 81(3) of the Companies Act and Regulation 70[12] of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and further being exempted from making an open offer under the Takeover Code the GOI acquired control in the Target at a discounted price. However, these exemptions stem from the provisions of legislations other than the Takeover Code enacted in the wisdom of the legislature and therefore it is questionable as to whether these aspects have a bearing on whether or not an exemption for an open offer obligation under the Takeover Code is granted.

– Mukul Aggarwal, Sahil Shah & Simone Reis
You can direct your queries or comments to the authors

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[1]WTM/RKA/CFD/DCR-I/38/2012.
[2]Regulation 70 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
[3]Section 81 of the Companies Act is for Further Issue of Capital, it provides:

1. " (1) Where at any time after the expiry of two years from the formation of a company or at any time after the expiry of one year from the allotment of shares in that company made for the first time after its formation, whichever is earlier, it

   is proposed to increase the subscribed capital of the company by allotment of further shares, then, -
   1. (a) such further shares shall be offered to the persons who, at the date of the offer, are holders of the equity shares of the company, in proportion, as nearly as circumstances admit, to the capital paid-up on those shares at that date ;
   2. (b) the offer aforesaid shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days from the date of the offer within which the offer, if not accepted, will be deemed to have been declined ;
   3. (c) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person ; and the notice referred to in clause (b) shall contain a statement of this right ;
   4. (d) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of directors may dispose of them in such manner as they think most beneficial to the company.
   5. ....
   6. ...
2. (3) Nothing in this section shall apply -
   1. (a) to a private company ; or
   2. (b) to the increase of the subscribed capital of a public company caused by the exercise of an option attached to debentures issued or loans raised by the company -
      1. (i) to convert such debentures or loans into shares in the company, or
      2. (ii) to subscribe for shares in the company :

      Provided that the terms of issue of such debentures or the terms of such loans include a term providing for such option and such term -
      1. (a) either has been approved by the Central Government before the issue of debentures or the raising of the loans, or is in conformity with the rules, if any, made by that Government in this behalf ; and

2. (b) in the case of debentures or loans other than debentures issued to, or loans obtained from, the Government or any institution specified by the Central Government in this behalf, has also been approved by a special resolution passed by the company in general meeting before the issue of the debentures or the raising of the loans.
3. ...
4. ..."

[4] Regulation 3(1) of the Takeover Code.

[5] Regulation 3(2) of the Takeover Code.

[6] Regulation 4 of the Takeover Code.

[7] Regulation 11(1) of the Takeover Code.

[8] Regulation 11(3) of the Takeover Code.

[9] Regulation 11(4) of the Takeover Code.

[10] Regulation 11(5) of the Takeover Code.

[11] Proviso to Regulation 11(5) of the Takeover Code.

[12] Regulation 70 in Chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 provide: "70. (1) The provisions of this Chapter shall not apply where the preferential issue of equity shares is made:
(a) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub- section (3) and (4) of section 81 of the Companies Act, 1956; ...."
Regulation 76 of the same Chapter VII provides the minimum price at which a listed company is required to make the allotment of equity shares.