Implementation of Regulation 37A - SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015

Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015 inserted regulation 37A with effect from June 15, 2023. Regulation 37A provides for compliances to be done by a listed company while carrying out sale, lease, or disposal of an undertaking outside scheme of arrangement. Section 180(1)(a) of Companies Act, 2013 also provides for restrictions on the powers of board pertaining to sell, lease, or otherwise dispose off the whole or substantially the whole of undertaking. This article highlights critical issues in implementing provisions of section 180(1)(a) read with regulation 37A.

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INTRODUCTION

The Securities and Exchange Board of India ('SEBI') amended the Securities and Exchange Board of India Listing Obligations and Disclosure Requirements regulations 2015 ('SEBI LODR') through notification dated June 15, 2023. SEBI vide this amendment inserted regulation 37A providing for sale, lease, or disposal of an undertaking outside Scheme of Arrangement. This provision became effective from July 14, 2023. Regulation 37A of SEBI LODR corresponds with Section 180(1)(a) of the Companies Act, 2013 ('the Act'). In this write-up we would delve deep into understanding the critical issues in complying with additional requirements prescribed by Regulation 37A.

BACKGROUND

Sale, lease or otherwise disposal of the whole or substantially the whole of undertaking of the company or where the listed company owns more than one undertaking, of the whole or substantially the whole of any such undertakings may happen through scheme of arrangement or outside scheme of arrangement framework.

SEBI vide its 'Master Circular on Scheme of Arrangement by Listed Company' dated November 23, 2021 ['Master Circular'] has stated that 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, and impact of such sale, lease, or disposal. Further, such listed entity is also required to submit a valuation report from a registered valuer and the registered merchant bankers have to provide a fairness opinion on the valuation done by the valuer. 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.

It was thus seen that 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.

In order to strengthen the framework for sale, lease or disposal of an undertaking executed outside the scheme of arrangement framework to safeguard the interest of minority shareholders and to align with the requirement SEBI floated consultation paper titled "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".

SEBI had made following proposals through this consultation paper:

a. Introducing provisions in SEBI LODR for sale, lease or disposal 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, lease or disposal;

c. Such sale, lease or disposal 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 Act.

In response to this consultation paper concerns were raised to SEBI that such sale, lease or disposal of an undertaking is already governed under Section 180 of the Act and additional requirement of obtaining majority of minority approval would add to the compliance burden on the listed company. Also, if the transaction of sale of undertaking is with unrelated party, then in such case, such requirement would add no value to compliance. Some key suggestions made to SEBI included exemption from passing shareholder resolution in case of transfer of undertaking to wholly owned subsidiary of the listed company and sale of undertaking due to covenant covered under an agreement with financial institution.

SEBI accepted the suggestion of granting exemption from shareholder resolution in case of transfer of undertaking to wholly owned subsidiary on the condition that, if the wholly owned subsidiary wishes to sell the undertaking to any other party in future, the listed company will have to obtain shareholder approval along with majority of minority approval. Further SEBI also added that if the listed company wishes to sell its stake in such a wholly owned subsidiary, then also it will have to obtain shareholder approval. In case of sale of undertaking due to agreement with lender, such sale can be exempt from shareholder approval only if the lender is registered with RBI or debenture trustee is registered with SEBI.

NOTIFICATION OF AMENDMENT OF REGULATION 37A OF SEBI LODR

Regulation 37A of SEBI LODR requires the listed company to obtain shareholder approval by passing a special resolution for sale, lease or disposal of whole or substantially the whole of undertaking outside the scheme of arrangement. Resolution under regulation 37A is deemed to have been passed only if the votes cast by public shareholders in favor of resolution are more than the votes cast by public shareholders against the resolution. The regulation prohibits the public shareholders who are directly or indirectly party to the sale of an undertaking from voting on the resolution. Further as recommended by the industry participant's, the regulation also provides exemption from passing shareholder resolution in case of transfer of undertaking to wholly owned subsidiary or sale of undertaking pursuant to agreement with lenders, but such exemptions are subject to conditions provided

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in the regulation. The most important part is that the regulation through an explanation, clarifies that, the undertaking shall have same meaning as provided under Section 180 of the Act.

CHALLENGES IN IMPLEMENTATION OF REGULATION 37A OF SEBI LODR

We would now discuss certain challenges in implementation of Regulation 37A of SEBI LODR:

a) Whether it is mandatory to disclose name of the party buying the undertaking?

Second proviso of Regulation 37A (1) says that no public shareholder shall not vote on resolution for sale, lease or otherwise disposal of the whole or substantially the whole of undertaking if public shareholder is party to the that transaction directly or indirectly.

This proviso has been inserted to ensure that votes cast by public shareholders parties to the transaction directly or indirectly are not considered.

Challenges may be faced by scrutinizers in giving effect to this proviso. If we peruse provisions under Section 180 of the Act and regulation 37A of SEBI LODR, it does not mandate disclosure of name of the party involved in sale, lease or disposal of whole or substantially the whole of undertaking. So, if name of the party is not disclosed it would be difficult for public shareholders to understand whether they are related to the transaction directly or indirectly? Moreover, even if such members vote on resolution, then how will the scrutinizer be able to identify that public shareholders who have casted their votes are related to the party to the transaction?

b) Solution

(i) It is not necessary to mention name of the party with whom transaction would be proposed to be undertaken: To understand the solution to this let us first understand various provisions wherein similar nature of resolutions are passed and whether it is mandatory to mention name of transacting parties. Following table depicts same:

Sl. No	Purpose of resolution	Section	Whether name of transacting party required to be mentioned?
1	Sell, lease or otherwise dispose off undertaking.	Section 180(1)(a)	It is not expressly provided that name of transacting party to whom sale, lease or otherwise disposal is required to be done shall be mentioned.
2	Increase in limits of loans, investments, guarantees and securities to be given.	Section 186(3)	It is not expressly mentioned to mention name of parties to whom Loan, Investment, Guarantee or Security needs to be given.
3	Raising of funds by way of non-convertible debentures.	Section 71	It is not expressly mentioned to give the names of persons to whom debentures are allotted.
4	Raising of funds by way of preferential allotment or private placement.	Section 62(1) (c) R/W section 42	Section 42(2) expressly says that allotment under private placement has to be made to selective group of persons called as identified persons. Therefore, name of allottee has to be mentioned.
5	Related Party Transactions.	Section 188 R/W rule 15 of Companies Meeting of board and its powers rules 2014	Rule 15(1) clearly says that agenda of board meeting should provide name of related party and relation with him. Therefore, giving name of related party is mandatory.

On perusal of above provision, it can be seen that disclosures of name(s) of party with whom transaction would be undertaken in the resolution is not always mandatory. For some resolutions it has been provided to mention the name of the transacting party. Regulation 37A of SEBI LODR nowhere prescribes to mention name(s) of party(ies) with whom transaction is proposed to be undertaken. It has been held by Lord Blackburn that, "We ought, in general, in construing an Act of Parliament, to assume that the legislature knows the existing state of the law"[1] Thus if a statutory provision is enacted by the legislature, which prescribes a condition at one place but not at some other place in the same provision, the only reasonable interpretation which can be resorted to by the courts is that such was the intention of the legislature and that the provisions was consciously enacted in that manner. In such cases, it will be wrong to presume that such omission was inadvertent or that by incorporating the condition at one place in the provisions the legislature also intended the condition to be applied at some other place in the provisions the legislature also intended the conditions to be applied at some other place in that provision.[2] SEBI is deemed to be aware of existing provisions under the Companies Act, 2013. As Regulation 37A does not expressly provide for disclosure of the name of party it can be inferred that it would not be necessary to provide the name of the party with whom transaction is proposed to be undertaken. But it needs to be highlighted here that proxy advisory firms have been raising concerns over resolutions proposing sale, lease or disposing of an undertaking wherein powers have been given to the Board of Directors of companies for identification and finalizing buyer or lessee and name of party with whom such transaction would be undertaken is never disclosed to shareholders. So, it is up to the discretion of the Board of Directors and shareholders of listed companies whether name of party with whom proposed transaction of sale, lease, or disposal of undertaking is being undertaken should be mentioned or not. This would require extensive engagement with shareholders of the listed companies by the investor relations team.

(ii) Listed companies may mention name of the party with whom transaction is proposed to be undertaken voluntarily: Now if it is not necessary to mention name of the party with whom transaction is proposed to be undertaken then question arises is how can effect be given to second proviso of sub-regulation (1) to Regulation 37A? Second proviso of sub-regulation (1) to Regulation 37A states that no public shareholder who is directly or indirectly party to sale, shall vote on the resolution. If the name of the party is not mandatorily required to be mentioned, then how can effect be given to this provision. Hon'ble Supreme Court has held that, 'The performance of an impossible duty must be excused in accordance with the maxim, lex non cogit ad impossibila.[3] Further Hon'ble Supreme Court has stated that law does not contemplate something which cannot be done.[4] So, it can be inferred that if the Board of Directors of a company have approved the name of the party with whom transaction is proposed to be undertaken and accordingly it would be mentioned in the resolution then it would be possible to give effect to second proviso to sub-regulation (1) of Regulation 37A. This will help the public shareholders to decide on whether they are eligible to vote and accordingly abstain from voting.

c) Is approval taken under Section 180 of the Act for sale, lease or otherwise dispose off undertaking still valid or does approval needs to be taken again under Regulation 37A?

Companies are required to pass special resolution for sale, lease or otherwise dispose off whole or substantially the whole of undertaking under Section 180 of the Act. Section 180 of the Act does not prescribe any timeline within which the resolution has to be given effect. Hence, there arises a question that, if any company had passed resolution for sale, lease or otherwise dispose off whole or substantially the whole of undertaking before notification of Regulation 37A (i.e., before July 14, 2023) and has not acted upon that resolution, then whether the special resolution passed is still valid or a fresh special resolution under Regulation 37A needs to be passed?

1. *Young vs Mayor of Lamington [1888] 8 AC 517 at 52*
2. *Oriental Insurance company ltd vs Hansrajbhai V Kodala [2001] 105 Comp Cas 743 (SC); 001 AIR SCW 1602; AIR 2001 SC 1832*
3. *Cochin State Power and Light Corporation Ltd vs State of Kerala AIR 1965 SC 1688*
4. *Standard Chartered Bank vs Directorate of Enforcement 2005 SC 2622*

d) Solution

a. Contracts for sale, lease, or disposal of undertaking where Regulation 37A would apply: As per Coke Maxim, "A new law ought to be prospective, not retrospective in its operation" Applying this maxim it can be inferred that provisions relating to Regulation 37A would apply prospectively and not retrospectively. So, provisions of Regulation 37A would apply for sale, lease, or disposal of undertaking or substantially the whole of undertaking post July 14, 2023. Further Regulation 37A is completely silent about the retrospective applicability. It is cardinal principle of construction that every statue is prima facie prospective unless it is expressly or by necessary implication made to have retrospective effect.[5]

However, while giving prospective effect to regulation 37A, there is one important point worth noting. Clause b of Regulation 37A sub-regulation 1 states that the Board of Directors should inform the shareholders through explanatory statement attached to notice of the meeting, about the object and commercial rationale for selling the undertaking and about the proposed use of the proceeds from sale of such undertaking. Now if any company has more than one undertaking and it proposes to sell any one of them, then in such a case, it will be difficult to provide exact commercial rationale for sale of undertaking without specifying which of the multiple undertakings is proposed to be sold. Also, it would be difficult to specify the proposed use of proceedings from sale of undertaking as the amount of proceeds would vary depending upon the undertaking being sold. Therefore, from the point of view of good governance, it is advisable to specify the details of the undertaking being sold in case of the existence of more than one undertaking with the company. The only exception being the sale of the undertaking to a wholly owned subsidiary.

b. Contracts for sale, lease or disposal of undertaking where Regulation 37A would not apply: Where listed company has passed a resolution at a general meeting or through postal ballot for sale, lease or disposal of whole or substantially the whole of undertaking prior to July 14, 2023 and has entered into a contract for sale or lease or disposal of whole or substantially the whole of undertaking or Board of Directors have in exercise of powers conferred on them by members for identification of party for sale, lease or disposal or otherwise disposal of undertaking have identified the party then in that case provisions of Reg 37A need not be complied with. Hon'ble Supreme Court has held that, "Statues prescribing formalities for effecting transfers are not applicable to transfers made prior to their enforcement[6] and similarly statues dispensing with formalities which were earlier necessary for making transfers have not the effect of validating transfers which were lacking in these formalities, and which were made prior to such statues"[7]. So, it means that enforcement of decisions relating to transfers are already taken or are taking place then in that case provisions of Regulation 37A would not apply.

e) What can be the ranking in which approvals needs to be taken for sale, lease, or disposal of whole or substantially the whole of undertaking transferred by listed company to wholly subsidiary company?

As per first proviso to Regulation 37A (2) of SEBI LODR prior to sale, lease, or disposal of whole or substantially the whole of undertaking by wholly owned subsidiary whether in whole or in part to any other entity listed entity shall comply with requirements specified in Regulation 37A (1). In such circumstances, questions arise as to whose approval needs to be taken first?

Firstly, wholly owned subsidiary needs to pass a resolution under Section 180(1)(a) of the Act giving powers to Board of Directors for sell, lease, or disposal or otherwise disposal of whole or substantially the whole of undertaking.

Further the Board of Directors of wholly owned subsidiary needs to approve the sale, lease, or disposal of the whole or substantially the whole of undertaking.

Then the matter will be placed before the Board of Directors of the listed company for their approval.

Once the Board of Directors of the listed company approves the transaction, they will recommend the transaction to the members of the listed company.

If the members of listed company approve the proposal of transaction for sale, lease, or disposal of undertaking or the whole of undertaking by wholly owned subsidiary then wholly owned subsidiary would be able to call general meeting for approving sale, lease or disposal of the whole or substantially the whole of undertaking, wherein listed company being sole shareholder would be able to approve the transaction for sale, lease, disposal of whole or substantially the whole of undertaking. In case the members of listed company do not approve the resolution then wholly owned subsidiary would not be able sale, lease or dispose of the whole or substantially the whole of undertaking.

CONCLUSION

From the ongoing discussions, it becomes evident that SEBI, following a thorough analysis and mindful of industry feedback, has introduced Regulation 37A. Regulation 37A serves the crucial purpose of safeguarding the rights and interests of minority shareholders. While there might be some minor uncertainties prevailing currently regarding the adherence to Regulation 37A, these can be easily addressed through the application of fundamental principles of interpretation and by delving deeper into the nuances of this regulation.

5. *Keshavan vs State of Bombay AIR 1951 SC 124.*

6. *Hassanji & Sons vs State of Madhya Pradesh AIR 1965 SC 470, p.472 (para 9): 1963 Supp (3) SCR 235, (mineral Concession Rules 1949 are not retrospective).*

7. *Mata Ram Prasad vs Nageshwari Sahai AIR 1925 PC 272, p. 278*