Cadbury minority buyout approved

August 8, 2014

Background

Listed companies in India can delist from the stock exchange through an exit offer in compliance with the Securities and Exchange Board of India (Delisting of Securities) Guidelines, 2003. However, practical experience shows that even after a successful delisting, some portion of the share capital continues to be held by public shareholders.

The Companies Act, 1956 (the Act) provides a window of capital reduction which enables companies to provide an exit to such public shareholders. In the past, some companies have used this window to buy out their public shareholders. Recently, the Bombay High Court approved the resolution passed by Cadbury India Limited (Cadbury) for such reduction of capital (by cancelling the shares held by and making a payment to the public shareholders).

In detail

Facts

- The global policy of Cadbury Plc, UK (Cadbury's ultimate parent) was to operate globally, only through wholly-owned subsidiaries or branches, unless otherwise required for complying with foreign investment laws, foreign exchange restrictions or compelling business reasons. Thus, Cadbury[1] operated as a wholly-owned subsidiary of Cadbury Schweppes Overseas Limited (Cadbury Schweppes) from 1948 to 1977. However government policy changes in 1977 required Cadbury Schweppes to dilute its shareholding from 100% to 60%. Post the economic liberalisation, foreign direct investment has been permitted up to 100%.
- Accordingly, the promoters of Cadbury made an open offer at INR 500 per share in January 2002, as a result of which the Cadbury Group's collective equity stake in Cadbury India rose to 93.47%, and subsequently, the shares of Cadbury were delisted from the NSE and BSE in November 2002. The exit offer at INR 500 per share still continued from November 2002 to March 2006, pursuant to which the Cadbury Group's shareholding increased to 97.44%.
- Post 2006, the Company made a series of buyback offers in each year from 2006 to 2009 (at prices ranging from INR 750 to INR 1030 per share), pursuant to which Cadbury Group's shareholding increased to 97.58%, with the balance 2.42% remaining with public shareholders.
- Cadbury convened an extraordinary general meeting (EGM), in accordance with section 100 of the Act, for passing a special resolution approving the reduction of capital. The special resolution was passed with an overwhelming majority as 99.96% of the shareholders present voted in favour of the resolution and only 0.04% voted against the resolution.
- For the purpose of valuation, Cadbury had obtained two valuation reports which returned a value of INR 1340 per share (Original Valuation Price).
- As various shareholders took exception to the Original Valuation Price, the Court directed for a fresh valuation to be done by an independent firm.

[1] Cadbury India Limited – Company petition 1072 of 2009

- The independent firm first returned a value of INR 1743 per share using the Comparable Companies Method (CCM), based on unaudited accounts up to July 2009. This report was later updated to also factor in Discounted Cash Flow Method (DCF) method of valuation for the shares. The revised value returned was INR 2014.50 per share (Revised Valuation Price), based on the unaudited accounts of September 2009 and with equal weightage given to DCF and CCM methods of valuation.

Minority shareholders' contentions and the Court's view on the objections

While initially, several shareholders objected to the Original Valuation Price, most of them accepted the Revised Valuation Price. However, two groups (Objectors) did not accept the Revised Valuation Price. These objectors had wide range of contentions such as, that there was no disclosed basis of valuation in the valuation reports, the method of valuation of the independent firm, the weightage assigned for each method of valuation, the applicability of control premium, etc. These objections, and the arguments thereon formed the bedrock of this prolonged litigation.

However, of the many contentions of the objectors, the Court has dealt specifically with three main objections;

Adoption of same growth rate as that of comparable companies

The objectors contended that the valuer ought to have adopted an identical growth rate to Nestlé Limited as they were in a similar business segment. However, the Court found the view to be untenable, since Nestlé Limited operated in a variety of other businesses, apart from the chocolates segment, and merely because there was an overlap in one segment of products, it did not warrant that the growth rates of all these companies be taken to be the same.

Kraft's global takeover of Cadbury

The objectors contended that the global takeover of Cadbury by Kraft should be taken into consideration for the valuation of Cadbury India's shares. However, the argument was ignored, since the objectors could not substantiate how the development would impact Cadbury India's operations.

Sale of property in Mumbai

The objectors contended that the sale of property in Mumbai by Cadbury should be taken into account for the purpose of the valuation. This contention was rejected by the Court, since the sale was a matter *post facto*.

Key doctrines for cases of minority buyout

The High Court clearly collated and laid out certain key doctrines to be pursued in matters of minority buy-out, listed below:

Guiding law aspects

Section 100 of the Act laid down three conditions:

1. the articles of association of the company must permit such a reduction of share capital;
2. the scheme for reduction must be approved as a special resolution in an extraordinary general meeting convened specifically for this purpose; and
3. post the resolution being passed by the requisite majority, the Court's ***sanction*** must be obtained to the resolution.

While sanctioning the application, the Court had to ensure that: (1) the scheme was not against the public interest; (2) the scheme was fair and just, and not unreasonable; and (3) the scheme did not unfairly discriminate against or 'prejudice' a class of shareholders.

Understanding the word 'prejudice'

The Court categorically observed that ***'prejudice'*** in this context, must mean something more than just receiving less than what a particular shareholder may desire. It meant a concerted attempt to force a class of shareholders to divest themselves of their holdings at a rate far below what is reasonable, fair and just. It must connote a form of discrimination, unfairness, a plot by which an entire class is forced to accept something that is inherently unjust.

The unfairness must apply to a class of shareholders and such class of shareholders could not be identified as some shareholders sharing a resentment against the company or an ideological animosity.

Valuation aspects

The Court re-emphasised that 'valuation' was not an exact science. It was always and only an estimation based on assumptions and could be described as nothing but a best-judgment assessment. A valuation could not be disregarded merely because it had used one or the other of various methods available.

Only in cases where a valuation was completely unreasonable, and it was unmistakably apparent that the result was absurd, could the Court decline sanction to a scheme. For an objector to challenge a valuation, it must be shown that the assumptions were so evidently erroneous that the end result was wrong, unfair and unreasonable. A plausible rationale provided by a valuer could not be readily discarded merely because an objector had a different point of view.

The Court was not a valuer as it did not have the necessary skills or expertise. The Court could not substitute its own opinion for that of the shareholders. Its jurisdiction was only peripheral and supervisory, not appellate.

Impact of view of majority of the non-promoter shareholders

The Court would duly take note of the view of the majority of the non-promoter shareholders expressed by them in a properly convened meeting. If the majority of the non-promoter shareholders had voted in favour of the resolution, the Court would not lightly disregard the commercial wisdom of such shareholders, though it was not bound by the majority.

Thus, a Court, before sanctioning an application should consider a minimum of these three tests:

1. Was a fair and reasonable value being offered to the minority shareholders?
2. Had the majority of non-promoter shareholders voted in favour of the resolution?
3. Was the valuation fair, reasonable and devoid of evident faults?

If the answers to all of the above were in the affirmative, the Court was more likely than not to sanction the application.

Conclusion

While the decisions in the case of Sandvik Asia Limited *v.* Bharat Kumar Padamsi and Ors[2] laid the foundation principles for capital reduction, and other subsequent cases strengthened it into a now well-settled concept, recent cases including this one have brought to the fore the frivolous attempts made by sections of minority shareholders to cast doubt on aspects of the valuation, and hold the other non-promoter shareholders to ransom from exiting the company.

However, the well-laid out doctrines in this order, should enable the smooth exit of minority shareholders in a fair and a reasonable manner, thus making it a win-win situation for both, the non-promoter shareholder as well as the company.

This judgment should encourage a lot of companies in similar situations, who may have been apprehensive of the various uncertainties, to provide an exit to non-promoter shareholders.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax & Regulatory Services – Mergers & Acquisitions

Shyamal Mukherjee, *Gurgaon*
+91-124 330 6536
shyamal.mukherjee@in.pwc.com

Ketan Dalal, *Mumbai*
+91-22 6689 1422
ketan.dalal@in.pwc.com

Vivek Mehra, *Gurgaon*
+91-124 330 6003
vivek.mehra@in.pwc.com

[2] Sandvik Asia Limited *v.* Bharat Kumar Padamsi [2009] (3) Bom CR 57

Our Offices

Ahmedabad

President Plaza
1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
+91-79 3091 7000

Bangalore

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai 600 006
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Andhra Pradesh
Phone +91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata - 700 091, West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai - 400 050
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cy ber City, Gurgaon
Haryana -122002
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
+91-20 4100 4444

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

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