PRIVATE AFFAIRS IMPACTING PUBLIC INTEREST ENTITIES — A SIFT THROUGH A RECENT SEBI AMENDMENT

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The Primary Marked Advisory Committee *('PMAC')* of the Securities and Exchange Board of India *('SEBI')* had identified and deliberated on certain challenges and issues arising out of (i) agreements indirectly binding public listed entities, (ii) special rights granted to shareholders of a public listed entity, (iii) sale, disposal or lease of an undertaking of a listed entity and (iv) the provision for board permanency in the context of a public listed entity. Based on PMAC recommendations, SEBI released a Consultation Paper[1] for public feedback, basis of which released a Board Memorandum[2] and consequently, on 14th June, 2023 introduced certain amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 *('Listing Regulations')* under the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023 *('Listing Regulations Amendment')*.[3]

One of the key amendments under the Listing Regulations Amendment relates to approval and disclosure requirements for certain types of agreements indirectly binding listed entities. These agreements could be in the nature of family arrangements, trust deeds, settlement agreements, shareholder agreements, voting agreements, family charters, consent terms, etc. to which the listed entity may not have been privy or party.

In this article, our attention is directed toward analysing the disclosure requisites emanating from this particular facet of the amendment, accompanied by a critique exploration of the attendant complexities.

1 Consultation Paper on 'Strengthening Corporate Governance at Listed Entities by Empowering Shareholders' on February 21, 2023.

2 Board Memorandum on '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' dated 17th April, 2023

3 The Listing Regulations Amendment came into force on July 14, 2023 (except certain specified amendments which will come into force on the date of their publication in the Official Gazette).

CONTEXT

Regulation 30 of Listing Regulations relates to the disclosure of material events and information by a listed company to stock exchanges. Prior to the Listing Regulations Amendment, clause 5 of Para A of Part A of Schedule III of Listing Regulations covered a disclosure requirements as under:

Clause 5: Agreements [viz. shareholder agreement(s), joint venture agreement(s), family settlement agreement(s)] (to the extent that it impacts management and control of the listed entity), agreement(s) / treaty(ies) / contract(s) with media companies) which are binding and not in the normal course of business, revision(s) or amendment(s) and termination(s) thereof.

The Listing Regulations Amendment introduced a new Clause 5A with an expanded scope as under:

"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 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 an obligation on the parties to such agreements to ensure that listed entities shall or shall not act in a particular manner.

The impetus behind the amendment through the introduction of Clause 5A primarily seems to originate from the context of shareholders agreements ('SHA(s)') and the requisite disclosures pertaining to these agreements as they pertain to shareholders of listed companies. SHAs manifest either as agreements between shareholders themselves or encompass agreements involving both shareholders and the listed entity. In practice, the rights and responsibilities stipulated within an SHA are normally seamlessly incorporated into the Articles of Association ('AoA') of the company.[4]

Furthermore, considering that any alteration to a company's AoA mandates shareholder endorsement via a special resolution, the assimilation of an SHA into the AoA would necessitate a similar level of endorsement. In this context SEBI discerned an incongruity wherein SHAs absent from the AoA evaded the scrutiny that would normally arise through the special resolution, thus negating the very purpose of disclosures as prescribed under Schedule III of the Listing Regulations.

SEBI's review also brought to light another issue, specifically concerning scenarios where listed company promoters entered into agreements with third parties (or within themselves) but did not involve the listed company as a contracting party. Such agreements might potentially impose restrictions, direct or indirect liabilities or obligations on the listed entity. Although the mechanism for generating obligations on a non-signatory to a contract might not be immediately evident from the Consultation Paper or the Board Memorandum; SEBI noted that if the listed entity were a party to such agreements, shareholders would gain access to copies for an assessment. This transparency would enable shareholders to evaluate potential adverse implications for their interests. Given that, before Listing Regulations Amendment stipulations pertained exclusively to agreements binding on listed companies, promoters could have evaded existing shareholders' scrutiny by excluding the listed entity as a contracting party in these agreements. In response to an observation received from the Consultation Paper, SEBI underscored the necessity for symmetry in information dissemination pertaining to any agreement impacting the management or control of a listed entity, irrespective of whether the listed entity is a direct party to the agreement.

The Listing Regulations Amendment categorises such agreements into two groups: (a) pre-existing and subsisting agreements and (b) agreements to be executed in the future.

For pre-existing and subsisting agreements that fall within the scope of the above Clause 5A, the Listing Regulations Amendment prescribed their disclosure on or before 14th August, 2023, in addition to the disclosure on the website as well as in the annual report of FY 2022-2023 and FY 2023-24. This requirement has been introduced through the inclusion of Regulation 30A.

For agreements to be executed in the future, the concerned parties are required to intimate the listed entity within two working days of entering into such agreement, and the listed entity would then be required to disseminate to the public within prescribed timelines.

COMMENTARY AND CRITIQUE ANALYSIS

Formerly, only binding agreements such as shareholder agreements, joint venture agreements, and certain family settlement agreements (insofar as their impact on the management and control of the listed entity was concerned), as well as agreements, treaties, or contracts with media entities, were subject to disclosure requirements. These obligations encompassed both the original agreements and any subsequent modifications, amendments, or terminations. However, this approach sometimes led to the omission of other arrangements involving promoters, shareholders, and other relevant parties, even if they held the potential to influence the management and control of the listed entity or impose restrictions upon it.

The newly introduced clause 5A broadly intends to cover agreements that:

(i) impact the management or control of the listed entity

or

(ii) impose any restriction on the listed entity or

(iii) create any liability upon the listed entity.

4 (i) V. B. Rangaraj vs. V.B. Gopalakrishnan and Ors, as reported in CDJ 1991 SC 464 + S.P. Jain vs. Kalinga Tubes Ltd, 1965 AIR (SC) 1535, (ii) World Phone India Pvt. Ltd. & Ors. v. Wpi Group Inc. (2013) 178 Comp Cas 173 (Del)

in each case either directly, indirectly or potentially.

The Listing Regulations Amendment instates an additional disclosure requirement upon not only the listed entity but also the promoters, shareholders and other contractual parties. This marks a departure from the previous stance and broadens the scope of disclosure obligations encompassing agreements. It is pertinent to note that such a disclosure is mandated without a predetermined assessment of their materiality.

Moreover, this amendment mandates the disclosure of previously undisclosed existing arrangements involving listed entities. Parties involved in such agreements, along with the listed companies themselves, are tasked with compiling a comprehensive inventory of all active agreements associated with the listed company. Subsequently, this information must be furnished to the relevant listed companies or stock exchanges within stipulated timelines.

It is widely acknowledged that the Indian listed securities landscape is characterised by a robust emphasis on disclosure. SEBI has consistently undertaken measures to address information asymmetry between listed entities and market participants. These measures encompass the enactment of amendments and regulations designed to bolster transparency and enhance stakeholder engagement in the governance of listed entities. Nevertheless, in the pursuit of these objectives, SEBI faces the intricate challenge of striking a delicate balance between promoting pertinent disclosures and imposing concurrent burdensome obligations on the concerned stakeholders.

While the Listing Regulations Amendment aligns with SEBI's overarching commitment to fostering transparency, certain aspects of the language and current formulation of the amendments may appear onerous and overly expansive to market participants unless subjected to further refinement.

1. Sweeping scope with unintended coverage: The current rendition of Clause 5A has a notably sweeping scope, encompassing agreements that not only directly or indirectly impact the management and control of a listed company but also those that create restrictions or liabilities for the listed entity, regardless of whether the listed entity is a direct party to such agreements.

The current wording of the clause being comprehensive has the potential to inadvertently encompass unintended categories of contracts. Such an arrangement, despite being irrelevant to the listed entity's shareholders and potentially including confidential nominee-related information, would be subject to mandatory disclosure to the exchanges.

2. The vast expanse of the terminology 'impose any restriction or create any liability upon the listed entity': Each and every agreement will impose some kind of restriction or liability on the listed entity. It is the actual purpose of any agreement to create certain restrictions or cast obligations and liabilities. The choice of words used in clause 5A goes beyond obligations that affect the management or control of the listed entity but covers any and all restrictions or liabilities created on the listed entity. Unless the listed entity is able to prove that such a restriction or liability is in the 'normal course of business', any restriction or liability, without application of materiality would warrant a disclosure.

This aspect was categorically considered by SEBI and below verbatim feedback from the Board Memorandum guides the regulatory through-process:

As regards the suggestions made by some commenters to define the terms '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.

3. Whether possible to impose restrictions without a listed entity being a signatory: The concept of a contract imposing restrictions or liabilities on a listed entity in the absence of the company's direct involvement poses conceptual challenges. If such restrictions or liabilities result from the commitment of shareholders to vote their shares in a specific manner, this would be encompassed under part (i), rendering part (ii) and (iii) of Clause 5A redundant.

4. Implications of retroactive disclosures: The application of the amendments to existing arrangements effectively renders the legislation retroactive, as the parties to such arrangements would not have anticipated their disclosure or the requirement for shareholder approval, as currently stipulated. The obligations on confidentiality, sub-judice, etc. may warrant close consideration.

5. Duplication with principles under SEBI Takeover Code: The SEBI (Substantial Acquisition of Shares and

Takeover) Regulations, 2011 *('Takeover Regulations')* encapsulates detailed provisions in relation to disclosure as well as tender offer provisions about acquisition / change of control of a listed entity. To introduce an additional requirement and its interplay with Takeover Regulations may result in unintended consequences. In addition to the word 'control', agreements impacting 'management' are also covered within the purview of the newly introduced Listing Regulations Amendment. The word 'management' however, is not defined under the Listing Regulations and SEBI considered this critique feedback in its response under the Board Memorandum as:

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.***

6. **Lack of guiding principles:** Clause 5A is positioned within Para A of Part A of Schedule III, which implies that disclosures hereunder are required irrespective of materiality thresholds, thereby mandating disclosure without an accompanying set of guiding principles. This broad inclusion would necessitate the disclosure of numerous agreements falling within the purview of Clause 5A, even if they bear a minimal impact on information symmetry between the listed entity and market participants. A notable contrast arises when juxtaposing this approach with the LODR's treatment of related party transactions, which mandates board approval only when transactions surpass a defined materiality threshold.

In the six months from February 2023, SEBI has floated over three dozen consultation papers seeking to overhaul the ground rules for market players and intermediaries. Such a frenzied pace or regulatory overhaul has been unprecedented. While it is *de rigueur* for market participants to crib and carp about ease of doing business whenever regulations are tightened, it would do good if these changes provide the right set of guidance, definitions and clear ambiguities. While SEBI's proactive approach is laudable, being on a regulatory overdrive runs a risk of skirting the robustness of a law-making process and resulting in implementation challenges, unintended consequences as well as needless litigation.

FOOTNOTE DISCLOSURES

Selected excerpts from disclosures made by certain listed entities in compliance with Clause 5A:

1. Titan Company Limited: Tamil Nadu Industrial Development Corporation Limited (TIDCO) and Tata Sons Limited (now known as Tata Sons Private Limited) ("TSPL") (which was replaced by Questar Investments Limited was replaced by TSPL) are parties to the Investment Agreement entered on 8th February, 1984 and the Supplementary Agreement entered on 10th April, 2007 ("Agreements"). TIDCO and TSPL are Promoters of the Company holding 27.88 per cent and 25.02 per cent respectively.

The purpose of entering into the Investment Agreement was for the establishment of the Company for the manufacture and sale of watches and watch components.

2. Bharti Airtel Limited: Bharti Telecom Limited ("BTL"), Promoter has entered into Shareholders' Agreement on 22nd January, 2009 with Pastel Limited, Bharti Enterprises (a partnership firm subsequently converted into Bharti Enterprises (Holding) Private Limited ("BEHPL") is the holding company of BTL), Bharti Infotel Private Limited (since the execution of the SHA, been merged with BEHPL0 and Indian Continent Investment Limited ("ICIL"), is a person acting in concert with BTL to set out their inter se rights and obligations in relation to BTL and its subsidiaries. (ii) Bharti Airtel Limited ("BAL") entered into a Shareholders' Agreement on 22nd January, 2009, with Bharti Telecom Limited, Pastel Limited to set out their inter se rights and obligations of BTL and Pastel about BAL and its subsidiaries.

3. Sun Pharmaceutical Industries Limited: Certain specific rights have been granted to the Promoter under the Article 108 of the Articles of Association of the Company.

4. Marico Limited: Harsh C. Mariwala, Chairman and promoter of Marico Limited entered into a Shareholders' Agreement to record the understanding of the parties to the SHA in relation to their shareholding in Marico to provide full support to the Mariwala family in the management of Marico.

5. Kirloskar Brothers Limited: A Joint Venture Agreement was executed on 27th January, 1988, between Kirloskar Brothers Limited, Kirloskar Ebara Pumps Limited and Ebara Corporation to establish a limited joint venture to be operated under and by virtue of the laws of the Republic of India in order to promote manufacture and sell industrial process pumps and / or such other products as the parties mutually agreed.

6. Hikaal Limited: Disclosure From Promoters, Mr. Jai Hiremath and Mrs. Sugandha Hiremath of the Hikaal Limited entered into a Family Arrangement in the year 1994 between Mr. Babasaheb N Kalyani ("BNK") and his father, whereby the shares of the Hikaal Limited held by KICL (Kalyani Investment Company Limited) and BFIL(Bharat Forge Investment Limited), both of which are under the ownership and control of the BNK Group, were required to be transferred to Mrs. Sugandha Hiremath. KICL and BFIL hold 34.01 per cent in Hikaal Limited.

7. Godfrey Phillips India Limited: A Shareholders Agreement was executed amongst Godfrey Phillips India Limited and Philip Morris Global Brands Inc. (erstwhile Philip Morris International Finance Corporation) ("PMGB"), promoter of the Company, Philip Morris Products S.A. ("PMSA" together with PMGB referred to as "Philip Morris Entities") and Modi Shareholders on dated 28th May, 2009, to record inter alia certain rights and obligations of Philip Morris Entities and Modi Shareholders concerning the Company and inter se mutual rights and obligations of Philip Morris Entities and the Modi Shareholders.

8. Geojit Financial Services Limited: A Promotional Agreement was executed between Kerala State Industrial Development Corporation Limited ("KSIDCL") and C.J. George ("Promoter of Geojit Financial Services Limited") on March 23, 1995 for Promotional association with KSIDCL when the Geojit Financial Services Limited was unlisted.

A Shareholders Agreement has been executed amongst C.J. George, Shiny George, BNP Paribas S.A., BNP Paribas India Holding Private Limited and Geojit BNP Paribas Financial Services Limited (presently Geojit Financial Services Limited) on 22nd January, 2016, for the purpose of governance of the Company and dilution of rights of BNPP in the Company to protect the Company from BNPP's conflict of interest consequent to BNPP acquiring full ownership and control of Sharekhan Limited, though the shareholding in the Company remains the same. ■