

EXPERT VIEWS

'We have seen a dismal failure to make material disclosures to the public'

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When the Reliance settlement was announced on Saturday, the disclosures regarding the contours of the settlement were so woefully inadequate that both the media and the investors were forced to rely on rumours and inspired leaks in order to understand the implications of the Reliance settlement. It is absolutely clear that a US listed company would not have got away with such poor disclosures.

In a US listed company, the promoter family would probably have written a letter to the Board detailing the family settlement and requesting the board to consider it. (The family agreement might also have stated that the family members would use their voting rights in favour of any general body resolutions that would be necessary to implement the settlement). The Board would have released this letter and the full text of the proposed settlement to the public and stated that it would consider the proposals from the point of view of the interests of the company and its shareholders before taking any decision.

That is not what we saw on Saturday. That we did not see such a comprehensive disclosure points to a failure of regulatory enforcement since the listing agreement in India has the some substantive requirements regarding material event disclosure as the US law does.

In fact during the last seven months of disputes in the promoter family of Reliance, we have seen a dismal failure to make material event disclosures to the public and a dismal failure of regulatory enforcement to ensure that this disclosure does happen.

Many people seem to be taking a sanguine view of this in the belief that the proposed demerger would leave outside shareholders of Reliance Industries Limited (RIL) with the same effective stake in the demerged companies as they currently have through RIL, and that, therefore the demerger transaction would be value neutral for them. This is not strictly true if RIL will have ongoing transactions with the demerged entities because these entities are not currently 100% owned by RIL.

The transfer prices governing continuing transactions between RIL and the demerged entity would have a value implication. Perhaps the most important transfer price in this context would be the price at which RIL contracts to sell gas to Reliance Energy in future. This transfer price could potentially transfer value in either direction between the current public shareholders of RIL and Reliance Energy.

Secondly, even a transaction that is value neutral for shareholders need not be value neutral for the creditors of RIL. A settlement in which RIL retains the entire existing debt but spins off major assets would definitely have implications for its credit rating. Any value transfer through distorted transfer prices would aggravate this impact.

Press reports talk about a cash settlement between the brothers to account for the difference in valuations between the two businesses. One way to reduce this cash


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settlement would be to reduce the value of the demerged RIL by letting RIL retain all the debt and also assume onerous future obligations. If this were to happen it is quite conceivable that RIL would suffer a rating downgrade.

On the other hand a different way of organising the division could leave the rating unchanged. Inadequate disclosures have created a great deal of uncertainty about the future credit rating of RIL.

Again many people seem to be unconcerned about this uncertainty because most of the debt of RIL is today privately placed. This complacency is misplaced because many income (and balanced) mutual funds have bought RIL debt and a large number of retail investors in these mutual funds thus have an exposure to RIL debt.

Inadequate disclosure is thus setting the field for massive insider trading in these mutual funds. Let us not forget how corporate investors and other large investors exited UTI before it imploded, leaving retail investors to face the music. We could well see the same thing happen to funds with a large exposure to RIL debt as large investors seek to profit from their superior information about the settlement.

—Former board member, Sebi

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