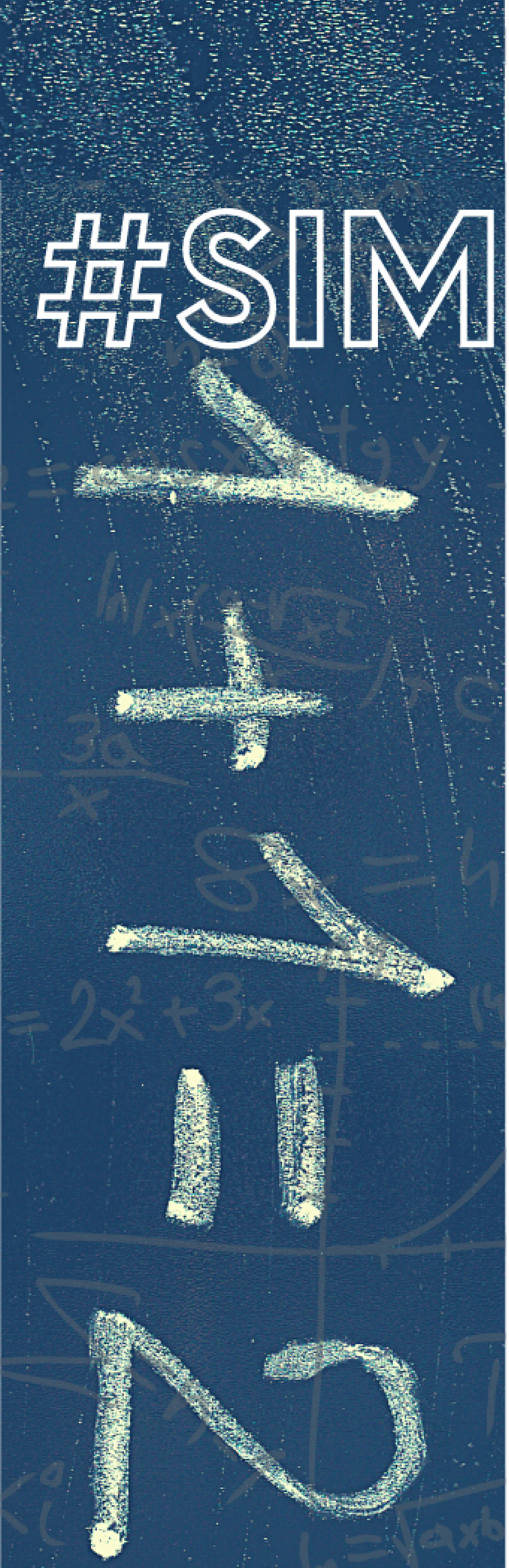

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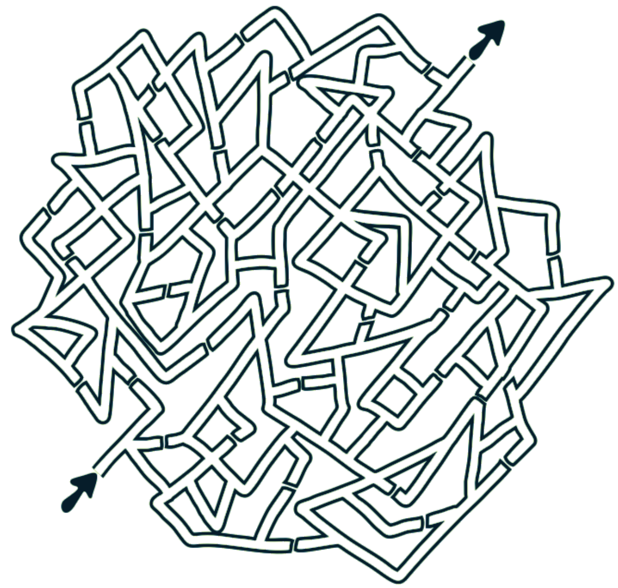


CAN OWNERS BE ACQUIRERS?

SRILAGNA DASH

How many of us like waterfalls? Got the refreshing visuals already? Let me guess, you are seeing a beautiful landscape, the upper course of river, flowing over a large steep rock, drops almost vertical to hit the lower rocks. Try taking this imagery further while blending it with Insolvency and Bankruptcy Code, 2016 ("**IBC**")? Imagine, the water falling on one rock after the other, and place the stakeholders involved in IBC on each rock.

According to the position of each such 'stakeholder rock', when the dues of an insolvent entity are paid under IBC. This process is called the 'Waterfall Mechanism'.

What do you mean by the 'Waterfall Mechanism'?

WATERFALL MECHANISM: CREDITORS > EQUITY SHAREHOLDERS?

The Waterfall Mechanism prioritises some stakeholders over the other. For instance, workers are paid first, then secured creditors, then unsecured financial creditors, … and lastly equity shareholders. Why?

The answer is simple— the equity shareholders are given the last priority during liquidation as they are equated with the owners of the company. They being the owners of the company have betted upon the company's growth before it went insolvent. And, unlike other stakeholders the company is not 'obligated' to pay them.

Going by this reasoning, the equity investors are not entitled to repayment when the entity goes insolvent and further, undergoes liquidation. But why give preference to creditors?

Simply because the creditors expect and oblige the company for repayment when they advance money towards the company. On the other hand, equity shareholders (being owners) advance money only to get a share out of the profits. This is why equity capital is called a risk capital. The investors are expected to invest only after thorough consideration of pros and cons of the business of the entity. Equity can either give a shareholder a multi-bagger returns or could end up in insolvency.

So, there rises no question of protecting interests of equity investors, right? Following above logic, yes. But, according to SEBI, no! How? Let me tell you, Securities and Exchange Board of India ("**SEBI**") has released a '<u>Framework for protection of interest of public equity shareholders in case of listed companies undergoing CIRP under IBC</u>' ("**SEBI Framework**"). Too many questions in your mind already? Let's give it a closer look.

Do you know?

Corporate Insolvency Resolution Process ("**CIRP**") is a technical term for Insolvency Resolution under IBC. This process is used for recovery of debts of the insolvent entity and further, resolve the entity by making it a going concern. Such a process can be initiated by the creditors or the debtor. However, in case all the options to make the insolvent entity a going-concern fail, the insolvent entity undergoes liquidation

THE SEBI FRAMEWORK- A CASE FOR PROTECTING EQUITY SHAREHOLDER'S INTEREST?

In this framework, SEBI has proposed to allow non promoter public shareholders of a listed company an opportunity to acquire equity of the company post insolvency. However, such equity shareholding needs to fulfil a minimum threshold of 5% and be limited up to 25%. Further, the equity shares of the new entity will be at the same cost as offered to Successful Resolution Applicants ("**RA**") (acquirer of the Insolvent entity).

But why? Keep reading, you will know!

Why minimum requirement of 5% and maximum threshold of 25%?

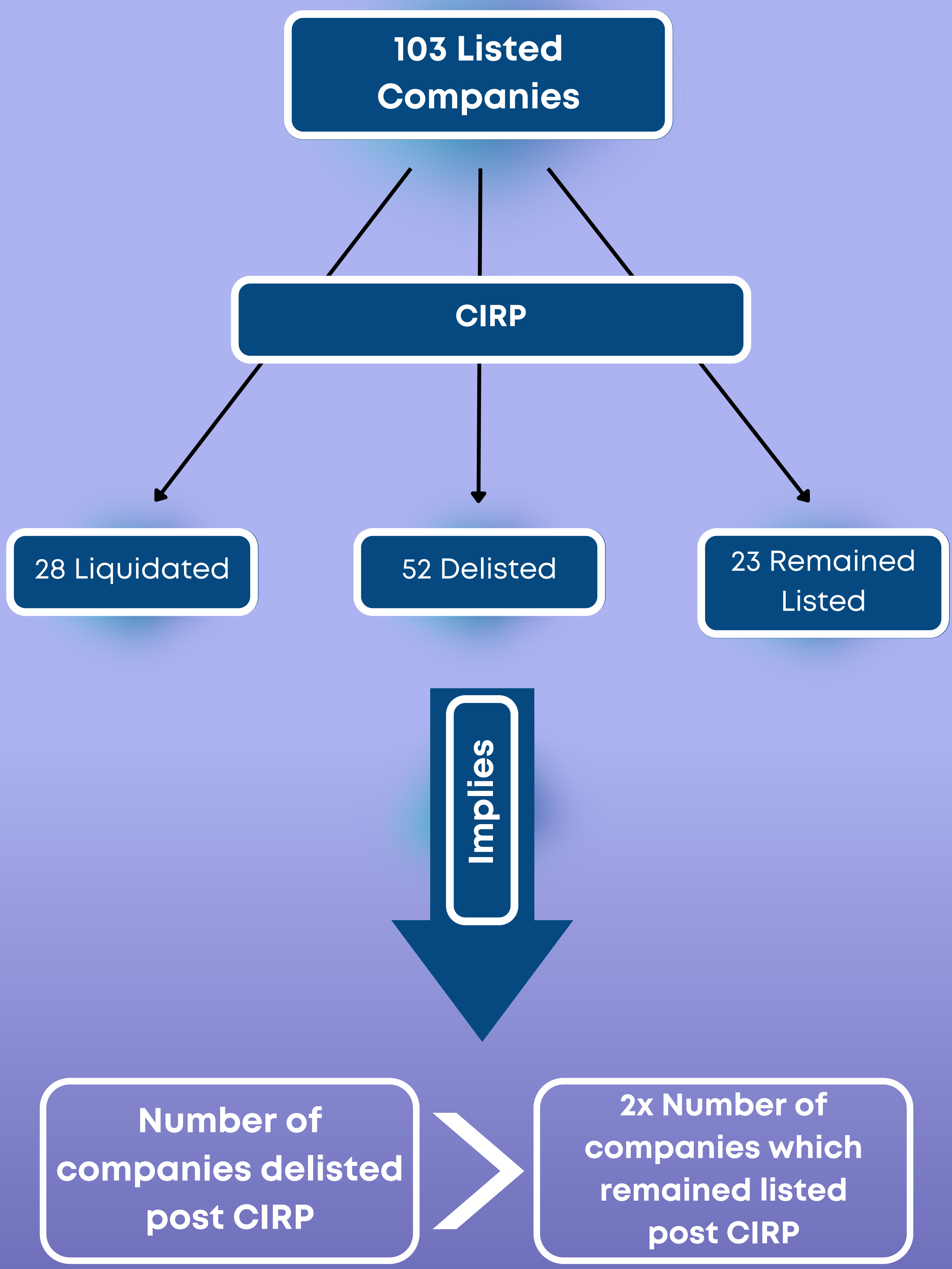
Normally, every listed company shall maintain public shareholding of at least 25%.

The above percents of 5% and 25% have been decided based on the 'SEBI Rules'. According to these norms, post-CIRP companies are mandated to have at least 5% public shareholding at the time of relisting. The default threshold of 25% percent is to be achieved in such cases within three years.

Generally, there can be three consequences of a listed company post CIRP- one, it remains listed; two, it gets delisted; three, it goes into liquidation. What do you think will the numbers of each of these be? Wait, don't google, see the infographic

AN INFOGRAPHIC

So far, out of total 103 CIRPs of listed companies, 28 listed companies have ended in liquidation pursuant to CIRP. Further, 52 listed companies have been delisted and 23 companies continued to remain listed pursuant to approval of Resolution Plan. This shows that the number of listed companies that have undergone delisting is twice the number that remained listed post CIRP.


103 Listed Companies
CIRP
28 Liquidated
52 Delisted
23 Remained Listed
Implies
Number of companies delisted post CIRP
2x Number of companies which remained listed post CIRP

EQUITY SHAREHOLDER'S PERSPECTIVE: CONCERNS HIGHLIGHTED IN THE SEBI FRAMEWORK

You must be thinking, how does it matter if an entity, post CIRP, remains listed or not. Why are the above-stated numbers relevant? Well, these numbers become relevant taking equity shareholders into consideration.

Because certain grievances were raised that non-promoter public shareholders suffer when their listed companies go insolvent— a big acquirer comes in, buys the company at throw away prices, and they are left with nothing. Even if some part of their holding is retained post CIRP, the company gets delisted leaving them with shares in their hand with no avenue to trade/sell.

This raised concerns calling for SEBI to intervene in the matter and allot shares to the new entity which comes into existence post CIRP of the insolvent entity. So, SEBI came up with the above stated framework to address these concerns.

RA'S PERSPECTIVE: CONCERNS YET UNRAISED?

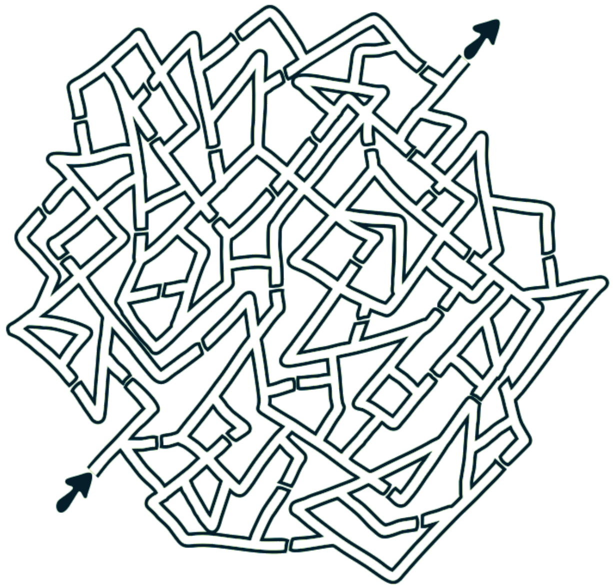
So wonderful!! Looks like a sweet world? Are you sure, it's not sugar coated? Well, I am afraid it seems all-so-good only because I have presented the shareholder's side to you. What about the RA's perspective? When they acquire an insolvent entity, they own 100% share in the new entity. But now, they have to dilute the capital as they will be offering 25% to equity shareholders at the same cost as per the terms of their resolution plan. This might cause a lot of problems to the RAs in raising capital for running the new entity.

You think that's it? Don't you think, if this keeps on happening for all listed entities undergoing CIRP, the RAs will be demotivated from bidding for acquiring such entities? If yes, then it will reduce the number of options to choose the successful RA from – ultimately affecting the pay out to the creditors.

Well, well, well, a lot of thinking to do? 'Sweet' or 'sugar coated' or a different 'sweet and sour', what are your views on the same? So, done with the 'Food for Thought' for this Simplified? Not yet, one last question to ponder, I swear.

FOOD FOR THOUGHT

As we read the piece, we see that according to philosophy of IBC, equity shareholders are equated as the owners of insolvent entity. And on the other hand, through this SEBI Framework, they will now be equated the same as the acquirers of the insolvent entity. Where do you see this going? Don't worry, I am as unsettled as you. Looking for answers and asking your view- Team Owners or Team Acquirers? Let us know, #Simplified's reading investors!!



#SIMPLIFIED #17
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