Public M&A: Does SEBI's Market Rumour Proposal Offer the Much-Needed Price Protection?

Key Takeaways

- In June 2023, SEBI introduced "*rumour verification requirements*" requiring listed companies to address market rumours; trigger for "materiality" pegged to "expected impact" on turnover, net worth, or value of profit/loss after tax
- SEBI's December 2023 Consultation Paper now proposes to (a) peg materiality thresholds to stock and index price movements; and (b) most importantly, offer price protection for deal-making
- Price protection basis market rumour verification is a leap forward as it plugs the price spike due to premature leakages; though taken a step backwards by making promoters (not just KMPs) liable
- SEBI has proposed two methods of price protection: (a) up to 60 days of price protection; or (b) protection from the day of material price movement until the end of the next trading day after rumour confirmation
- This analysis focuses on the price protection mechanism, and not on "material price movement" thresholds proposed in the Consultation Paper
- For an in-depth analysis of the rumor verification regime, please refer to our previous paper titled "*SEBI's Proposed Disclosure Regime: Impact on Public M&A and Directors' Liabilities*" and our webinar on "*Public M&A – Deal-making and Director Liabilities*."

Prior to June 14, 2023

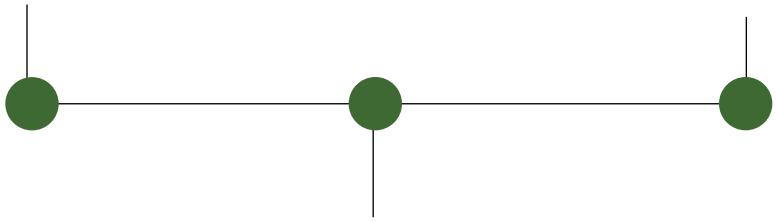
Regulation 30 of SEBI (LODR) Regulations, 2015

Listed entities were required to disclose events outlined in Para A of Part A of Schedule III. They also had to disclose events specified in Para B of Part A of Schedule III based on subjective criteria without any objective thresholds. There was a discretionary requirement for listed entities to disclose any events or information considered to be material by their board of directors.

December 28, 2023

Consultation Paper on the Verification of Market Rumours

The Consultation Paper proposes to change the criteria of verifying market rumours to be "material price movement" instead of material event in terms of Regulation 30 of SEBI (LODR) Regulations, 2015. The Consultation Paper also proposes a "price protection" mechanism, for the determination of which two alternative frameworks have been proposed by SEBI.



June 14, 2023

Second Amendment of SEBI (LODR) Regulations, 2015

SEBI added some objective thresholds based on turnover, net worth, or value of profit/loss after tax, to diminish subjectivity in determining "materiality" of events.

Listed entities must confirm, deny or clarify any reported event or information in the mainstream media which is not general in nature and which indicates that rumours of an impending specific material event or information circulating amongst the investing public, within twenty-four hours from the reporting of the event/ information.

On June 14, 2023, SEBI (LODR) Regulations, 2015 was amended. Prior to the amendment, every listed entity had to disclose events specified in Para A of Part A of Schedule III, irrespective of any materiality guidelines. The listed entity also had to disclose events specified in Para B of Part A of Schedule III based on certain subjective criteria[1], which lacked any objective thresholds. Additionally, there was a subjective element wherein the listed entity had to disclose any events or information considered material by the board of directors of the listed entity.

[1] Regulation 30(4)(i) states that (a) the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or (b) the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date.

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So, in June 2023, the SEBI (LODR) Regulations, 2015 were amended by adding some objective thresholds for evaluating the "expected impact in terms of value."

However, as analysed by us at length in our previous paper on "***SEBI's Proposed Disclosure Regime: Impact on Public M&A and Directors' Liabilities***", this framework could lead to over-disclosure or under-disclosure of information. The challenges associated with the disclosure regime have been discussed in detail in our webinar on "***Public M&A – Deal-making and Director Liabilities***."

As for addressing the reported events/information, colloquially referred to as "*market rumours*", the existing regulation prior to the amendment was that the listed entity may, on its own initiative, also confirm or deny any reported event or information to stock exchange(s). Pursuant to the amendment, it was added that listed entities shall confirm, deny or clarify any reported event or information in the mainstream media which is not general in nature and which indicates that rumours of an impending specific material event or information circulating amongst the investing public, as soon as reasonably possible and not later than twenty-four hours from the reporting of the event or information.

Now, SEBI proposes to eliminate such disclosure-related discrepancies and change the criteria for addressing such market rumours to prices of the securities and index movements under the NSE and Sensex.

This requirement of protecting the price for public M&A deal making is a particularly important amendment proposed under the consultation paper ("**Consultation Paper**") published by SEBI on December 28, 2023.

In this Consultation Paper, SEBI has proposed to change the criteria for verification of market rumours and address concerns related to price protection in situations wherein rumour verification triggers market price fluctuations. These include:

1. Changing the criteria for rumor verification requirements from material events as per SEBI (LODR) Regulations, 2015 to prices of the securities and index movements under the NSE and Sensex.

2. More significantly, with a sliver of hope, the Consultation Paper also puts forth a proposal to extend price protection, easing the public M&A deal-making process for the acquirers.

In this article, we delve into these proposed frameworks, and analyse the implications on acquirers involved in M&A deals.

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Price Protection – Need of the Hour

What is "price protection"?

Price protection serves as a crucial safeguard for acquirers, guaranteeing that the impact of a verified rumour does not impede deal-making in-turn enhancing deal stability and fostering a fair environment for M&A transactions.

How does the price protection mechanism work?

As per the suggested mechanism, the listed entity is mandated to verify rumours circulating in mainstream media that could lead to material price movements in the market. Upon confirmation, the price of the securities remains protected for a certain period of time (depending upon the proposed framework taken into consideration). The price taken into consideration for such protection is the unaffected price, which refers to the price of the securities unaffected by any market fluctuation resulting from the verification of a market rumour. This grants acquirers a substantial window to execute the deal within the approximate deal value discussed, protecting them from repercussions of a verified market rumour. Such protection not only accords acquirers the necessary time to execute the deal but also acts as a preventive measure against the risk of the deal falling through due to market fluctuations or premature disclosures.

Why does an acquirer need the safety mechanism of price protection?

Typically, when entering into a deal, every acquirer sets a ballpark figure of a deal value in their mind. While some variations are expected due to external circumstances, the challenge arises when a rumour triggers an extreme and unpredictable reaction in the price of the securities of the entity being acquired.

As an acquirer, such unexpected and extreme reactions to the price, could potentially jeopardize the entire deal. Thus, the implementation of a robust price protection mechanism becomes crucial for ensuring deal integrity in the face of unpredictable market reactions.

For instance, a listed company is actively engaged in negotiations for a proposed acquisition deal, valuing its shares at INR 100 each. Now, if a rumour demanding confirmation emerges and is clarified prematurely, it could lead to a substantial shift in securities' prices, reaching, for instance, INR 180 per share. This unexpected surge might disrupt negotiations with the other entity, possibly resulting in a breakdown of the deal.

In light of these price fluctuations in public M&A deal-making; the Consultation Paper proposes two frameworks.

Framework A: Ideal for Acquirers in M&A

Under Framework A, the unaffected price, which refers to the price of the securities unaffected

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by any market fluctuation resulting from the verification of a market rumour shall be protected for a period of 60 days from the date of confirmation of market rumour till the relevant date as per the existing regulations. The "new relevant date" for the calculation of pricing transactions as per Framework A shall be the date immediately preceding the date on which the listed entity first confirms the rumour. Under the proposed framework, the look back period for calculation of volume-weighted average price (VWAP), which represents the unaffected price in this case shall be considered from the date preceding the new relevant date. As mentioned above, the VWAP is proposed to be applicable for a period of 60 days from the date of rumour confirmation till the relevant date as per the existing regulations.

Please refer to **Annexure A** for a detailed example of Framework A.

Advantages of Framework A:

- Price fluctuations in the market triggered by a rumour, and subsequent confirmation of such a market rumour, are not considered when determining the pricing of transactions related to the securities of a listed entity.

- Since the unaffected price assumes precedence, all deliberate attempts to manipulate prices of the securities through false rumours are thwarted.

Disadvantages of Framework A:

- While effective in preventing manipulation and addressing market fluctuations, the framework discounts the influence of favourable externalities like public announcements or general market conditions on a listed entity's securities' price. This could potentially deprive investors of the fair value of the securities. For instance: Company A is set to acquire Company B. Consequently, Company A's share price sees a material price fluctuation. Owing to the legal requirement, Company A confirms such a rumour, and the price derived through Framework A becomes protected for a maximum period of 60 days. In this period of 60 days, the government announces substantial tax advantages which may prove beneficial to Company A. However, owing to the price protection, the shareholders of Company A shall not be able to benefit from any such favourable circumstances.

Framework B:

Under Framework B, there is no change to the relevant date for the calculation of pricing transactions. However, price variation due to rumour and confirmation of rumour is excluded from VWAP calculations. The price variation adjustment however is only for a limited period - from the date of material price movement until the next trading day following the confirmation of the rumour. This approach ensures that the fluctuation in the securities' price resulting from the confirmation of the rumour is not considered for one trading day after the confirmation.

Please refer to **Annexure B** for a detailed example of Framework B.

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Advantages of Framework B:

- Framework B appears to favour only one set of the stakeholders – the retail shareholders. In Framework A, retail shareholders were precluded from benefiting from windfalls that may happen during the unaffected price period of 60 days. To that extent, Framework B Investors are protected from price fluctuations resulting from a rumour for one trading day post-confirmation, and any other favourable externalities are considered in determining the price to preserve the fair market value of the securities of the listed entity.

Disadvantages of Framework B:

- There is an assumption in this context that the announcement to the exchange (within 24 hours of material price movement) would instantaneously disseminate the information to the general public, without considering any potential time lag between the two events. The general public and market participants might take more than 24 hours to become aware of and react to the confirmation of a rumour.

- The impact of confirming a rumour on the price of the securities of the listed entity could extend well beyond the end of the next trading day after confirmation of the rumour for which pricing is adjusted. Therefore, it remains unclear as to why the Consultation Paper advocates for a price freeze only until one trading day after the confirmation of the rumour. This approach may not effectively eliminate the possibility of a securities' price being influenced by rumour confirmation, posing volatility in deal negotiations for institutional investors and listed entities.

Conclusion:

In conclusion, the introduction of "price protection", as proposed in the Consultation Paper has the potential to safeguard the interests of acquirers amidst market uncertainties. This initiative has been met with enthusiasm, as it addresses concerns regarding price fluctuations and their impact on M&A transactions. The anticipation surrounding SEBI's incorporation of these proposals into the regulatory framework underscores the importance of ensuring practical challenges are carefully considered and resolved.

Framework A offers a favourable approach for acquirers in M&A transactions by providing a 60-day window to execute deals without exposure to market price fluctuations triggered by rumours. This structured timeframe enhances certainty and facilitates smoother transaction execution.

On the other hand, Framework B falls short in providing effective price protection due to its inadequate timeframe for addressing market price fluctuations resulting from rumours. The effectiveness of price protection measures may vary depending on the nature of the rumour and the reaction of the market. Therefore, a more flexible and adaptable approach to price protection may be necessary to address the dynamic nature of market rumours and their impact on transaction stability.

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While the provision of price protection is a welcome move, the Consultation Paper also proposes to impose enhanced obligation on Promoters, Directors, KMP and Senior Management of listed entities regarding the verification of market rumours. By this move, in holding not just the directors, KMP and senior management of the listed company, but also its promoters directly liable, SEBI appears to have diluted the agency of the company and the principles of attribution. SEBI's application of the attributability principle when holding promoters responsible beyond their involvement appears ill-founded. While SEBI's intent may be sanctimonious, the means employed to achieve the purpose seem unduly harsh.

Overall, the introduction of price protection is a positive step forward. Careful consideration of the practical implications and flexibility in implementation of the proposed changes will be crucial for ensuring its effectiveness in safeguarding the interests of acquirers in M&A transactions.

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Annexure A

Framework A Example:

Trading Day:	Daily WAP	No. of Shares (Volume)	Daily VWAP = WAP*No. of Shares	Remarks	As per existing ICDR Regulations	Framework A
13 July	100.00	44,863	4486300			**NT-10**
14 July	110.00	33,466	3681260			
17 July	105.00	32,223	3383415			
18 July	120.00	19,968	2396160			
19 July	121.00	49,398	5977158			
20 July	118.00	47,004	5546472			
21 July	110.00	24,750	2722500			
24 July	106.00	37,262	3949772		**T-10**	
25 July	108.00	15,000	1620000			
26 July	109.00	44,519	4852571			**NT-1**
27 July	160.00	760853	121736480	**Date of material price movement**		**New Relevant Date(NT)**
28 July	180.00	238320	42897600	**Date of rumour confirmation**		
31 July	188.00	88,450	16628600	**Next trading day after rumour confirmation**		
01 Aug	183.00	68,613	12556179			
02 Aug	179.00	41,954	7509766			
03 Aug	175.00	56,267	9846725			
04 Aug	210.00	599197	125831370		**T-1**	
07 Aug	208.00	108762	22622496	**Date of Board approval to preferential issue to QIBs**	**Relevant Date (T)**	

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** The figures considered in the table are merely for ease of understanding of Framework A and do not necessarily corroborate with the proposed framework for material price movement in the Consultation Paper.*

Example:

This example is taken considering an instance of preferential issue to qualified institutional buyers (QIBs) as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Key Dates:

- Date of material price movement (Relevant Date): July 27, 2024
- Date of confirmation of market rumour: July 28, 2024

According to Framework A, the unaffected price would be applicable for a period of 60 days, from the date of confirmation of the market rumour, until the relevant date as per the existing regulations.

Lookback Period:

The lookback period for calculating the VWAP is set at 2 weeks preceding the relevant date (July 13, 2024, to July 26, 2024).

Example Calculation:

- During the lookback period, the daily VWAP values are calculated based on trading data.
- The unaffected price, determined by this VWAP calculation, is INR 110.82.

Application of Unaffected Price: For the period of 60 days:

- Any potential M&A deal during this time would be based on the unaffected price of INR 110.82.
- This means that fluctuations in the share price during this period, caused by market rumours, would not impact the deal's valuation.

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Annexure B

Framework B Example

Trading Day	Daily WAP	No. of Shares	Adj. Daily WAP for Framework B	Numerical Difference between Daily WAP	Percentage Difference between Daily WAP	Numerical difference between Adjusted WAP (As per Framework B)	Percentage difference between Adjusted WAP (As per Framework B)	Adj. Daily VWAP – Adj. WAP* No. of Shares) (As per Framework B)	Remarks	Framework B
24 July	100.00	37,262	100.00					3726200.00		**T-10**
25 July	110.00	15,000	110.00					1650000.00		
26 July	120.00	44,519	120.00					5342280.00		
27 July	200.00	760853	120.00					91302360.00	**Date of material price movement**	
28 July	220.00	238320	120.00					28598400.00	**Date of rumour confirmation**	
31 July	240.00	88,450	120.00	-5	-2.08%	-5	-4.17%	10614000.00	**Next trading day after rumour confirmation**	
01 Aug	235.00	68,613	115.00	-7	-2.98%	-7	-6.09%	7890495.00		
02 Aug	228.00	41,954	108.00	-2	-0.88%	-2	-1.85%	4531032.00		
03 Aug	226.00	56,267	106.00	49	21.68%	49	46.23%	5964302.00		
04 Aug	275.00	599197	155.00	-4	-1.45%	-4	-2.58%	92875535.00		**T-1**
07 Aug	271.00	108762	151.00					16423062.00	**Date of Board approval to preferential issue to QIBs**	**Relevant Date (T)**

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** The figures considered in the table are merely for ease of understanding of Framework B and do not necessarily corroborate with the proposed framework for material price movement in the Consultation Paper.*

** In this scenario, the Daily WAP exhibits a price difference, which is then adjusted in the Adjusted Daily WAP. For instance, in the Daily WAP column, the difference between INR 240 and INR 235 is INR 5, as indicated in the fifth column. This same difference is mirrored in the Adjusted Daily WAP, where INR 120 decreases to INR 115. Following this adjustment, the VWAP is computed based on the two weeks preceding the relevant date, resulting in a value of INR 129.46.*

** The sixth and eighth column portray the percentage difference between the Daily WAP values and Adjusted WAP values respectively. For instance, in the Daily WAP column, the percentage difference between INR 240 and INR 235 is 2.08% as reflected in the sixth column. The numerical figures in the above-mentioned paragraph are symmetrical, i.e., the difference of INR 5 is duly adjusted in the fifth and seventh column. However, the percentage difference does not match. The corresponding difference to 2.08% is 4.17% (INR 120 - INR 115) as mentioned in the eighth column. This asymmetry can be remedied by using percentage as an adjusting factor, instead of numerical values to ensure that one gets the fair value of shares in light of such adjustments.*

Example:

This example is taken considering an instance of preferential issue to qualified institutional buyers (QIBs) as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Key Dates:

- Date of material price movement: July 27, 2024
- Date of confirmation of market rumour: July 28, 2024
- Relevant Date: August 07, 2024

According to Framework B, the price variation due to rumour and confirmation of rumour shall be excluded from the calculation of VWAP. The price on the closing day of July 27 shall be protected from the day of material price movement till the end of the next trading day after confirmation of the rumour.

Lookback Period:

The lookback period for calculating the VWAP is set at 2 weeks preceding the relevant date (July 24, 2024, to August 04, 2024).

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Example Calculation:

- During the lookback period, the daily VWAP values are calculated based on trading data.
- Let's assume the protected price is INR 120. Thus, the price of INR 120 shall be protected for July 27, 28, and 31.

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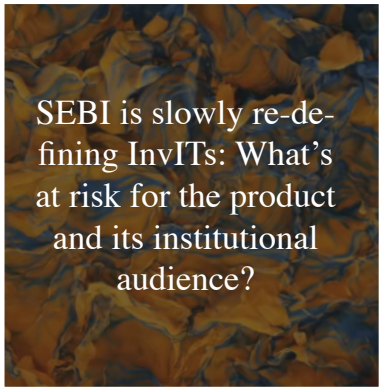
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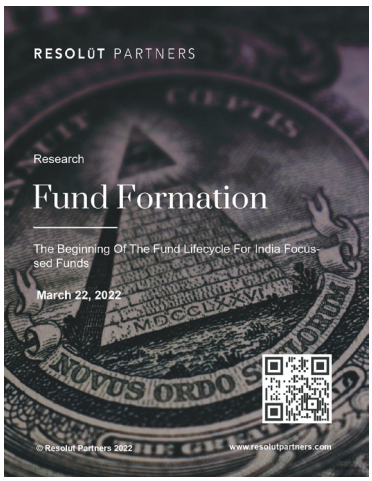








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