Judicial Pronouncements in Valuation

Valuation Standards Board

and

ICAI Registered Valuers Organisation

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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Message

The Hon'ble Supreme Court of India, through its various judgements, has elaborated the scope of court's jurisdiction to interfere with the opinion of a valuer. It has often considered Valuers to be experts in their field and held that their opinions ought not to be rejected without proper consideration. Court's obligation is to be satisfied that valuation was in accordance with the law and it was carried out by an independent body.

Considering the kind of respect and credibility this profession has garnered over the years, it is imperative for Registered Valuers to adhere to the highest standards of professionalism while undertaking the valuation assignments in the interest of the stakeholders. To achieve this goal a Registered Valuer is expected to exercise utmost care and caution while deriving a value and are also supposed to continuously train themselves and upskill their competency.

As part of our knowledge dissemination initiatives and considering the need to create awareness about the practical aspects and procedures of law in the sphere of Valuation, ICAI RVO together with the Institute of Chartered Accountants of India has decided to bring out the publication Judicial Pronouncements in Valuation.

I am extremely happy for all the joint initiatives taken by the Institute of Chartered Accountants of India with ICAI RVO. I would like to appreciate the dedicated efforts of all the members of the Valuation Standards Board of ICAI under the leadership of CA. Anil S Bhandari, Chairman, Valuation Standards Board (VSB) and M. P. Vijay Kumar, Vice Chairman, Valuation Standards Board (VSB). I would also like to appreciate the support provided by my colleagues on the Board of ICAI RVO, Shri Pawan Singh Tomar, Shri Ashok Haldia, Prof. Anil Saini, CA. Nihar N. Jambusaria & CA. Prafulla P. Chhajed – the Directors of ICAI RVO, in encouraging all our initiatives.

I commend the sincere efforts put in by Shri Rakesh Sehgal, Managing Director, ICAI RVO, CA. Sarika Singhal, Officiating CEO, ICAI RVO and Ms. S. Rita, Deputy Secretary, ICAI for finalising this publication.

I am confident that this publication will help Registered Valuers (RVs) and other stakeholders in developing their skills and competencies.

Date: 3rd February, 2022 **Rajeev Kher**
Place: New Delhi Chairperson and Independent Director, ICAI RVO

Foreword

The Valuation profession has emerged as an important institution in the Indian economy as the valuers provide reliable information to serve as a reference for evaluation of choices and decision making in many market-based transactions.

A valuer shall ensure that the valuation report prepared by him/her can be put to the test in the crucible of legal evidence in judicial proceedings. The Insolvency and Bankruptcy Board of India (IBBI) recognises the need for registered valuers to provide reasonable disclaimers, however, a valuation report shall not carry a disclaimer, which has the potential to dilute the responsibility of the Valuer or makes the valuation process unsuitable for the purpose for which the valuation was conducted.

I applaud the efforts of the Valuation Standards Board of ICAI and ICAI Registered Valuers Organisation in putting together this publication "Judicial Pronouncements in Valuation" as a part of the continuous efforts towards upgradation of knowledge of members in this field of practice. The publication covers important case analysis based on the decisions of the Hon'ble Supreme Court of India, Hon'ble High Courts, NCLAT, ITAT and NCLT on issues concerning Valuation.

I extend my appreciation to the entire Valuation Standards Board especially to CA. Anil S. Bhandari, Chairman and CA. M. P. Vijay Kumar, Vice-Chairman, Valuation Standards Board for bringing out this publication for the benefit of members and other stakeholders.

I am confident that this publication would be of great help to the members, especially to Registered Valuers and other stakeholders in all their professional endeavours.

CA. Nihar N Jambusaria
President, ICAI
Director ICAI RVO

Date: 31st January, 2022

Place: New Delhi

Preface

Valuation as a profession has garnered significant credibility over the years. The Apex Court, in several of its judgements, has held that the valuation of shares is a technical and a complex problem that shall be appropriately left to the consideration of the experts in this field of practice. The Courts have also held that the Valuers are considered to be experts in their field and their opinions ought not to be rejected without proper consideration.

Over a period of time, due recognition to the opinion of the valuers has been part of emerging jurisprudence and their opinions even have an evidentiary value before a Court of Law. In the case of G.L Sultania and another V/s. Securities and Exchange Board of India, the Hon'ble Supreme Court has held that unless it is shown to the court that some well accepted principles of valuation have been departed from without any reason, or that the approach, adopted is patently erroneous or that relevant factors have not been considered by the valuer or that the valuation was made on a fundamentally erroneous basis or that the valuer adopted a demonstrably wrong approach or a fundamental error going to the root of the matter the court cannot interfere with the valuation of an expert.

The Valuation Standards Board of ICAI aims to create awareness about this emerging area of practice amongst the members at large and also facilitate in educating the members on the critical aspect and procedures of the Law concerning this sphere of practice.

As part of its initiative towards knowledge dissemination, the Valuation Standards Board of ICAI jointly with ICAI Registered Valuers Organisation has decided to bring out this publication on Judicial Pronouncements in Valuation. The publication is a compilation of case studies based on Key Judicial Pronouncements in the field of Valuation under various acts like The Companies Act 2013, The Income Tax Act 1961, The Insolvency and Bankruptcy Code, 2016 and the SEBI Regulations. It also talks about the key learnings and takeaways from these verdicts for Valuation Professionals.

We would like to thank the President of ICAI and Director ICAI RVO, CA. Nihar N. Jambusaria and Vice President of ICAI, CA. (Dr.) Debashis Mitra for their continued support in all the endeavours of the Board.

We would like to take this opportunity to convey our sincere thanks and gratitude towards the Board of ICAI RVO comprising of Shri Rajeev Kher, Chairman of the Board and other Directors, Shri Pawan Singh Tomar, Shri Ashok Haldia, Prof. Anil Saini and Shri Prafulla P. Chhajed, for joining in the constant endeavours of the Board.

We also place on record our appreciation to Members of the Valuation Standards Board, Co-opted Members and Special Invitees for their support and guidance in framing and bringing out this publication.

We would like to thank Shri Rakesh Sehgal, Managing Director, ICAI RVO; CA. Sarika Singhal, Officiating CEO, ICAI RVO and Secretary VSB, ICAI and Ms. S. Rita, Deputy Secretary ICAI for their contribution in finalisation of this Booklet and also their team members viz. Ms. Seema Jangid, Assistant Secretary ICAI, CA. Pragya Agrawal, Assistant Project Officer ICAI and CA. Nikita Aggarwal, Project Associate for developing and bringing out this publication.

We are confident that this publication will be of significant help to all professionals, industries and other stakeholders.

CA. Anil S. Bhandari
Chairman
Valuation Standards Board, ICAI

CA. M P VijayKumar
Vice Chairman
Valuation Standards Board, ICAI

Date: 31st January, 2022

Place: New Delhi

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Orders passed by the Hon'ble Supreme Court of India

Case No. 1
Alok Kaushik Vs Bhuvaneshwari Ramanathan and Ors (2021)

IN THE SUPREME COURT OF INDIA

Appellant: Alok Kaushik
Vs.
Respondent: Bhuvaneshwari Ramanathan and Ors.

Civil Appeal No. 4065 of 2020

Decided On: 15.03.2021

1. Brief Facts of the Case

- The Appellant was appointed as a Registered Valuer of the Corporate Debtor, under Regulation 27 of the Insolvency and Bankruptcy Board of India Regulations, 2016. The Appellant was appointed to value the plant and machinery of "Kavveri Telecom Infrastructure Limited" (hereinafter referred to as "Corporate Debtor") across India.
- The Appellant's appointment fee and other expenses were ratified by the Committee of Creditors (CoC), led by second respondent.
- The Appellant claimed to have conducted valuation work of over eighty-four sites and to have visited forty sites. Further, several outstation meetings were also stated to have been conducted between the Appellant and the first Respondent i.e., the Resolution Professional.
- The National Company Law Appellate Tribunal (NCLAT) set aside the initiation of CIRP against the Corporate Debtor. The NCLAT remanded the matter back to the NCLT to decide on the issue of CIRP costs. The NCLT decided on the fee of the Resolution Professional and reduced it by twenty percent from the fee ratified by the CoC.
- In view of the order of the NCLAT, the Resolution Professional cancelled the appointment of the Appellant. In relation to the fee payable to the Appellant, the first Respondent requested him to consider a waiver. In return, the Appellant agreed to reduce his fee by twenty five percent from

the fee ratified by the CoC, along with the expenses payable. However, the first Respondent informed the Appellant that the fee as ratified could not be paid and paid a certain sum.

- The Appellant then filed an application under Section 60(5) of the Insolvency and Bankruptcy Code, 2016 before the NCLT challenging the non-payment of the fees. However, the NCLT dismissed the application concluding that it had been rendered functus officio. In appeal, the NCLAT rejected the contention of the Appellant, noted that a certain amount had already been paid over (Rs. 50,000/-).

2. Key Grounds of Appeal

The real issue which has been sought to be canvassed in the appeal is that in a situation such as present, where the CIRP was set aside by the Appellate Authority, there has to be within the framework of the Insolvency and Bankruptcy Code, 2016 (IBC, 2016) a modality for determining the claim of a professional valuer such as the Appellant.

3. Decision

The Hon'ble Supreme Court set aside the impugned judgment and order of the NCLAT and remitted the proceedings back to the NCLT for determining the claim of the Appellant for the payment of the professional charges as a Registered Valuer appointed by the Resolution Professional in pursuance of the initiation of the CIRP. The Hon'ble Apex Court held as under: -

(i) The view of NCLT that it was rendered functus officio in relation to the Appellant's claim is an incorrect reading of the jurisdiction of the NCLT as an Adjudicating Authority under the IBC. The Hon'ble Apex Court relied upon its decision in the case *of Gujrat Urja Vikas Nigam Ltd. Vs. Amit Gupta and Ors.* and held that though the CIRP was set aside later, the claim of the Appellant as Registered Valuer related to the period when he was discharging his functions as a Registered Valuer appointed as an incident of the CIRP and hence, the NCLT would have been justified in exercising its jurisdiction under Section 60(5)(c) of the IBC, 2016 and, in exercise of jurisdiction under Article 142 of the Constitution to make a determination of the amount which is payable to an expert Valuer as an intrinsic part of the CIRP costs.

(ii) The Appellant was justified in contending that there must be a forum within the ambit and purview of the IBC, 2016 which had the jurisdiction to make a determination on a claim of the present nature, which had been instituted by a Valuer who was appointed in pursuance of the initiation of the CIRP by the Resolution Professional.

(iii) Regulation 34 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 20161 defines 'insolvency resolution process cost' to include the fees of other professionals appointed by the Resolution Professional.

(iv) The availability of a grievance redressal mechanism under the IBC, 2016 against an Insolvency Professional does not divest the NCLT of its jurisdiction under Section 60(5)(c) of the IBC, 2016 to consider the amount payable to the Appellant. In any event, the purpose of such a grievance redressal mechanism was to penalize errant conduct of the RP and not to determine the claims of other professionals which form part of the CIRP costs.

4. Key Learnings for Valuers from the above Case

(i) Section 217 of the IBC 2016 empowers a person aggrieved by the functioning of a Resolution Professional to file a complaint to the IBBI. If the IBBI believes on the receipt of the complaint that any Resolution Professional has contravened the provisions of IBC 2016 or the Rules, Regulations or Directions issued by the IBBI, it can, under Section 218 of the IBC 2016 direct an inspection or investigation. Under Section 220 of the IBC 2016, IBBI can constitute a Disciplinary Committee to consider the report submitted by the Investigating Authority. If the Disciplinary Committee is satisfied that sufficient cause exists, it can impose a penalty.

(ii) The availability of above grievance redressal mechanism under the IBC 2016 against an Insolvency Professional does not divest the NCLT of its jurisdiction Under Section 60(5)(c) of the IBC 2016 to consider the amount payable to a Registered Valuer appointed under the IBBI Regulations. The purpose of such a grievance redressal mechanism is to penalize errant conduct of the RP and not to determine the claims of other professionals which form part of the CIRP costs.

(iii) A Registered Valuer appointed under Regulation 27 of the Insolvency and Bankruptcy Board of India Regulations, 2016 can approach NCLT to settle its claims forming part of CIRP cost as NCLT in exercising its jurisdiction under Section 60(5)(c) of the IBC 2016 and, in exercise of jurisdiction under Article 142 of the Constitution, can make a determination of the amount which is payable to an expert valuer as an intrinsic part of the CIRP costs.

Case No. 2
Maharashtra Seamless Limited Vs Padmanabhan Venkatesh and Ors. (2020)

IN THE SUPREME COURT OF INDIA

Appellant: Maharashtra Seamless Limited
Vs.
Respondent: Padmanabhan Venkatesh and Ors.

Civil Appeal Nos. 4242 and 4967-4968 of 2019

Decided On: 22.01.2020

1. Brief Facts of the Case

12th June 2017 – The National Company Law Tribunal, Hyderabad Bench admitted the petition filed under Section 7 of IBC, 2016 by Indian Bank and initiated the CIRP proceedings against the United Seamless Tubulaar Pvt. Ltd (hereinafter referred to as the Corporate Debtor).

The Resolution Professional so appointed received four resolution plans and same along with the liquidation value and fair value were placed before the Committee of Creditors (COC). In the 8th COC Meeting, the resolution plan submitted by Maharashtra Seamless Ltd. was approved by the majority of COC by 87.10% of voting share, consisting of the Deutsche Bank International (Asia) Limited holding 73.40% vote share and the Indian Bank holding 12.90% voting share in the CoC.

Two Registered Valuers were initially appointed by the Resolution Professional for determining the value of the Corporate Debtor. Their valuations were to the tune of Rs. 681 crores and Rs. 513 crores respectively. On account of substantial difference in their valuations, the Committee appointed a third Valuer. They valued the Corporate Debtor at Rs. 352 crores. The Committee thereafter took into consideration the average of the two closest estimates of valuation and liquidation value was assessed to be Rs. 432.92 crores.

2. Regulations pertaining to Valuation under Insolvency and Bankruptcy Code, 2016

There are two important Regulations under the Insolvency and Bankruptcy Code 2016 which provide guidelines with respect to Valuation.

(i) Regulation 27 of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016: -

Under Regulation 27, a Resolution Professional has to

a) Appoint two Registered Valuers;

b) Within seven days of his appointment, but not later than forty-seventh day from the insolvency commencement date;

c) to determine the fair value and the liquidation value of the corporate debtor in accordance with Regulation 35;

Further Regulation 27 clearly spells out that the following shall not be appointed as a Registered Valuer by Resolution Professional: -

a) a relative of the Resolution Professional;

b) a related party of the corporate debtor;

c) an auditor of the corporate debtor at any time during the five years preceding the insolvency commencement date; or

d) a partner or director of the Insolvency Professional Entity of which the Resolution Professional is a partner or director;

(ii) Regulation 35 (1) of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016:-

a) Requirements from a Registered Valuer under Regulation 35(1)

(i) The two Registered Valuers firstly need to undertake physical verification of the inventory and fixed assets of the Corporate Debtor;

(ii) Thereafter the two Registered Valuers shall estimate the fair value and the liquidation value in accordance with internationally accepted valuation standards;

(iii) The two Registered Valuers shall then submit their report to the Resolution Professional;

(iv) The Registered Valuers shall maintain confidentiality of the fair value and the liquidation value.

b) Requirements from a Resolution Professional under Regulation 35(1)

(i) If in his opinion the two estimates of value are significantly different, he may appoint another Registered Valuer who shall submit an estimate of the value computed in the same manner; and

(ii) He needs to consider the average of the two closest estimates of a value to determine the fair value or the liquidation value;

(iii) Resolution Professional shall provide the fair value and the liquidation value to every member of the committee in electronic form, on receiving an undertaking from the member to the effect that such member shall maintain confidentiality;

(iv) The Resolution Professional shall maintain confidentiality of the fair value and the liquidation value;

Further, the term '"Fair Value" and "Liquidation Value" have been defined under Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (hereinafter referred to as CIRP Regulations, 2016) as follows:

"Clause 2(hb): "Fair Value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion.

Clause 2(k): "Liquidation Value" means the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date.

3. Case Analysis – Observations and Directions in Orders issued by NCLT and NCLAT

a) 28th September 2018 – NCLT Order

The Resolution Professional filed an application before the NCLT Bench of Hyderabad for the approval of the Resolution Plan of Maharashtra Seamless Ltd. (hereinafter referred to as MSL). The NCLT Bench disposed-off the

application and further directed the Resolution Professional to re-determine the liquidation value of the Corporate Debtor by taking into consideration the average of the first and second valuation and consequently, the valuation was revised from INR 432.92 Crores to INR 597.54 Crores. The Adjudicating Authority directed the Resolution Professional to convene a meeting of the Committee of Creditors to place the qualified Resolution Plan for reconsideration in light of revised liquidation value of the Corporate Debtor.

b) 12th November 2018 – NCLAT Order

The aforesaid order of the NCLT Bench of Hyderabad was challenged before the National Company Law Appellate Tribunal ("NCLAT") by the Resolution Applicant, Maharashtra Seamless Limited. The Tribunal vide its order dated 12th Nov 2018 disposed of the appeal with directions to the NCLT Bench of Hyderabad to pass orders on the Resolution Plan under Section 31 of the IBC, 2016.

c) 21st January 2019 – 2nd NCLT Order – observations therein

The National Company Law Tribunal, Hyderabad Bench by an order dated 21.01.2019, approved the Resolution Plan proposed by MSL which involved an upfront payment of Rs. 477 Crores and additional fund infusion on the takeover of Corporate Debtor. The Adjudicating Authority, inter-alia, held.

The CoC has examined all eligible resolution plans again in the 9th CoC meeting held on 16.10.2018. The Resolution Plan submitted by M/s MSL is below the revised Liquidation Value. The difference is about Rs. 120 crores. However, as per directions of the Hon'ble NCLAT, this Tribunal to decide the plan filed by M/s. MSL without being influenced by its previous order.

The Adjudication Authority held that as per the order of the NCLAT the Tribunal has to observe question whether the plan submitted by M/s MSL is in conformity with Section 30(2) of the IBC, 2016 and if it is in conformity, then the plan is to be approved under Section 31 of the IBC, 2016. The Liquidation Value prior to re-determination if taken into account, the upfront payment offered by M/s MSL is over and above the Liquidation Value. Therefore, the objection taken by the Director (Suspended Board) and also Indian Bank could not be taken into account in view of the direction of Hon'ble NCLAT.

d) 8th April 2019 – 2nd NCLAT Order

A number of parties raised objections against the 'Resolution Plan' submitted by 'M/s. Maharashtra Seamless Ltd.' – ('Resolution Applicant') on different

grounds and accordingly, appeals were filed against the same before NCLAT. One of the key grounds was that the approval of the Resolution Plan amounting to Rs. 477 crores were giving the Resolution Applicant windfall gain as they would get assets valued at Rs. 597.54 crores at a much lower amount.

The parties contended that the 'Resolution Plan' is below the liquidation value and the fair value should be adopted before approval of the 'Resolution Plan'. The other ground taken by the objectors was that one of the other Resolution Applicants had made a revised offer of Rs. 490 crores, which was more than the amount offered by the MSL.

In this regard, the Resolution Applicant submitted as under: -

- As per 'M/s. Maharashtra Seamless Ltd.' their total exposure was around Rs. 657.50 crores wherein Rs. 477 crores was upfront amount and in addition to that Rs. 180.50 crores were to be infused directly by them. Further, Rs. 57 crores was to be infused towards 25% margin money of working capital expenditure. Moreover, in fact, the total working capital requirement was Rs. 224 crores, and the balance was to be taken as a loan from Bank(s), which would also require corporate guarantees.
- It was further contended that the Corporate Debtor's plant has been lying closed for the last three years therefore; the aforesaid infusion of funds by MSL aggregating to Rs. 657.50 crores was for the maximization of the assets of the 'Corporate Debtor'.

The NCLAT held that since the amount provided in the Resolution Plan was lower than the average of the liquidation value arrived at by the Valuers, therefore, the Resolution Plan approved by the Adjudication Authority is against Section 30(2) of the IBC, 2016 and is against the statement and object of the 'I&B Code, 2016'.

It held that *"'M/s. Maharashtra Seamless Ltd.' should increase upfront payment of Rs. 477 Crores as proposed to the 'Financial Creditors', 'Operational Creditors' and other Creditors to Rs. 597.54 Crores by paying additional Rs. 120.54 Crores approximately to make it at par with the average liquidation value of Rs. 597.54 Crores."*

It held that if the 'Resolution Applicant' modifies the 'Resolution Plan', as ordered above and deposits another sum of Rs. 120.54 Crores within 30 days, by improving the plan, the Adjudication Authority will allow 'M/s. Maharashtra Seamless Limited' to take over the possession of the 'Corporate Debtor' including its moveable and immoveable assets and the plant. On failure, the plan approved in favour of 'M/s. Maharashtra Seamless Ltd.' deemed to be set

aside and the Adjudication Authority will pass appropriate order in accordance with law.

4. 22nd January 2020 – Order of the Hon'ble Supreme Court of India

Grounds of Admission

Aggrieved by the decision of NCLAT, the M/s. Maharashtra Seamless Ltd. preferred an appeal before the Hon'ble Supreme Court of India. The two primary issues for consideration before the Apex Court was whether the scheme of the Insolvency & Bankruptcy Code, 2016 contemplates that the sum forming part of the resolution plan should match the liquidation value or not and whether Section 12-A of the IBC, 2016 is the applicable route through which a successful Resolution Applicant can retreat.

Judgement

The Hon'ble Supreme Court held as under: -

(i) No provision in the IBC, 2016 or IBBI Regulations has been brought to our notice under which the bid of any Resolution Applicant has to match liquidation value arrived at in the manner provided in Clause 35 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

(ii) The objective behind prescribing such valuation process is to assist the CoC to take decision on a Resolution Plan properly. Once, a resolution plan is approved by the CoC, the statutory mandate on the Adjudicating Authority under Section 31(1) of the IBC, 2016 is to ascertain that a resolution plan meets the requirement of sub-sections (2) and (4) of Section 30 thereof.

(iii) MSL cannot withdraw from the proceeding in the manner they have approached the Court. The exit route prescribed in Section 12-A of the IBC, 2016 is not applicable to a Resolution Applicant. The procedure envisaged in the said provision only applies to applicants invoking Sections 7, 9 and 10 of the IBC, 2016.

(iv) Court ought to cede ground to the commercial wisdom of the creditors rather than assess the Resolution Plan on the basis of quantitative analysis. Such is the scheme of the IBC, 2016. Section 31(1) of the IBC, 2016 lays down in clear terms that for final approval of a Resolution Plan, the Adjudication Authority has to be satisfied that the requirement of sub-section (2) of Section 30 of the IBC, 2016 has been complied with.

The Supreme Court, after taking into consideration the facts of the case held that there is no breach of the provisions of the IBC, 2016 or the Regulations thereunder; upheld the order of the Adjudicating Authority approving the Resolution Plan and set aside the order of NCLAT dated 8 April, 2019.

5. Key Learnings for Valuers from the above Case

The Preamble of the Insolvency & Bankruptcy Code, 2016 states: -

"An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto."

Hence, the IBC, 2016 effectively lays emphasis on reorganisation and insolvency resolution, albeit in a time bound manner to promote going concern, with liquidation as the last resort. The IBC, 2016 is first and foremost, a Code for reorganisation and insolvency debtors. Unless such reorganisation is effected in a time-bound manner, the value of the assets of such persons will deplete. Therefore, maximisation of value of the assets of such persons so that they are efficiently run as going concerns is another very important objective of the IBC, 2016.

The Adjudicating Authorities have to act on substantive matters of law and concede to the wisdom of the COC on commercial aspects provided other legal requirements have been met.

The Valuation process prescribed under the IBC, 2016 is to assist the Committee of Creditors to take decision on the resolution plan and no provision in the IBC, 2016 or Regulation thereunder lays down that the bid of any Resolution Applicant has to match liquidation value arrived at in the manner provided in clause 35 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

Case No. 3
G.L. Sultania and Ors. Vs The Securities and Exchange Board of India and Ors. (2007)

IN THE SUPREME COURT OF INDIA

Appellants: G.L. Sultania and Ors.
Vs.
Respondent: The Securities and Exchange Board of India and Ors.

Civil Appeal No. 1672 of 2006

Decided On: 16.05.2007

1. Brief Facts of the Case

The issue in the instant case was on valuation of shares by SEBI under the 'Takeover Code' viz Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (which has now been substituted by Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011) in context of offer for takeover of Hindustan National Glass and Industries Ltd. (target company) by ACE Glass Containers Ltd and C.K. Somany.

The Somany family comprising of four brothers managed several companies including the target company. All the brothers held equal shares in the target company and the public share-holding in the target company was negligible (less than 0.30%). The shares of the target company were infrequently traded.

In the year 1994, about 40% of the equity capital of the target company was transferred to Shri C.K. Somany pursuant to a family settlement arrived at between the brothers. According to the appellants on August 5, 1994; there was an agreement between Shri C.K. Somany, and his brothers for the sale of the entire balance shareholding in the target company held by his brothers to Shri C.K. Somany at Rs. 267/- per share. This, however, is disputed by Shri C.K. Somany and in this background, disputes arose between the parties and the brothers and Civil Suit was filed in Calcutta High Court.

During the pendency of the suit, Shri S.K. Somany, one of the brothers offered to sell 7.30% share held by him in the target company to Shri C.K. Somany on the basis of price mutually acceptable to the parties. In view of the agreement arrived at between the two brothers, Shri C.K. Somany moved to Calcutta High Court for modification of the interim order thereby permitting him to acquire 7.30% shares of Shri S.K. Somany in the target company. This triggered the provisions of the Takeover Code which obliged Shri C.K. Somany to make a public announcement to acquire shares in accordance with the Takeover Code.

2. Scheme of Events and Valuations Done

(i) The Takeover Code having been triggered, acquirers were directed to make an open offer under the provisions of the Takeover Code by order dated 2.9.2003. The merchant banker, appointed by the acquirer, determined the price of shares to be offered to the shareholders in accordance with the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 viz Takeover Code at Rs. 40 per share.

(ii) Some of the appellants not being satisfied with the price of the share which was offered to the shareholder under aforesaid SEBI Regulations objected to the price being low and complained that the same had not been determined in accordance with the parameters laid down in Regulation 20(5) of the Takeover Code.

(iii) Respondents in consultation with the Merchant Banker appointed a renowned firm of Valuers (First Valuer) to value the shares of the target company. The aforesaid firm of Valuers determined the price of each share of the target company as Rs. 43.02 per share.

(iv) The appellants still persisted in their objection that the value of each share determined by the aforesaid firm of Valuers was also not correct.

(v) SEBI took serious note of the objections and appointed an Independent Valuer (Second Valuer), to once again value the shares of the target company under Regulation 20(5) of the Takeover Code. The said Independent Valuer, carried out valuation of the target company and submitted a report on 20.5.2004 to SEBI. The valuation was done on the basis of the market price of the shares of the target company and other methods as required under valuation principles and revised the valuation to Rs.64.17 per share.

(vi) The acquirers felt aggrieved by the hike in the valuation and felt that the valuation by the first Valuer at Rs. 43.02 was reasonable. The merchant bankers pursuant to this objection by the acquirers wrote a letter dated 9.3.2005 to SEBI on this aspect of the matter. SEBI permitted the merchant bankers to obtain valuation from a third Chartered Accountant.

(vii) Accordingly, the merchant bankers in consultation with SEBI appointed third Valuer to carry out the valuation of the shares of the target company. The said Valuer submitted a report on 13.4.2005 stating that the fair market value of the share was Rs. 60.04 per share of the target company.

(viii) SEBI after considering all the three reports felt that in public interest justice must be done to the shareholders and held that the highest price per share amongst the three valuations be the fair price.

(ix) The merchant bankers and acquirers accepted the suggestion of SEBI.

(x) Appeal was filed before the Appellate Tribunal and it may be further noted that the appellant G.L. Sultania had complained against the valuation of shares by the Merchant Banker and while doing so he had enclosed copies of two Valuation Reports valuing the shares of the target company at much higher rates namely, Rs.408/- and Rs.590/- per share.

(xi) The Appellate Tribunal did not accept the Valuation Reports of produced by the appellants which valued the shares at abnormally high rates of Rs. 408/- and Rs. 590/- per share. Apart from other reasons, the very fact that there was such a wide disparity in valuation in the aforesaid two reports, was itself a sufficient ground to reject them.

(xii) The Appellate Tribunal held that the Board (SEBI) had acted strictly in terms of the Takeover Code and approved the public offer. The valuation of shares as accepted by the SEBI was arrived at after following the norms laid down in Regulation 20(5) of the Takeover Code and, therefore, it could not be characterized as either erroneous, arbitrary or unreasonable.

(xiii) Aggrieved by the order of the Appellate Tribunal the appellants had filed the instant appeal under Section 15(Z) of the Securities and Exchange Board of India Act, 1992.

3. Issues Raised

(i) First objection was that the SEBI, as well as the Merchant Banker had

not properly valued the shares of the target company in accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (which has now been substituted by Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011).

(ii) Learned counsel argued that the price approved by the Board was not a fair price.

4. Relevant clause of SEBI Regulations

Regulation 20(5) of the Takeover Code provides as follows

"Offer price –

(1) The offer to acquire shares under Regulation 10, 11 or 12 shall be made at a price not lower than the price determined as per Sub-regulation (4) and (5).

…………………..

(5) Where the shares of the target company are infrequently traded, the offer price shall be determined by the acquirer and the merchant banker taking into account the following factors:

(a) the negotiated price under the agreement referred to in sub-regulation (1) of Regulation 14;

(b) the highest price paid by the acquirer or persons acting in concert with him for acquisitions, if any including by way of allotment in a public or rights or preferential issue during the twenty-six week period prior to the date of public announcement.

(c) other parameters including return on networth, book value of the shares of the target company, earning per share, price earning multiple vis-à-vis the industry average;

Provided that where considered necessary, the Board may require valuation of such infrequently traded shares by an independent merchant banker (other than the manager to the offer) or an independent chartered accountant of minimum ten years' standing or a public financial institution.

Explanation;

(i) For the purpose of sub-regulation (5), shares shall be deemed to be infrequently traded if on the stock exchange, the annualized trading

turnover in that share during the preceding six calendar months prior to the month in which the public announcement is made is less than five per cent (by number of shares) of the listed shares. For this purpose, the weighted average number of shares listed during the said six months period may be taken.

(ii) In case of disinvestments of a Public Sector Undertaking, the shares of such an undertaking shall be deemed to be infrequently traded, if on the stock exchange, the annualized trading turnover in the shares during the preceding six calendar months prior to the month, in which the Central Government of the State Government as the case may be opens the financial bid, is less than five per cent (by the number of shares) of the listed shares. For this purpose, the weighted average number of shares listed during the six months period may be taken.

(iii) In case of shares which have listed within six months preceding the public announcement, the trading turnover may be annualized with reference to the actual number of days for which the shares have been listed."

So far as Clauses (a) and (b) are concerned, there can be no dispute that the highest price offered by the acquirers for the shares of the target company under the Memorandum of Undertaking dated 7th October, 2002 was Rs. 40/- per share and the price to be paid by C.K. Somany group for purchase of shares permitted by the High Court of Calcutta was also Rs. 40/- per share. Thus, the offer price based on factors under Clauses (a) and (b) of Regulation 20(5) works out to be not less than Rs. 40/- per share. **The thrust of the challenge to the valuation is with respect to Clause (c) of Regulation 20(5) of the Takeover Code.**

5. Salient features of Valuation Report accepted by the SEBI (i.e. Report of the Second Valuer)

- The Report takes note of the three commonly adopted methods of valuation of shares, namely, the Net Asset Method, the Profit Earning Capacity Method, and the Market Price Method.
- While the Net Value Method represents the value of the shares with reference to the value of the assets owned and the liability as on the valuation date, the Profit Earning Capacity Method (for short the "PECV") involves determination of the future maintainable earnings of the Company from its normal operations. Under the Market Approach, the common method employed to derive the value of the business is to

multiply estimated maintainable earnings with the price earning ratio of comparable companies in the industry.

- **Profit Earning Capacity Method** – The Valuer calculated the "yield value" by taking the average of 9 years, from 1993-1994 to 2001-2002. The year 2002-2003 was excluded for the reasons recorded in the Report which show that on account of abnormal situations the profits of the Company had decreased. Taking the capitalization rate as 15% as suggested for manufacturing companies in erstwhile Controller of Capital Issues guidelines, the value of shares was worked out to Rs. 55.06 per share.
- **Net Asset Value Method -** The Valuer ascertained a value of Rs. 77 per share by dividing the Share Capital of the Company plus Reserves and Surplus (excluding Revaluation Reserve and Contingent Liabilities) by the number of equity shares of the Company.
- **Market Value Method -** having regard to the infrequently traded shares of the Company, the average market price of six months prior to October 7th, 2002, the reference date as stated in the letter of offer was considered, and same resulted in a value of Rs. 66.87 per share.
- Weightage for market value was reduced from 2 to 1 because. in the case of infrequently traded shares, the market price has less relevance. Thereafter, applying the same weightage as in Hindustan Lever, (except for the market price), the fair value per share was found to be Rs. 63.50 paise.
- The Valuer expressly noticed the provisions of Regulation 20(5) of the Takeover Code in their Valuation Report and after taking the values by the three methods i.e. PECV, NAV and EPS and giving them weightage, the value per share was ascertained to be Rs. 57.55 per share.

6. The Hon'ble Apex Court's View and Decision

(i) With respect to the Regulation 20(5) of the Takeover Code the Court observed the following:

- This Regulation applies to infrequently traded shares of a company and lays down the parameters that must be considered in arriving at the valuation. But it must be understood that the parameters laid down are by no means exhaustive. There are many other considerations which may be factored into any valuation process.

- The Regulation mandates that the parameters expressly laid down therein must in all cases be considered by the Valuer since they are basic and essential to the valuation of infrequently traded shares of a company.
- If the Valuation Report discloses non-consideration of any of the enumerated parameters, the report shall stand vitiated for that reason. This, however, does not prevent the valuer from considering other relevant factors according to accepted principles of valuation of shares.
- The Regulation seeks to protect the interest of an investor by ensuring that he gets a fair price for his shares in the target company.
- The Board has to act prudently and within the limits of its jurisdiction. It cannot object to the price offered by the acquirer unless it has reasons to suspect that the price offered has not been determined fairly taking into account the enumerated factors. In case of doubt, it may require valuation of the shares by an Independent Merchant Banker or Chartered Accountant. If the valuation determined by the acquirer or his merchant banker agrees with the valuation of the Board's Valuer, more or less, then the Board has no option but to accept the offer price of the acquirer.

(ii) With respect to the allegations on the Valuation Report

- **Allegation No. 1**

  Valuer took P/E ratio at 9.6 instead of 20.9. According to the appellants, the figure pertaining to March 1 to 14, 2004 which had been taken into account by the Valuer was not relevant and he should have taken the figures relevant to the public announcement dated 13th November 2003 and the letter of offer dated 25th August, 2005.

  Observation: - The Capital Market which is a fortnightly magazine gives the necessary data with regard to each industry. The data pertaining to every industry category reflect the "full year", the "latest quarter" and the "trailing twelve months" figures. The "trailing twelve months" reflects the most current computation of the price earnings multiple and that period includes more companies with an EPS of more than 1 and was, therefore, more representative of the market.

  The Valuer in his Report had observed that the Industry P/E of 20.9 is not the correct indicator of the industry. As the industry (glass and glass products) covers 12 companies out of which 6 companies are loss

making; hence having a negative P/E ratio and the other 3 companies having minimal profit, the Industry Composite P/E ratio of 20.9 is calculated based on P/E ratio of 3 profit making companies only, thereby ignoring the performance of other 9 companies.

- **Allegation No. 2**

  The Net Asset Value comes to Rs. 133.27, if reserves and surplus as per consolidated accounts of the target company and subsidiaries at book value were taken. According to the appellants, the Net Asset Value would have come to Rs. 233.04 if 50% of the net worth of the controlled associate company, ACE Glass Containers Ltd. was considered. The value of the shareholding of the target company in the subsidiaries and ACE Glass as reflected in the Balance Sheet of the target company merely reflected the historical cost of such investments and not the true value thereof.

  Observation:- ACE Glass was a potentially sick company registered with the BIFR having carry forward losses of Rs. 266 crores as on March 31, 2003 and there is no reasonable prospect of earning any dividend from ACE Glass in the immediately foreseeable future. There was no question of consolidating the net worth of ACE glass into the net worth of the target company or the profit earning capacity of ACE Glass with the profit earning capacity of the target company.

  Further, it is not mandatory to derive the valuation of shares on the basis of consolidated financial statement. As per normal accounting practices, for determining the value of shares as a going concern only individual financial statements are considered because parent company is entitled to dividend only and has no right whatsoever in the assets of subsidiary and associate companies.

- **Allegation No. 3**

  The capitalization ratio of 15% was taken; whereas the capitalization ratio should have been 8% and the guidelines issued by the CCI had been repealed.

  Observation:- CCI guidelines had been followed which laid down the principles which are applicable in working out the profit earning capacity which involve two important factors, namely - average profit before tax and capitalization ratio.

- **Allegation No. 4**

  If revaluation reserve was considered, the Net Asset Value would have come to Rs. 124.82.

  Observation:- Revaluation reserves are never considered as part of the net-worth computation. Section 2(29A) of the Companies Act, 1956 (now substituted by the Companies Act, 2013) which defines "net worth", expressly excludes revaluation reserves. Moreover the CCI guidelines for "Valuation of equity shares for companies and the business and net assets of branches" clearly provided that the revaluation reserves arising out of revaluation of fixed assets should ordinarily be ignored. Only after an efflux of 15 years would it be reasonable to consider non-exclusion of revaluation reserves. Even SEBI guidelines for initial public offerings of shares expressly exclude capitalization arising out of revaluation reserves for purposes of determining "promoter's contribution" to be eligible to make an initial public offering.

- **Allegation No. 5**

  Profit Earning Capacity Value should not be calculated on the basis of past earnings alone as done by the Valuer but on future maintainable profit basis.

  Observation:- The Valuer has correctly applied the HLL/TOMCO principles for computation of the "Yield Value". Adopting those principles audited financial statements of 9 years between 1993-1994 and 2001-2002 were considered. The financial statement for the year 2002-2003 was excluded since the profits for that year had fallen by nearly 50%. Adopting these principles and taking into account the discounting rate of 15% applicable in terms of the CCI guidelines a value of Rs. 55.06 per share was computed by the valuer. The Valuer also independently applied the yield value and without applying HLL principles computed the value of the shares as Rs. 34.39. After having arrived at two distinct values as aforesaid, the Valuer adopted the higher of the two values.

(iii) The Court held that unless it is shown to the Court that some well-accepted principles of valuation have been departed, without any reason; or that the approach adopted is patently erroneous; or that relevant factors have not been considered by the Valuer; or that the valuation was made on a fundamentally erroneous basis; or that the Valuer adopted a demonstrably wrong approach or a fundamental error in going to the root of the matter; the Court cannot interfere with the valuation of an expert.

(iv) The Court held that the Valuer, had not committed any such error which may justify their interference. They have considered all the factors relevant under Regulation 20(5) of the Takeover Code and have adopted a reasonable approach which does not call for interference by the Court.

The Court held that "Board committed no error in accepting the Report, as Valuer has acted in a reasonable manner. Unless it is shown to the Court that some well-accepted principle of valuation has been departed from without any reason or that the approach adopted is erroneous, the Court cannot interfere with the valuation of an expert."

Hence, Board had exercised its discretion wisely.

7. Key Learnings for Valuers from the above Case

(i) **Important Valuation Principles upheld**

- o It is an established principle that for working out the average profit under the Profit Earning Capacity Method, profit of only those years which were normal and not affected by abnormal situations should be considered.
- o It is not mandatory to derive the valuation of shares on the basis of consolidated financial statement. As per normal accounting practices, for determining the value of shares as a going concern only individual financial statements are considered because parent company is entitled to dividend only and has no right whatsoever in the assets of subsidiary and associate companies.
- o Revaluation reserves are never considered as part of the net-worth computation. Section 2(29A) of the Companies Act, 1956 (now substituted by the Companies Act, 2013) which defines "net worth", expressly excludes revaluation reserves. Moreover, the CCI guidelines on "Valuation of equity shares for companies and the business and net assets of branches" clearly provided that the revaluation reserves arising out of revaluation of fixed assets should ordinarily be ignored. Only after an efflux of 15 years would it be reasonable to consider non-exclusion of revaluation reserves. Even SEBI guidelines for initial public offerings of shares expressly exclude capitalization arising out of revaluation reserves for purposes of determining "promoter's contribution" to be eligible to make an initial public offering.
- o CCI guidelines on "Valuation of equity shares for companies and the business and net assets of branches" have always been and continued

to be a material and significant indicator for purpose of valuation in India. The mere fact that the CCI as a Statutory Authority has since been abolished does not make the CCI guidelines redundant.

(ii) Mathematical precision and exactitude are not the attributes of share valuation, for at best the valuation arrived at by an expert is only his opinion as to what the value of the share should be. No doubt the variation may not be very wide between two valuations prepared honestly by two Valuers applying the correct approach and the correct principles, but some variation is unavoidable.

(iii) Views may differ and even experts may differ in their conclusions or even reasoning. The Court must take notice of this fact and must not interfere unless there are compelling reasons to upset the finding of the expert Valuer. While the appellant expects Courts to step in to the role of an expert; the Court is forbidden to act in the said role and examine the imponderables in exercise of valuation of shares. As per the rationale laid in the case of Miheer H. Mafatlal, the Apex Court has held that the valuation of shares is a technical and complex problem and shall be appropriately left to the considerations of an expert.

(iv) For the acquirer, the decision to acquire shares is a commercial decision. The same block of shares may have different value for different acquirers. An acquirer who intends to control the management of the target company by acquisition of the shares in question, without acquiring majority shares, may value the shares differently from an acquirer who is already in management of the Company but wishes to acquire the majority of shares to strengthen his voting rights.

(v) A majority shareholder may also wish to acquire shares so as to hold 75% of the equity capital which will ensure passage of special resolutions. Such an acquirer may value the shares differently from his point of view. Similarly, a shareholder already holding 75% shares may acquire more shares only to consolidate his holding in the target company. It may not suit his objectives to pay a higher price than the other three categories noticed above.

Case No. 4
Renuka Datla Vs Solvay Pharmaceutical B.V. and Ors. (2003)

IN THE SUPREME COURT OF INDIA

Appellant: Renuka Datla
Vs.
Respondent: Solvay Pharmaceutical B.V. and Ors.

Special Leave Petition (C) No. 18035 of 2000 with Interlocutory Application No. 2 of 2002 with S.L.P. (C) Nos. 18041-18042/2000 with I.A. Nos. 3 and 4/2002

Decided On: 30.10.2003

1. Brief Facts of the Case

The case arose from the dispute between the petitioners, Mrs. Renuka Datla and her husband Dr. Vijay Kumar Datla, and the company Solvay Pharmaceutical and Shri D. Vasant Kumar. The petitioners were shareholders of two Pharmaceutical Companies namely Duphar Pharma India Ltd. (DPIL renamed as Solvay Pharma India Ltd.) and Duphar Interfran Ltd. (DIL). The dispute was with respect to the transfer of shares of these two Pharmaceutical Companies to the respondents.

The petitioners filed three appeals in the High Court under Order 43 Rule 1 C.P.C. The appeal filed by the petitioner in the first S.L.P. against the refusal of injunction was dismissed by the High Court and the other two appeals filed by the aggrieved defendants were allowed and the ad interim injunction in both the cases was vacated.

Against this common order of the High Court, the present S.L.Ps. were filed by the petitioners namely, Mrs. Renuka Datla and Dr. Vijay Kumar Datla. During the course of the hearing itself, the parties settled the disputes and the terms of mutual settlement were signed by all the parties. The Court passed the following order on 15th July, 2002 to give effect to the settlement.

Counsel for the parties stated that the dispute between them has been settled. A copy of the terms of mutual settlement signed by the parties has been filed

in Court and initiated by the Court Master. Terms of settlement are recorded. The terms contemplate valuation to be done of the intrinsic worth of the two companies and the value of 4.91% shares in the said two companies held by the petitioners. Valuation has to be completed within a period of four weeks. The terms of mutual settlement shall form part of this order. Copy of the order be sent to the Valuers.

According to the terms of settlement, M/s. Solvay Pharmaceuticals and Mr. Vasant Kumar agreed to purchase 4.91% shares held by the petitioners (Dr. Renuka Datla/Dr. Vijay Kumar) in the two companies namely Duphar Pharma India Ltd. (DPIL renamed as Solvay Pharma India Ltd.) and Duphar Interfran Ltd. (DIL). A Chartered Accountant, had to evaluate the intrinsic worth of both the Companies— DPIL and DIL as going concerns and the value of the said 4.91% shares held by the petitioners in those two Companies "by applying the standard and generally accepted method of valuation". The Valuer was also asked to give an opportunity to the respective parties to make their submissions.

2. Basic Principle and Valuation Methodology adopted by the Valuer

The Valuer considered three methods of valuation.

(i) Asset based

(ii) Earning based

(iii) Market based.

DCF was not applied in absence of any independent projections and also because the projections provided by both the parties differed substantially.

a) Intrinsic Value

As per the Valuer, intrinsic value of the share should be based on the asset and earnings-based value with appropriate weightage given to the two methods.

Since the value of a company/business is more influenced by its earnings value, a higher weightage was given to the earnings value as compared to its asset value. The asset value is considered as an integral part of the intrinsic value as it has a persuasive impact. The Valuer hence allocated following weightage for determining the intrinsic value: -

i) Asset based value -1/3rd weightage

ii) Earnings based value- 2/3rd weightage

b) Market Value

The market (for listed company--its market price) based value indicates the value ascribed by the buyer/seller of the share at a given point in time. This is influenced by:

(i) the floating stock and the supply and demand, which gets reflected in the volume and price of market transactions; and

(ii) market perceptions related to

- ❖ the overall market
- ❖ the industry
- ❖ the company

c) Recommended Value

The recommended value considered by the Valuer was higher of the intrinsic value or the market-based value. Though ideally, the recommended value should be the intrinsic value but, in some cases, it may be possible that the market-based value at a given point of time is higher than the intrinsic value, which is indicative of a bullish phase/ perception of the market and/or industry and/or the company. Therefore, to take into account this practical reality, the Valuer suggested higher of the two as the final value.

Based on the above methodology, the intrinsic worth of the two Companies and the value of 4.91% shares in the two Companies was worked out at Rs 8.24 crores.

3. Issues Raised by the Petitioners

The petitioners objected to the valuation on the following grounds:-

a) Control premium had not been added;

b) The value of the brands Vertin and Colopsa, which according to the petitioners continued to be the property of DIL, was not included;

c) Discounted Cash Flow method had not been adopted though it is a generally accepted method, even according to the Valuer.

4. The Apex Court's View and Decision

a) Contention 1 - Control premium had not been added;

It was the contention of the petitioners that 4.91 percent shareholding which the respondents Mr. Vasant Kumar and another have agreed to purchase was part of the promoters' shareholding of 25% and certain special rights and privileges were attached to these promoters' shareholding.

As per the Valuer, this holding of 4.91% did not give any special advantage to the holder or in this case even to the purchaser since the respondents collectively held in the two companies 60.5% of the share capital of each company. On that consideration, the value of the shares could only be 4.91% of the intrinsic worth of the two companies.

The Court held that in answering this question, the terms of settlement must be kept uppermost in the mind. The Court has to go by the terms of settlement which is the last word on the subject. The terms did not, either in express terms or by necessary implication, contemplated the valuation by determining the intrinsic worth of 4.91% shares, having due regard to their special or distinctive characteristics.

If the parties wanted a special treatment to be given to these shares and a control premium or the like had to be added, it should have been specifically expressed and mentioned in the terms of settlement. Such an important aspect should not have been omitted while framing the terms of settlement if the parties had agreed to the valuation on that basis. What has not been said in the terms of settlement in specific and clear terms, cannot be superimposed by the Court while interpreting the terms of settlement.

b) Contention No 2 - The value of the brands Vertin and Colopsa was not included

The petitioners contended that DIL was legally entitled to carry on its business in 'Vertin' and 'Colospa' along with other brands. The rights over these two brands were transferred to Dupen Laboratories Private Ltd. and such transfer, according to the petitioner, was in breach of contractual obligations under the Trademark License Agreement dated 15.7.1975 etc.

In this respect, the respondents submitted that the brands VERTIN and COLOSPA have been purchased by Solvay Pharmaceuticals BV from Dupen Laboratories Private Limited. As such, these were not the assets of DIL. DIL also has no investment in Dupen Laboratories Private Limited. This is not a matter which should affect the valuation of the shares of DIL.

The Court held that the petitioners cannot be permitted to thwart the terms of the settlement by inviting the Valuer or this Court to go into the extraneous issue as regards the validity of the transfer or incidental matters. The assets as per the relevant records had to be taken into account by the Valuer and that had been done. The Hon'ble Court, therefore, found no apparent error in excluding those brands.

c) Discounted Cash Flow Method had not been adopted though it is a generally accepted method, even according to the Valuer.

The Court held that the DCF method is adopted while resorting to valuation based on future earnings but the future earning based valuation is not the only reliable method of 'earnings-based valuation'.

Moreover, the petitioners have not placed any facts and figures to show that such method of valuation would result in a definite increase in the share value going by independent projections.

There were vast discrepancies between the projection given by the parties and independent projections had not been provided; the Valuer had chosen the best possible method of evaluation by capitalizing the past earnings. In doing so, the future maintainable profits based on past performance were also an element that had gone into the calculation. No prejudice whatsoever was shown to have been caused to the petitioners by the earnings-based valuation.

The court decided that the Valuer approached the question of valuation having due regard to the terms of settlement and applying the standard methods of valuation. The valuation has been considered from all appropriate angles. No case has been made out that any irrelevant material has been taken into account or relevant material has been eschewed from consideration by the Valuer. The plea that the valuation is vitiated by fundamental errors cannot but be rejected.

5. Key Learnings for Valuers from the above Case

(i) In the given Case, the appellant faced substantial loss on account of poor drafting of the terms of settlement. Hence, while drafting an agreement/settlement one shall ensure to incorporate all the points that are there in his/her mind, and nothing shall be left to the interpretation of the readers. To avoid damages one shall apply a thorough mind and try and engage professional help in such situations.

(ii) An explanation on Valuation Methodology applied to arrive at a specific valuation and 'selection' of any particular method or for 'disregarding' any approach shall always be included in a valuation report. In the given case the Valuer, clearly shared the logic and understanding behind the selection of Valuation Methodology and assignment of weightage in his Valuation Report. This surely helped him when his Valuation Report was being tested by the Court.

(iii) Valuation is an opinion of value; it needs to be properly supported for credibility. It must be supported by relevant evidence and logic as necessary for the intended use.

(iv) The valuation approaches and methods shall be selected in a manner which would maximise the use of relevant observable inputs and minimise the use of unobservable inputs. In the given case the Valuer didn't select the DCF method as adequate inputs i.e. the projected cash flows were not available from an independent party and also there were vast discrepancies between the projections given by the parties.

(v) It was held that "If the valuer had applied the standard method of valuation, considering the matters from all the appropriate angles, his valuation could not be challenged on the ground of being vitiated by fundamental error."

(vi) Further DCF method was not considered by Valuer due to unavailability of independent projections. In respect of projections, the Valuer had chosen the best possible method by capitalizing past earning and considering maintainable profits.

(vii) In case the minority holding does not give any special advantage to the holder or the purchaser then the control premium is not to be added while ascertaining the value of the shares. In the above case, the holding of 4.91% did not give any special advantage to the holder or in this case

even to the purchaser since the respondents collectively held in the two companies 60.5% of the share capital of each company. On that consideration, the value of the shares can only be 4.91% of the intrinsic worth of the two companies.

(viii) It was further held that "If a valuer has not added control premium in intrinsic value and the same has not been specifically mentioned in the terms of settlement, the treatment done by Valuer will be considered as correct."

(ix) The Court also ruled that the Valuer had arrived at market-based valuation in addition to the other modes of valuation and observed that the recommended value is the higher of the intrinsic value or the market-based value. Thus, the petitioners had the benefit of higher valuation. The first principle laid down in the above decision has been kept in view. Moreover, the profit earning method which has been referred to in the above decisions in the context of valuation of shares of a private limited company has also been applied, though future earnings-based valuation has not been done in the absence of reliable figures. As observed by us earlier, the profit earning capacity of the company has not been excluded from consideration, Thus, the Valuer's mode of valuation does not in any way infringe the principles laid down in the case of ***Commissioner of Gift Tax, Bombay v. Smt. Kusumben D. Mahadevia*** to the extent they are applicable.

Case No. 5
Miheer H. Mafatlal Vs Mafatlal Industries Ltd. Ors. (1996)

IN THE SUPREME COURT OF INDIA

Appellant: Miheer H. Mafatlal
Vs.
Respondent: Mafatlal Industries Ltd.

Civil Appeal No. 11879 of 1996

Decided On: 11.09.1996

1. Brief Facts of the Case

The Scheme of Amalgamation of M/s Mafatlal Industries (MIL) being the transferee company and the Mafatlal Fine Shipping and Manufacturing Company Limited (MFL) being the transferor company was proposed.

The transferor-company MFL was proposed to be amalgamated with the respondent-company MIL under the following circumstances and for the following reasons:

(i) The proposed amalgamation will pave the way for better, more efficient and economical control in the running of operation.

(ii) Economies in administrative and management costs will improve in combined profitability.

(iii) The amalgamated company will have the benefit of the combined reserves, manufacturing assets, manpower and cash flows of the two companies. The combined technological, managerial and financial resources are expected to enhance the capability of the amalgamated company to invest in larger and more sophisticated projects to ensure rapid growth.

(iv) The amalgamated company will have a strong and large resource base. With a strong resource base, the risk bearing capacity of the amalgamated company will be substantial. Hitherto, with limited

resources and capacity, either company had to forego business opportunities that would otherwise have been profitable to the group.

(v) "Exports" have been identified as a 'thrust' area for both the companies and response in time to customers' needs is considered to be critical in this area of operations. An amalgamated company will be strategically better placed to reduce the response time. Customers' confidence in dealing with such a mega company ensures timely delivery of large orders.

(vi) The amalgamated company will be able to source and absorb new technology and spend on Research and Development, Market Surveys etc. more comprehensively.

(vii) More particularly in the Textiles Division, with 5 operating units at the company's disposal, the flexibility in operations will be very much pronounced. The Managers will not be inhibited by capacity constraints and will have the freedom of choosing from various options.

(viii) Both the companies have been subject to the pressures of raw material price fluctuations and of adverse market conditions in their respective product mix. Hence, the amalgamation will neutralise the adverse effects of contrary business cycles. The operations of one unit will be complementary to the other and stable profitability will be achieved.

The directors of both the companies approved the proposal for amalgamation of the MFL with MIL and pursuant to the respective resolutions passed by them the detailed Scheme of Amalgamation was finalised. The directors of both the companies were of the opinion that such amalgamation was in the interest of both the companies.

It is pertinent to note at this stage that the appellant who had objected to the amalgamation before the High Court in the present proceedings so far as the amalgamation of the transferee company is concerned, was himself one of the directors of the transferor-company being MFL.

Sequence of events is as follows:

- Transferor company filed an application at Bombay High Court and the court sanctioned the Scheme of Amalgamation.
- The Transferee company approached the Gujarat High Court for approving the scheme.

- Appellant who was one of the shareholders of the transferee-company filed his objection to the Scheme of Amalgamation moved under Section 391 of the Companies Act, 1956.
- In the meeting of equity shareholders convened pursuant to the order of the High Court, overwhelming majority of the equity shareholders approved the Scheme.
- Pursuant to the public advertisement, only the present appellant filed an affidavit opposing the Scheme of Amalgamation.
- The Single Judge Bench of Gujrat High Court sanctioned the said Scheme moved on behalf of the respondent transferee-company.
- Appeal was filed against the impugned judgement before the Division Bench and the said appeal was dismissed.
- Further Appeal was filed before the Hon'ble Supreme Court. The Case came for Appeal by Special Leave.

2. Issues Raised before the Hon'ble Supreme Court

In view of the aforesaid rival contentions, the following points were raised for determination:

(i) Whether the respondent company was guilty of hiding the special interest of its director Shri Arvind Mafatlal from the shareholders while circulating the explanatory statement supporting the Scheme and whether thereby the voting by the equity shareholders got vitiated?

(ii) Whether the Scheme is unfair and unreasonable to the minority shareholders represented by the appellant?

(iii) Whether the proposed Scheme of Amalgamation was unfair and amounted to suppression of minority shareholders represented by the appellant and hence liable to be rejected?

(iv) Whether separate meetings of minority shareholders represented by the appellant were required to be convened on the basis that the appellant's group represented a special class of equity shareholders?

(v) Whether the exchange ratio of two equity shares of MIL for five equity shares of MFL was ex facie unfair and unreasonable to the equity shareholders of MIL and consequently the Scheme of Amalgamation on that account was liable to be rejected?

3. The relevant provisions of the Companies Act, 1956

The relevant provisions thereof read as under:

Section 391

391. (1) Where a compromise or arrangement is proposed –

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them;

the Court may, on the application of the company, or, of any creditor or member of the company, or, in the case of a company which is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Court directs.

(2) If a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting either in person or, where proxies are allowed under the rules made under Section 643, by proxy, at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors, all the creditors of the class, all the members, or all the members of the class, as the case may be, and also on the company, or, in the case of a company which is being wound up, on the liquidator and contributories of the company :

Provided that no order sanctioning any compromise or arrangement shall be made by the Court unless the Court is satisfied that the company or any other person by whom an application has been made under Sub-section (1) has disclosed to the Court, by affidavit or otherwise, all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under Sections 235 to 251, and the like.

Section 392

392. (1) Where a High Court makes an order under Section 391 sanctioning a compromise or an arrangement in respect of a company, it –

(a) shall have power to supervise the carrying out of the compromise or arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement.

(2) If the Court aforesaid is satisfied that a compromise or arrangement sanctioned under Section 391 cannot be worked satisfactorily with or without modifications, it may, either on its own motion or on the application of any person interested in the affairs of the company, make an order winding up the company, and such an order shall be deemed to be an order made under Section 433 of this Act.

(3) The provisions of this section shall, so far as may be, also apply to a company in respect of which an order has been made before the commencement of this Act under Section 153 of the Indian Companies Act, 1913 (7 of 1913), sanctioning a compromise or an arrangement.

Section 393

393. (1) Where a meeting of creditors or any class of creditors, or of members or any class of members, is called under Section 391,-

(i) with every notice calling the meeting which is sent to a creditor or member, there shall be sent also a statement setting forth the terms of the compromise or arrangement and explaining its effect : and in particular, stating any material interests of the directors, managing director, managing agent, secretaries and treasurers or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise, and the effect on those interests, of the compromise or arrangement, if, and in so far as, it is different from the effect on the like interests of other persons; and

(ii) in every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid on a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.

4. Decision of the Court

The Decision against the issues raised before the court were as under:-

Issue No. 1

Whether the respondent company was guilty of hiding the special interest of its director Shri Arvind Mafatlal from the shareholders while circulating the explanatory statement supporting the Scheme and whether thereby the voting by the equity shareholders got vitiated?

Decision

Out of 100% of the share capital, 75.75% in value participated of which 95.75% voted in favour of the proposed Scheme. Out of 95.75% of the votes in value, a paltry 8.43% of votes had been attributed to Arvind Mafatlal group consisting of individuals and trust. While 39.45% were the votes attributable to financial institutions which can be said to have no interest other than their own interests as men of business in considering the proposed Scheme. Over 23% of votes have been attributed to public limited companies or private limited companies which held the shares of MIL and in which Arvind Mafatlal was also alleged to have interests.

Thus, the requisite statutory majority of votes approving the scheme could not have been adversely affected by the non-mentioning of this pending litigation in the explanatory note even assuming that the Division Bench was right in holding that it was required to be informed to the voters as per the requirements of Section 393(1)(a) of the Companies Act, 1956.

Issue No. 2

Whether the Scheme is unfair and unreasonable to the minority shareholders represented by the appellant?

Decision

Financial Institutions and statutory corporations held a substantive percentage of shares in respondent-company. This class of shareholders who are naturally well informed about the business requirements and economic needs and the requirements of corporate finance in the light of their personal interest would not have wholly approved the Scheme if it was contrary to the interest of shareholders as a class. Individual personal interest of a minority shareholder like the appellant is absolutely out of consideration when such class meeting acting for the benefit to the whole class of equity shareholders take up the

consideration of the Scheme for its approval. Consequently, it could not be said that the majority shareholders had sacrificed the class interest of appellant minority shareholders when they voted with overwhelming majority in favour of the Scheme.

Issue No. 3

Whether the proposed Scheme of Amalgamation was unfair and amounted to suppression of minority shareholders represented by the appellant and hence liable to be rejected?

Decision

No such situation ever existed both at the time when the Scheme of Compromise and Arrangement was cleared and proposed by the Board of Directors of both the transferor and transferee companies and also at the stage when the Scheme was put to vote before the meeting of equity shareholders forming a common class of which the appellant was also a member though a minority member.

Issue No. 4

Whether separate meetings of minority shareholders represented by the appellant were required to be convened on the basis that the appellant's group represented a special class of equity shareholders?

Decision

Unless a separate and different type of Scheme of Compromise is offered to a sub-class of a class of creditors or shareholders otherwise equally circumscribed by the class; no separate meeting of such sub-class of the main class of members or creditors is required to be convened. On the facts of the present case, the appellant has not been able to make out a case for holding a separate meeting of dissenting minority equity shareholders represented by him.

Issue No. 5

Whether the exchange ratio of two equity shares of MIL for five equity shares of MFL was ex facie unfair and unreasonable to the equity shareholders of MIL and consequently the Scheme of Amalgamation on that account was liable to be rejected?

Decision

When the Scheme as a whole is examined and found to be advantageous to the economic and commercial interest of shareholders as a class, only one or two items implicatory for deciding the exchange ratio cannot tilt the balance as so many factors and aspects would enter that exercise. The Supreme Court finally concluded that 'Once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the Court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies.

5. Court's Observations and Key Learnings for Valuers from the above Case

- As per the statutory provisions of Sections 391 and 393 of the Companies Act, 1956 the question of void ability of the scheme will have to be judged subject to the rider that a scheme sanctioned by majority will remain binding to a dissenting minority of creditors or members, as the case may be, even though they have not consented to such a scheme and to that extent absence of their consent will have no effect on the scheme.
- In case of such a Scheme of Compromise and Arrangement put up for sanction of a Company Court (now NCLT) it will have to be seen whether the proposed scheme is lawful and just and fair to the whole class of creditors or members including the dissenting minority to whom it is offered for approval and which has been approved by such class of persons with required majority vote.
- It is the commercial wisdom of the parties to the scheme who have taken an informed decision about the usefulness and propriety of the scheme by supporting it by the requisite majority vote that has to be kept in view by the Court. The Court certainly would not act as a Court of appeal and sit in judgment over the informed view of the concerned parties to the compromise as the same would be in the realm of corporate and commercial wisdom of the concerned parties.
- The Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the

company who have ratified the Scheme by the requisite majority. Consequently, the Company Court's (NCLT's) jurisdiction to that extent is peripheral and supervisory and not appellate.

- The Court acts like an umpire in a game of cricket who has to see that both the teams play their game according to the rules and do not overstep the limits. But subject to that how best the game is to be played is left to the players and not to the umpire.

The court also gave certain guidelines pertaining to the scope and ambit of the jurisdiction of the Company Courts which are as follows:

(i) The sanctioning Court has to see to it that all the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meetings as contemplated by Section 391(1)(a) of the Companies Act, 1956 (the Act) have been held.

(ii) That the scheme put up for sanction of the Court is backed up by the requisite majority vote as required by Section 391(2) of the Companies Act, 1956.

(iii) That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at an informed decision for approving the scheme in question. That the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.

(iv) That all necessary material indicated by Section 393(1)(a) of the Companies Act, 1956 is placed before the voters at the concerned meetings as contemplated by Section 391(1) of the Companies Act, 1956.

(v) That all the requisite material contemplated by the proviso of Sub-section (2) of Section 391 of the Companies Act, 1956 is placed before the Court by the concerned applicant seeking sanction for such a scheme and the Court gets satisfied about the same.

(vi) That the proposed scheme of compromise and arrangement is not found to be violative of any provision of law and is not contrary to public policy. For ascertaining the real purpose underlying the Scheme with a view to be satisfied on this aspect, the Court, if necessary, can pierce the veil of apparent corporate purpose underlying the scheme and can judiciously X-ray the same.

(vii) That the Company Court (now NCLT) has also to satisfy itself that members or class of members or creditors or class of creditors, as the case may be, were acting bona fide and in good faith and were not coercing the minority in order to promote any interest adverse to that of the latter comprising of the same class whom they purported to represent.

(viii) That the scheme as a whole is also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.

(ix) Once the aforesaid broad parameters about the requirements of a scheme for getting sanction of the Court are found to have been met, the Court will have no further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons who with their open eyes have given their approval to the scheme even if in the view of the Court there would be a better scheme for the company and its members or creditors for whom the scheme is framed. The Court cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the Court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction.

Case No. 6
Hindustan Lever Employees' Union Vs Hindustan Lever Limited and Ors. (1994)

IN THE SUPREME COURT OF INDIA

Appellant: Hindustan Lever Employees' Union
Vs.
Respondent: Hindustan Lever Limited and Ors.

Spl. Leave Petn. (C) No. 11006 of 1994 etc.

Decided On: 24.10.1994

1. Brief Facts of the Case

This case arose from the Merger under the Companies Act, 1956 of the two big companies-one, Hindustan Lever Limited (HLL), a subsidiary of Uni Lever (UL), London based multi-national company, and other Tata Oil Mills Company Ltd. (TOMCO), the first Indian company found in 1917 and public since 1957. The merger was challenged in the High Court by few shareholders of TOMCO, Federation of Employees Union of both the TOMCO and HLL, Consumer Action Group and Consumer Education and Research Centre. The High Court rejected the appeal and hence, a Petition was filed before the Supreme Court of India challenging the same.

TOMCO manufactured and sold products like soaps, detergents, toiletries and animal feeds. HLL also manufactured and sold similar products. Both the Companies had their registered office at Bombay. TOMCO had more than 60,000 shareholders with the following break-up:

Particulars	% of holding
Tata Group	22%
Financial Institutions	41%
General Public	37%

Business of Tata Oil Mills Co. Ltd. ("TOMCO") started declining in the year 90-91, they incurred a loss of Rs 13 Crore in the year 91-92 and another Rs 16

Crores in the first half of the year 92-93. Hence, the Board of TOMCO Ltd. decided to collaborate with Hindustan Lever Ltd. ("HLL"), a 100% subsidiary of Unilever ("UL"). The Scheme, inter alia, provided for transfer and vesting in HLL of the Undertaking and business of TOMCO together with assets and liabilities excluding certain assets and/or licence rights to use certain premises.

Both TOMCO & HLL availed service of Senior Partner of a reputed Chartered Accountant firm, for the purpose of evaluation of the share-price of the two Companies in order to arrive at a fair share exchange ratio. The said person was also a director of TOMCO.

He gave the Valuation Report and recommended an exchange ratio of two equity shares of HLL for every fifteen ordinary shares of TOMCO. The Board of Directors of both the Companies at their separate and independent meetings accepted the recommendation and approved the Scheme of Amalgamation.

The valuation of the shares for exchange ratio was determined by combining three well-known methods –

a) the yield method;

b) the asset value method; and

c) the market value method

The Valuation was further checked and approved by two other independent bodies at the instance of shareholders of TOMCO by the High Court and it has been found that the determination did not suffer from any infirmity.

2. Scheme of Events

(i) Company Application No. 250 of 1993 filed by TOMCO.

(ii) The Court passed an order of 29th April, 1993 directing TOMCO to call the meetings of the debenture holders, creditors, ordinary shareholders arid preference shareholders on 29th and 30th June, 1993.

(iii) Individual notices of the said meetings together with a copy of the Scheme of Amalgamation, the statement as settled by the Company Registrar and as required under Section 393(1)(a) of the Companies Act, 1956 (the Act) and a proxy form was sent to concerned members as required by law.

(iv) The meeting of the ordinary shareholders was held on 29th June, 1993 and was attended by 1,294 members holding 85,85,009 ordinary shares and by 1,652 members holding 55,18,251 ordinary shares through proxies. In the shareholder's meeting amendment was proposed to the effect that the exchange ratio should be 5:15 shares in place of 2:15 shares as envisaged in the Scheme. 99.64% of ordinary shareholders voted against amendment and 99.72% voted in favour of the Scheme as proposed.

(v) Debenture holders voted 99%, secured creditors voted 100%, unsecured creditors voted 84.30% and preference shareholders voted 100% in favour of the Scheme.

(vi) Similar directions were also issued to HLL by the Court on 29th April for convening the meeting on 30th June, 1993 of the equity shareholders and creditors,

(vii) On 30th June, 1993, shareholders of HLL at their Extraordinary General Meeting approved the proposed scheme by the requisite majority.

(viii) The meeting of the creditors was held on 2nd July, 1993 under the chairmanship of Mr. S.M. Datta, Chairman of HLL, as directed by the Court. The creditors also voted for the Scheme.

(ix) The merger scheme was challenged by few shareholders of TOMCO, Federation of Employees Union of both the TOMCO and HLL, Consumer Action Group and Consumer Education and Research Centre.

3. Issues Raised by the objectors

According to the appellants, the Scheme should not be sanctioned for the following reasons:

(i) Violation of Section 393(1)(a) of the Act in not making required disclosures in the explanatory statement.

(ii) Valuation of share exchange ratio is grossly loaded in favour of HLL.

(iii) Ignoring the effect of provisions of the Monopolies and Restrictive Trade Practices Act (the Monopolies & Restrictive Trade Practices Act).

(iv) Interest of employees of both the Companies was not adequately taken care of.

(v) Preferential allotment of shares at less than market price to Unilever is not in public interest.

(vi) Mala fide on account of existence of quid pro quo between Unilever and Tata Sons Ltd.

(vii) Valuer's Report is not acceptable to the TOMCO shareholders as he was a director of TOMCO and further as the valuation of the shares for exchange ratio was determined by combining three methods of valuation.

One shareholder of TOMCO, Mr. M.C. Jajoo, gave direction to two Valuers to give their opinion on the Valuation Report. The said two Valuers by their joint letter with copy to Mr. Jajoo confirmed that the share exchange ratio determined by the Valuer was proper.

4. Court's Observations and Decision in the case

(i) With respect to the first contention that Valuer's report is not acceptable to the TOMCO shareholders, as the valuation of the shares for exchange ratio was determined by combining three methods, the court's observations were as under:-

Equity Share Data

Hindustan Lever Ltd. – Market Price as on 17th Jun 1993 was Rs. 375

As at	31.12.92	31.12.91	31.12.90
Face Value/Share (Rs.)	10	10	10
Book Value/Share (Rs.)	23.8	20.75	27.36
EPS (Rs.)	42%	38.50%	42%
Dividend (%)	7.03	5.73	6.29

The Tata Oil Mills Company Ltd. - Market Price as on 17th Jun 1993 was Rs. 52.50

As at	31.12.92	31.12.91	31.12.90
Face Value/Share (Rs.)	10	10	10
Book Value/Share (Rs.)	29.75	29.45	36.17
EPS (Rs.)	0.3	0.5	5.19
Dividend (%)	0.0%	12.5%	20.0%

The Market price of TOMCO share truly reflected the bleak outlook of the Company, hence it cannot be said that the market price as on 17.6.93 did not reflect the true picture of the value of the Company's shares.

On the market price basis as on 17.6.93 (the last price available before the circular letter dated 21.6.93 issued to the shareholders of the two Companies), the exchange ratio of 2:15 was very apt. If the yield method was adopted, the ratio would be astronomically high in favour of HLL. But, if the book value was taken per share, then TOMCO shares would be of higher value than HLL shares.

In this respect, the court has held that the usual rule is that shares of the going concern must be taken at quoted market value but in case of amalgamation, a combination of all or some of the methods of valuation may be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies. It was noted that even in such a situation, the book value method has been described as more of talking-point than a matter of substance.

(ii) With respect to the next contention that Valuer's report is not acceptable to the TOMCO shareholders as he was a Director of TOMCO, the courts observations were as under:-

The Valuer was a Director of TOMCO and HLL had no difficulty in accepting the share exchange ratio fixed by him, even though he was a Director of TOMCO. Hence if there was any bias, it should have been in favour of TOMCO and not against TOMCO.

(iii) With respect to the next contention that Valuation of Shares exchange ratio is grossly loaded in favour of HLL the Court’s observations were as under:-

- Jurisdiction of the Court in sanctioning a scheme of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetic test.
- A Company Court does not exercise appellate jurisdiction. It exercises a jurisdiction founded on fairness.
- What requires a thoughtful consideration is whether the Company Court has applied its mind to the public interest involved in the merger.

- It is not required to interfere only because the figure arrived at by the Valuer was not as better as it would have been if another method would have been adopted.
- What is imperative is that such determination should not have been contrary to law and that it was not unfair to the shareholders of the company which was being merged.
- Court's obligation is to be satisfied that valuation was in accordance with the law and it was carried out by an independent body.
- Since 95% of the shareholders who are the best judge of their interest and are better conversant with market trends agreed to the valuation determined, the court declined to interfere with the same.
- It was held that sales by open public auction or inviting tenders from general public may have fetched more price due to competition, but that could not result in vitiating the determination of the valuation. The amalgamation cannot be faulted for this reason.

(iv) With respect to the contention that the interest of employees of both the companies was not adequately taken care of, the Court's observations were as under:-

- The scheme of amalgamation provided that all the staff, workmen or other employees in the service of the transferor company (TOMCO) immediately preceding the effective date shall become the staff, workmen and employees of the transferor company.
- There were Clauses in the scheme of amalgamation that protected the interest by providing that the terms and conditions of such employees shall not be less favourable and all benefits such as PF etc. shall stand transferred to the HLL.
- The grievance of the employees that no safeguard had been provided for Hindustan Lever Employees Union appeared to be off the mark as it is the interest of the employees of TOMCO which had to be protected.

(v) With respect to the contention that a foreign company was being given a large interest in the assets of TOMCO at a gross undervalue the Court held as under:-

- The shareholder has no interest in the assets of the company while the company is in existence. It is only at the stage of liquidation of the company that the shareholders become interested in the assets of the company. The share of any member in a company is movable property and transferable in the manner provided by the Articles of the company.

(vi) The Apex Court also relied upon its judgement in the case of Fertilizer Corporation Kamgar Union v. Union of India, wherein it held that " ...it if not a part of the judicial process to examine entrepreneurial activities to ferret out flows. The Court is least equipped for such oversights. Nor, indeed, it is the function of the judges in our constitutional scheme. "Now merely because the scheme envisages allotment of 51% equity shares to Unilever, the scheme cannot be held to be against public interest.

In view of the aforesaid, the Appeals and the Special Leave Petitions were dismissed.

5. Key Learnings for Valuers from the above Case

(i) More than 95% of the shareholders who are the best judge of their interest and are better conversant with market trends agreed to the valuation determined and hence, it could not be interfered by Courts as, certainly, it is not part of the judicial process to examine entrepreneurial activities to ferret out flaws.

(ii) The Court in sanctioning a claim of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetical test. A Company Court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness. It is not required to interfere only because the figure arrived at by the Valuer was not as better as it would have been if another method would have been adopted. What is imperative is that such determination should not have been contrary to law and that it was not unfair for the shareholders of the company which was being merged. The Court's obligation is to be satisfied that valuation was in accordance with law and it was carried out by an independent body.

(iii) The following factors must be taken into account while determining the share exchange ratio. The stock exchange prices of shares of two companies, dividend presently paid on the shares of the company,

relevant growth prospects of two company, the cover (ratio of after-tax earnings to dividends paid during the year) for the present dividend of two company, the relative gearing of the shares of two company, the value of net assets of two company, voting strength in the merged enterprise of the shareholders, past history of prices of two companies.

(iv) It is not required to interfere only because the figure arrived at by the Valuer was not as better as it would have been if another method would have been adopted.

(v) It was further held that the exchange ratio determined cannot be considered as malafide merely on the fact that the share exchange ratio is calculated through combination of three well-known methods i.e., net worth, market value and earning method.

(vi) It was further held that "A financial institution holding 41% of shares of the transferor company did not find any fault in the valuation of share, the Court should not interfere with such valuation."

Orders passed by the Hon’ble High Courts

Case No. 7
Pr. Commissioner of Income Tax-2 Vs Cinestaan Entertainment Pvt. Ltd. (DEL HC) (2021)

IN THE HIGH COURT OF DELHI

Appellant: Pr. Commissioner of Income Tax-2
Vs.
Respondent: Cinestaan Entertainment Pvt. Ltd.

ITA 1007/2019 and CM Appl. 54134/2019

Decided On: 01.03.2021

1. Brief Facts of the Case

M/s. Cinestaan Entertainment Pvt. Ltd. (Respondent) was incorporated on 19.09.2013 and was engaged in the business of entertainment. During the AY 2015-16, the Respondent allotted shares at a very high premium to various persons and filed return of income for the Assessment Year with Nil income.

Pursuant to notice under 143(2) of the Income Tax Act, 1961 (herein after referred to as 'the Act') along with the notice under Section 142(1), the Respondent filed a Valuation Report dated 15.12.2014.

Assessment Order was issued under Section 143(3) of the Act and the total income of the Respondent-Assessee was assessed as Rs. 90,95,46,200/-. The findings of the Assessing Officer ('AO') were as follows:-

(i) No effort was made by the assessee for achieving the projections made in the Valuation Report as per Section 11UA of the Act. Assessee company had invested share capital and share premium received during the year in 0% debenture of associate companies. Hence, the projection made to issue the shares on premium as per Rule 11UA report is not justified with the actual working of the company.

(ii) The assessee failed to provide any scientific basis for adopting the projections/estimated figure used in valuation.

(iii) Assessee company booked a loss of Rs. 71,99,40,002/- in P&L A/c for the year ended 31st Mar 2017 on account of loss on sale of investment in unsecured compulsorily convertible debenture of Rs. 1000 each in M/s. Script Stories Media P. Ltd. Since, the investment was in zero percent debentures there was no scope of any income rather the transactions resulted in the loss of Rs. 71,99,40,002/-.

(iv) Even in 2017-18, the assessee company kept raising share capital on premium and at the same time booked losses on account of sale of zero percent debentures which are in contradiction of each other. Hence, the premium taken by the assessee is not justified even on merits.

Aggrieved by the assessment order, the Respondent preferred an appeal before the Commissioner of Appeals [CIT (A)], who upheld the additions made by the AO.

The second appeal before the ITAT was allowed in favour of assessee and the order of the CIT (A) was set aside.

Revenue appealed against the aforementioned order on the grounds that the Ld. ITAT has erred in law and on facts in deleting the addition made u/s 56(2)(vii)(b) of the Income Tax Act, 1961, by ignoring the sound reasoning and detailed analysis of the AO that the Cash Flow projections considered in the Discounted Cash Flow Method by the assessee are nothing but paper plans that have no relation with the reality.

2. Key Observations and Decision of ITAT

- It is the prerogative of assessee as to how much capital is to be raised based on its long-term and short-term funding requirements for the purpose of running its business.
- Any businessman or entrepreneur visualise the business based on certain future projections and undertakes all kinds of risks. It is the risk factor alone that gives a higher return to a businessman and the Income Tax Department or Revenue Official cannot guide a businessman in which manner risk has to be undertaken. Such an approach of the revenue has been judicially frowned by the Hon'ble Apex Court on several occasions.
- At the time when valuation is made, it is based on reflections of the potential value of business at that particular time and also keeping in

mind underline factors that may change over the period of time and thus, the value which is relevant today may not be relevant after a certain period of time.

- In DCF method, the value is based on estimated future projection and these projections are based on various factors and projections made by the management and the Valuer, like growth of the company, economic/market conditions, business conditions, expected demand and supply, cost of capital and host of other factors. These factors are considered based on some reasonable approach, and they cannot be evaluated purely based on arithmetical precision as value is always worked out based on approximation and catena of underline facts and assumptions.
- Section 56(2)(vii)(b) of the Income Tax Act,1961 is not applicable to genuine business transactions and the genuineness and creditworthiness of the strategic investors were not doubted by either the AO or the CIT(A). In accordance with sub clause (i) of explanation, the Respondent-Assessee had an option to carry out a valuation and determine the fair market value (FMV) only on the Discounted Cash Flow method (DCF), which was appropriately followed by the Respondent-Assessee.
- The shares were issued based on the valuation received from the prescribed expert i.e., a Chartered Accountant who used the DCF method which is one of the methods stipulated under Section 56(2)(vii)(b) of the Income Tax Act, 1961 read with Rule 11UA(2)(b) of the Income Tax Rules, 1962.
- Section 56(2)(vii)(b) of the aforesaid Act is a deeming provision and one cannot expand the meaning of scope of any word while interpreting such deeming provision. There has to be some enabling provision under the Rule or the Act where Assessing Officer has been given a power to tinker with the Valuation Report obtained by an Independent Valuer as per the qualification given in the Rule 11U of the IT Rules, 1962. Rule 11UA(2) of the said Rules does not give any power to the Assessing Officer to examine or substitute his own value in place of the value determined or requires any satisfaction on the part of the Assessing Officer to tinker with such valuation.
- The shares have not been subscribed by any sister concern or closely related person, but by outside investors who are one of the top investors

and businessmen of the country and if they have seen certain potential and accepted this valuation, then how AO or Ld. CIT(A) can question their wisdom.

3. Cases relied upon

- In the case of SA Builders and also in case of **CIT vs. Panipat Woollen and General Mills Company Ltd,** the Hon'ble Apex Court has held that Income Tax Department cannot sit in the armchair of businessman to decide what is profitable and how the business should be carried out. Commercial expediency has to be seen from the point of view of businessman.
- In the case of **Securities & Exchange Board of India & Ors.** [2015] [ABR 291] the Hon'ble Bombay High Court has held that:-
    - ❖ It is a well settled position of law with regard to the valuation that valuation is not an exact science and can never be done with arithmetic precision.
    - ❖ The attempt on the part of SEBI to challenge the valuation which is by its very nature based on projections by applying what is essentially a hindsight view that the performance did not match the projection is unknown to the law on valuations.
    - ❖ Valuation being an exercise required to be conducted at a particular point of time has of necessity to be carried out on the basis of whatever information is available on the date of the valuation and a projection of future revenue that Valuer may fairly make on the basis of such information.
- In the case of Rameshwaram Strong Glass Pvt. Ltd. Vs. ITO the learned ITAT has held that :-
    - ❖ DCF Method is essentially based on the projections (estimates) only and hence, these projections cannot be compared with the actuals to expect the same figures as were projected.
    - ❖ The Valuer has to make a forecast on the basis of some material but to estimate the exact figure is beyond its control.

- At the time of making a valuation for the purpose of determination of the fair market value, the past history may or may not be available in a given case and therefore, the other relevant factors may be considered.

4. Decision

- DCF methodology adopted by the Respondent is a well-recognized and well-accepted method. The Approach of Revenue that the performance did not match the projection slacks material foundation is irrational.
- Appellant-Revenue is unable to show that the assessee adopted a demonstrably wrong approach, or that the method of valuation was made on a wholly erroneous basis, or that it committed a mistake which goes to the root of the valuation process.
- Valuation is intrinsically based on projections which can be affected by various factors. We cannot lose sight of the fact that the Valuer makes forecast or approximation, based on potential value of business. However, the underline facts and assumptions can undergo change over a period of time.
- The Courts have repeatedly held that valuation is not an exact science, and therefore cannot be done with arithmetic precision. It is a technical and complex problem which can be appropriately left to the consideration and wisdom of experts in the field of accountancy, having regard to the imponderables which enter the process of valuation of shares.
- The shares have not been subscribed by any sister concern or closely related person, but by outside investors. Indeed, if they have seen certain potential and accepted this valuation, then Appellant-Revenue cannot question their wisdom.
- The appeal was dismissed and the order of Ld. ITAT was upheld.

5. Key Take Away for Valuers from the above Case

(i) DCF Method is essentially based on the projections (estimates) only and hence, Income Tax Authorities cannot adopt a hindsight view and compare these projections with the actuals to expect the same figures as were projected.

(ii) The value which is relevant today may not be relevant after certain period of time. At the time when valuation is made, it is based on reflections of the potential value of business at that particular time and also depends upon various underlying factors that may change over the period of time.

(iii) Courts have repeatedly held that valuation is not an exact science, and therefore cannot be done with arithmetic precision. It is a technical and complex problem which can be appropriately left to the consideration and wisdom of experts in the field of accountancy, having regard to the imponderables which enter the process of valuation of shares.

(iv) In DCF method, the value is based on estimated future projection and these projections are based on various factors and projections made by the management and the Valuer, like growth of the company, economic/market conditions, business conditions, expected demand and supply, cost of capital and host of other factors. These factors considered shall be based on some reasonable approach as they cannot be evaluated purely based on arithmetical precision.

(v) Valuation, other than rule-based, is an estimation and hence, the forecasts and projection cannot match the actual performance. Valuation at two different dates cannot be same due to change in the various internal and external socio-economic factors that impact the concerned asset. However, a Valuer and Assessee both shall analyse the variance between the actual and projections and prepare a just and proper reason to justify their valuation assumptions to AO.

(vi) Any Valuer when working on any projections and estimations works with some inherent limitations. A valuer can use various tools and analysis like regression analysis or trend analysis to limit risks of these assumptions and to determine the fairness of projections.

(vii) A valuer shall maintain documentation which provides:

   a. sufficient and appropriate record of the basis of the Valuation Report; and

   b. evidence that the valuation assignment was planned and performed in accordance with the ICAI Valuation Standards, 2018 or other applicable Valuation Standards along with other applicable legal and regulatory requirements.

Case No. 8
Cushman and Wakefield India Private Limited and Ors. Vs Union of India and Ors. (DEL HC) (2019)

IN THE HIGH COURT OF DELHI

Appellants: Cushman and Wakefield India Private Limited and Ors.
Vs.
Respondent: Union of India and Ors.

W.P.(C) 9883/2018, CM No. 38508/2018

Decided On: 31.01.2019

1. Brief Facts of the Case

The petitioners were engaged in the business of real estate consultancy services including provision of real estate valuation services. Being a subsidiary of a reputed body corporate they were universally recognized as a lauded leader in providing valuation service.

On October 18, 2017, Section 247 of the Companies Act, 2013 was notified along with the Companies (Registered Valuers and Valuation) Rules, 2017 (herein after referred to as Registered Valuers Rules, 2017), which provided that where a valuation is required to be made in respect of any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities under the provision of the Companies Act, 2013 it must be valued by a Registered Valuer.

Rule 3(2) of the Registered Valuers Rules, 2017 and in particular the rule 3(2)(a) of the said Rules explicitly provides that a company shall not be eligible to be a Registered Valuer, if it is a subsidiary, joint venture or associate of another company or body corporate.

Hence, it ousts the petitioner from being a Registered Valuer on the ground of it being a subsidiary of a body corporate.

Petition was filed to declare Rule 3(2) of the Companies (Registered Valuers and Valuation) Rules, 2017 as unconstitutional for violating Article 14, Article 19(1)(g) and Article 301 of the Constitution of India. The aforementioned rule 3(2) is reproduced as under:

"(2) No partnership entity or company shall be eligible to be a Registered Valuer if-

(a) it has been set up for objects other than for rendering professional or financial services, including valuation services and that in the case of a company, it is a subsidiary, joint venture or associate or another company or body corporate."

2. Issues raised by the Petitioner

(i) The petitioner held that it has over the years been instrumental in setting benchmark for high standards, transparency and fairness with respect to valuation services in India. Further, the petitioner had invested time, money and experience in creating a pool of resources to carry out quality valuation services in India.

(ii) The subsidiaries or joint ventures or associates of foreign and Indian companies will continue to impart more professionalism, quality, high standards and transparency in valuation industry.

(iii) The advent of Section 247 of the Companies Act, 2013, has impaired the right of the petitioners to carry on trade and business, which is guaranteed by the Constitution of India and it imposes unreasonable restriction on the petitioner's right to carry on trade and business.

(iv) The petitioner is not only discriminated against individuals and partnership entities but also such companies which are not subsidiaries, joint ventures or associates of other companies/body corporates.

3. Submission of the Respondent

(i) Explanation to Rule 1(3) of the Companies (Registered Valuers and Valuation) Rules, 2017 clearly stipulates that the conduct of valuation under any other law other than the Companies Act, 2013 shall not be affected by the coming into the effect of the Rules in question.

(ii) Valuers had been adopting divergent methodologies resulting in vast differences in their conclusions. Due to divergent valuation outcomes and criteria, asset valuation in India was not considered credibly. Credible valuation of assets is critical to the efficient working of the financial

market. Till the commencement of the Act and the Rules, there had not been any generally accepted and uniform standards in asset valuation system in India.

(iii) It is in order to regulate valuation profession under a regulatory regime and to guide and develop the same, the Parliament decided to bring in uniformly acceptable norms and generally accepted global valuation practices in India by incorporating a separate Chapter in the Companies Act, 2013 to set regulatory norms for various classes of asset valuation for the purposes of Companies Act, 2013.

(iv) Given the importance of valuation in fairness of business transactions, every effort has been made by the respondents to avoid situation of conflict of interest with an entity conducting the valuation. The endeavour of the Rules is to introduce a class of professionals where the focus is on the professional skills of the individuals rather than a business venture.

(v) There is a rational nexus to the object of disqualifying all entities with interest in other professions or business/enterprises so that the integrity of the profession be maintained and there is no conflict of interest. Hence, the Rules do not suffer from the vires of excessive delegation.

(vi) If a Registered Valuer Company is a subsidiary, joint venture or associate of another company, the said entity may not be able to stand out as an independent professional body. Hence, if valuation is allowed to be undertaken as a business by such entities, independence and credibility cannot be ensured.

4. Decision

The objective and intention behind laying down the impugned Rule is clearly to introduce higher standards of professionalism in valuation industry, specifically in relation to valuations undertaken for the purpose of Companies Act, 2013 and IBC, 2016. The impugned Rule obviates the possibility of conflict of interest on account of divergent interests of constituent/associate entities which resultantly shall undermine the very process of valuation, being one of the most essential elements of the proceedings before NCLT.

The court also relied upon the judgment of the Supreme Court in the case of **Dr. Haniraj L. Chulani** and held that the exclusion of a subsidiary company, joint venture or associate of other company, for purpose of eligibility for registration as a Valuer is reasonable.

Case No. 9
Cadbury India Limited (BOM HC) (2014) - Petition for reduction of Share Capital

IN THE HIGH COURT OF BOMBAY

Cadbury India Limited

Company Petition No. 1072 of 2009, Company Application No(s). 1332 of 2009, 71 and 120 of 2010

Decided On: 09.05.2014

1. Brief Facts of the Case

Cadbury India Ltd. was incorporated on 19th July 1948 under the name of Cadbury Fry (India) Pvt. Ltd. Cadbury India was a subsidiary of Cadbury Schweppes Overseas Limited which in turn was held by Cadbury Plc, UK. This was later taken over by Kraft Food Inc. Cadbury had a policy of operating globally only through wholly-owned subsidiaries; however, exceptions have had to be made only for compelling business reasons, foreign investment laws or foreign exchange restrictions. From 1948 to 1977 Cadbury India was a wholly-owned subsidiary of Cadbury Schweppes. In 1977, the policy of the Government then in power required Cadbury Schweppes to dilute its shareholding in Cadbury India from 100% to 60%. It was only then that Cadbury India ceased to be a wholly-owned subsidiary of Cadbury Schweppes.

Following economic liberalisation of 2002, FDI was allowed up to 100%. Thereafter, Cadbury Schweppes and another group company, i.e., Cadbury Mauritius Ltd. increased their collective holdings in Cadbury India to 90%, by making various open market offers, and public shareholding fell below 10%. Consequently, Cadbury India got de-listed from the stock exchanges. Over time, the shareholding of the Cadbury Group increased to about 97.58% through a series of open and buy back offers. The details of some of these are listed below.

Year of Buyback	Price per share	No. of shares bought Back
2002-2006	500	14,15,271
2006	750	13,52,605
2007	815	11,53,374
2008	950	10,20,300
2009	1030	11,16,168

2. Contentions/Allegation Raised

In 2009, only 2.4% of shares were held by public, CIL made an offer to these remaining minority shareholders at Rs. 1,340 per share, based on Valuation Reports of two reputed and independent Valuers. Against same petition was filed by the minority shareholders before the Bombay High Court on the contention that Cadbury India Ltd has been under-valued and they are being suppressed due to minority shareholding.

Observation/Decision of Court

Thereafter, an order was passed by the Hon'ble High Court appointing a third valuer as Independent Valuer. This valuation was to be as on the appointed date and based on the unaudited balance sheet as on 31st July 2009.

On the date of the petition, the issued share capital of Cadbury India Ltd. stood at Rs. 31,06,95,530 divided into 3,10,69,553 equity shares of Rs. 10/- each and the subscribed share capital was Rs. 31,06,70,400 divided into 3,10,67,040 equity shares of Rs. 10 each. The audited accounts of the Company for the year ending 31st December 2008, showing the financial position of the company was as follows:

Particulars	Rs in Mn
Net worth (share Capital & Reserves)	4,644.0
Secured Loans	320.2
Unsecured Loans	96.8
Fixed Assets (incl CWIP & Adv)	7,552.5
Investments	29.2
Current Assets Loan & Advances	5,818.8

Particulars	Rs in Mn
Current Liabilities & Provision	4,495.7
Net Current Assets	1,323.1
PBT 2008	2,018.9
PAT 2008	1,657.8

The Third Valuer submitted its Valuation Report on 20th May 2010 ("the first report") wherein it adopted the Comparable Companies Multiples ("CCM") method of valuation using Nestle, GSK & Britannia as the comparable companies, and returned a value of Rs. 1,743/- per fully paid-up equity share.

In the above reports, following were worth noting:

a) Valuer did not take into account any premium,

b) The PE multiple was arrived at considering factors like stock market trends, size and growth trends of comparable companies vis-à-vis CIL, market share of CIL in the chocolate segment.

c) The selected PE multiple was higher than the then prevailing PE multiples of BSE Sensex and BSE FMCG Index.

d) Nestle and Britannia both had factories located in tax benefit zone in Uttarakhand.

However, the minority shareholders opposed this report as well and produced their own valuation of Rs 2,500 per share and demanded that the valuation shall be done on DCF Method. This valuation of 2,500 was not based on any data or material pertaining to Cadbury India, but on the supposed market value of Nestle India Limited. The minority shareholders held that since on 19th January 2010, Nestle's shares were being traded at Rs. 2,542/- per share, Cadbury India's shares should be at least Rs. 2,500/-, for the two must be held to be "competitors". The court found the valuation approach completely untenable and further directed the Third Valuer to update its Valuation Report dated 20th May 2010 taking into account the valuation of the Company based on the Discounted Cash Flow ("DCF") method along with the CCM method.

Approach	Methodology	Used	Remarks
Market approach	Market Price method	No	• The shares of CIL were not listed on any stock exchange.
	Comparable Companies method	Yes	• This method was used considering that there were stocks of comparable companies like Nestle, GSK Consumer Healthcare and Britannia being traded on the Indian stock exchanges.
	Comparable Transactions method	No	• Method not used due to lack of availability of credible and complete data about the transactions in public domain.
Income approach	DCF method	Yes	• Initially, did not use this method as the financial projections were not provided. However, later with Court orders, CIL provided the same and the DCF method was used.
Cost approach	Net Asset Value	No	• CIL's business being a B2C business with huge brand recall, the value lied in the business operations and not the underlying assets of the Company. • Though there was value in the real estate owned by the company, however, all of these were being used for business operations.

The third Valuer performed valuation basis both the methods giving equal weightage to both and came up with a valuation of Rs. 2,014.5 per share. The basic assumptions considered in same were as under: -

(a) CAGR of sales for next 10 years considered at 18.3% as against 14.5% of last 10 years.

(b) Cost of Equity considered at 11%, wherein Rf = 7% and Rm = 15%; Beta Considered based on betas of comparable companies @ 0.50

(c) Debt/Equity Ratio = 0, hence WACC = Cost of Equity

(d) Terminal Growth Rate considered @ 6% based on comparison between future projections with past performance, and with the projections of comparable companies.

(e) Income Tax considered flat at 33.33% assuming that Tax regimes are liable to change at short notice. Hence in long run a flat tax rate in a projection might, in fact, provide a very realistic and fairer value than something that is presently at a lower marginal rate.

(f) Equal Weightage given to both CCM and DCF method to arrive at final valuation

The revised Valuation of Rs 2,014/- as well was challenged by the minority shareholders but the High Court, in a detailed judgment, agreed with third Valuers' approach and dismissed all objections raised against the Report.

3. Key Learnings for Valuers from the above Case

(a) The Court held that "In order to decline sanction it must be shown that the valuation is ex-facie unreasonable and cannot be accepted on the face of it. The mere existence of other possible methods of valuation would not be sufficient to deny sanction to such a scheme. It was held that the assent of the court would be given if:

  (i) the scheme is not against the public interest;

  (ii) the scheme is fair and just; and

  (iii) the scheme does not unfairly discriminate against or prejudice a class of shareholders"

(b) The sanctioning Court has no power or jurisdiction to exercise any appellate functions over the scheme as it is not a Valuer and it does not have the necessary skills or expertise. The sanctioning Court cannot substitute its own opinion for that of the shareholders. Its jurisdiction is

peripheral and supervisory, not appellate. The Court is not "a carping critic, a hair-splitting expert, a meticulous accountant or a fastidious counsel; the effort is not to emphasize the loopholes, technical mistakes and accounting errors".

(c) Valuation is not an exact science, it is always and only an estimation, a best-judgment assessment. All valuations proceed on assumptions and the fact that a particular estimation might not catch an objector's fancy is no ground to discredit it. To dislodge a valuation, it must be shown that those assumptions are such as could never have been made, and that they are so patently erroneous that the end result itself could not but be wrong, unfair and unreasonable.

(d) The Court must not venture into the realm of convoluted analysis, extrapolation, and taking on itself an accounting burden that is no part of its remit or expertise, and no part of a statutory obligation.

4. Decision of the Hon'ble High Court

The Hon'ble Bombay High Court held that the valuation of Rs. 2,014.50/- per fully paid-up equity share arrived at by the Court-appointed Valuer in its second (supplementary) report dated 29th July 2011 was accepted.

Case No. 10
Sanction to the Scheme of Amalgamation - Reliance Petroleum Ltd. with Reliance Industries Limited (BOM HC) (2009)

IN THE HIGH COURT OF BOMBAY

Sanction to the scheme of Amalgamation of

Reliance Petroleum Ltd. (Transferor Company) with Reliance Industries Limited (Transferee Company)

Company Petition No. 296 of 2009 and Company Application No. 288 of 2009

Decided On: 29.06.2009

1. Brief Facts of the Case

- The Petition was moved by Reliance-Industries Ltd. to obtain sanction to the scheme of Amalgamation of Reliance Petroleum Ltd. (Transferor company) with Reliance Industries Limited (Transferee Company). The Transferor Company was 75 per cent subsidiary of the Transferee Company.
- The Board of Directors of both the Transferor as well as Transferee Company in their respective Board Meetings approved the proposed scheme, keeping in mind the exchange ratio suggested by two well-known valuation firms. The said swap ratio was approved by two other reputed consultants appointed to give their fairness report.
- The Scheme was duly approved by overwhelming majority of the Equity shareholders and unanimously by the secured and unsecured Creditors.
- The Petition was moved by the Transferee Company for sanction of the scheme of amalgamation under Section 391/394 of the Companies Act, 1956 (now substituted by the Companies Act, 2013) on 6-4-2009.
- After publication of notice, three objectors came forward to oppose the Scheme.

- The Court noted from the record that the Petitioner company has complied with all the statutory formalities and the Scheme was approved with overwhelming majority of the Equity Shareholders and unanimously by the Secured Creditors, the Regional Director and the Registrar of Companies have also consented for approving the proposed Scheme. Ordinarily, in this backdrop, the Court would readily accord approval to the proposed scheme keeping in mind, the well-established position restated in the case of **Mafatlal Industries Ltd., In re [1996] 87 Comp. Cas. 792 (Guj): [1995] 3 SCL 69 (Guj.)**
    - It is well established that the Court cannot undertake the exercise of scrutinising the scheme placed for its sanction with a view to find out whether a better scheme could have been adopted by the parties. In the same decision, the Apex Court has observed that such exercise remains only for the parties and is in the realm of commercial democracy permeating the activities of the concerned creditors and members of the company who in their best commercial and economic interest of majority agree to give green signal to such a compromise or arrangement.
- The objectors vehemently argued that the Court should decline to exercise its discretion according to approval to the proposed scheme.

2. Contentions & Allegations raised by the Objectors and Observations of the Ld. High Court for same.

(i) Contention no. 1

Firstly, it was contended that the act of the Petitioner Company smacks of undue haste, as can be seen from the admitted dates. In that, the Board Meeting of the Transferee Company was held on 27-2-2009, in which decision to amalgamate two companies was taken. It was a Friday. It is intriguing that in a short interval of only two days during the weekend, Valuation Report was prepared on Monday 2-3-2009. Not only that, the fairness report of other two experts were obtained on the same day on 2-3-2009 and the Board of Directors proceeded to pass resolution at 10.15 a.m. on the same day on 2-3-2009. These circumstances clearly indicate that the matter was hastened by the Petitioner Company for reasons best known to them and it is a clear case of non-application of mind - not only of the Board of Directors, but also by the Valuers appointed by the Petitioner Company.

Observation of the Court

If, the meeting of the transferee company was held on 27-2-2009 and the report of the experts were made ready on 2-3-2009 coupled with the fact that the Board of Directors approved the proposed scheme on the same day on 2-3-2009, that, by itself does not mean that it is a case of non-application of mind. The fact that the entire process was completed in short spell, may at best indicate that the Experts gave their opinion on urgent basis. We cannot be oblivious to the developments in computer technology where the working of calculations can be programmed.

The report of the Valuer and the Fairness Report prepared by subsequent Valuers if read as a whole, takes into account all the relevant factors which ought to be kept in mind to form an opinion about the swap ratio.

The valuers have indicated the approach and the basis of the amalgamation. It has referred to four possible methods that could be borne in mind for arrival of the decision. Each method has been analysed in the Report. As far as **Net Asset Value Methodology** is concerned, it was mentioned that the Valuers have computed Net Asset Value of equity shares of both the companies. They have used the provisional consolidated balance sheet as at 31-12-2008 of RIL, and provisional balance sheet as at 31-12-2008 of RPL to make suitable adjustments as deemed appropriate. The valuers have adverted to the **Comparable Companies' Multiple (CCM) Method.** It is noted in the Report that the Valuers have used Enterprises Value (EV) to EBITDA valuation multiple of comparable listed companies for the purpose of the valuation analysis. They have then considered **Historical and Current Market Price Method** which is with reference to the equity shares quoted on a Stock Exchange. in the present case shares of RIL and RPL are listed on BSE and NSE and there are regular transactions in their equity shares with reasonable volumes. Keeping that in mind, the volume weighted average share price of RIL over an appropriate period was considered for determining the value of RIL and RPL under the market price methodology. It is clearly mentioned that **Discounted Cash Flows (DCF)** Method was not applied in the facts of the present case.

Decision of the Court

The objectors had not substantiated in plea as to why the swap ratio determined by the Experts is wrong. No other Expert Report is relied upon by the Objectors to make good that argument. Nor any legal basis is pointed out

to discard the said Valuation/Fairness Reports. If so, this Court cannot sit over the decision of the Board of Directors and of the class of stakeholders as Court of Appeal and scrutinise the criticism pressed into service by the Objectors disregarding the commercial wisdom of the overwhelming majority of the Equity Shareholders as a class.

It is not the case of the objector that necessary material indicated under Section 393 of the Companies Act, 1956 was not placed before the voters at the concerned meeting, as was required to be held in terms of Section 391 of the said Act and directions given by this Court.

(ii) Contention no. 2

The next criticism was in relation to the contents of the Valuation Report. It was pointed out that the Valuers' Report if read clause by clause or as a whole clearly indicated that no details are forthcoming. Forecast was not given, nor the valuation of the shares of the Transferee Company and the basis on which the same is done could be discerned and the experts have given their opinion without analysing the relevant matter. Further, it was submitted that the report clearly admits the fact that due diligence had not been carried out and gives conflicting opinions, without disclosing any logic.

Observation of the Court

On reading the reports clause by clause and as a whole, no fault could be found with the ultimate opinion reached by the experts regarding share swap ratio, which is founded on tangible material and basis. The fact that the language of the report would give an impression that the Expert does not take the responsibility of the accuracy of the figures furnished to them by the Company or that they have not made any independent valuation of the assets and liabilities of the companies on their own, does not mean that the relevant factors for determination of swap ratio have not been considered by the experts. Obviously, the opinion of the Experts is based on the information provided by the Company. There is nothing to show that the figures available in the Books of Account provided to the Experts were incorrect or otherwise. Thus, there is nothing in the said Reports to indicate that the consideration weighed with the Experts in arriving at the opinion is impermissible or unacceptable.

Decision of the Court

The Court relied upon the judgement of the Madras High Court in the case of Kamala Sugar Mills Ltd and of the Apex Court in the case of Miheer H. Mafatlal v. Mafatlal Industries Ltd. and held that no one has doubted the integrity and honesty of the Valuers, who have given their Share Valuation Report or Fairness Report, as the case may be. Nor the objectors have been able to point out that the method adopted by the Valuers was impermissible or absurd. Therefore, there was no reason to discard the valuation of shares or the swap ratio determined by the Experts.

(iii) Contention no. 3

A crucial fact that there are some proceedings pending regarding Gas Supply Agreement between the Petitioner Company and M/s. Reliance Natural Resources Ltd. had not been taken into account. For, the impact due to the outcome of the said proceedings qua the Petitioner Company had not been reckoned at all; though relevant. Indeed, the reply filed by the Petitioner Company records that the same has been duly considered, which fact, however, cannot be substantiated from the reports.

Observation and Decision of the Court

The Petitioner in the reply filed before the Court has stated that the facts relating to the said proceedings have been in the public domain. The valuers and advisors were aware of and took the same into account as is normally done in similar circumstances. Even if this statement appearing in the affidavit was to be ignored as it is not supported by the contents of the Reports it would make no difference. Inasmuch as, once the Valuation Report is accepted, the impact due to the outcome of the pending legal proceedings cannot be the basis to reject the scheme propounded by the Company, especially when the same has been approved by overwhelming majority of shareholders and unanimously by the secured and unsecured creditors.

(iv) Contention no. 4

It was argued that 41 percent shares of the Petitioner Company had been acquired by group companies and the swap ratio determined was unfair to the Shareholders of the Petitioner Company. Counsel for the said objectors in the alternative submitted that the Court may direct revaluation and invite fresh report from an Independent Valuer.

Observation and Decision of the Court

There is force in the submission made on behalf of the Petitioner that at best there is a grievance concerning mis-utilisation of funds of the group company, which cannot be reckoned while considering the issue of approval of the scheme submitted under Section 391 of the Act by the transferee-company.

(v) Contention no. 5

It was argued that the two companies ought to prepare separate books of account which alone would facilitate the true valuation of the shares of the respective companies. Relying on the averments in the affidavit filed by the Regional Director that all intercompany transactions between the Transferor Company and Petitioner Company will be eliminated in the Books of Account, it was argued that even Regional Director had taken exception to grant of approval to the proposed scheme.

Observation and Decision of the Court

For, elimination of all transactions between the transferor and transferee-company would be the natural consequence of merger. In as much as, the transaction of transferor-company would naturally be adjusted after the merger and would not continue to remain in the books of account of the transferee-company. Even the argument of the objectors that separate accounts of the two companies ought to be prepared is an argument of desperation.

(vi) Contention no. 6

It was also argued that there were certain proceedings and investigations pending against the Petitioner Company before the Regulatory Authority. The attempt of propounding the present scheme was to frustrate the said pending action. For all these reasons, it was argued that the Court may reject the present Petition. These are the broad arguments that were canvassed across the bar.

Observation and Decision of the Court

As far as the apprehension of the objectors that consequent to merger, the petitioner-company would be extricated from all pending proceedings and investigations pending before the Regulatory authority, the same is also misplaced. There is no such provision in the present Scheme. On the other

hand, the pending proceedings and investigations will have to be continued and carried to its logical end irrespective of the approval to the present scheme of merger.

3. Key Learnings for Valuers from the above Case

(i) The scope of intervention by the Company Judge while considering the scheme of amalgamation such as the present one, is no more res integra.

If the company has complied with all the statutory requirements and formalities and the Regional Director as well as Registrar of Companies including the concerned Stock Exchanges have given their approval/consent to the proposed scheme and the scheme not being prejudicial to any stakeholders of the petitioner-company or public, the Petition deserves to be allowed.

If all the requisite material envisaged under Section 391(2) of the Companies Act, 1956 have been placed before the court, then it is not possible for the Court to take a view that the scheme is prejudicial either to the shareholders or the public. It is not the case of the objector that necessary material indicated under Section 393 of the said Act was not placed before the voters at the concerned meeting, as was required to be held in terms of Section 391 of the said Act and directions given by this Court.

(ii) The Court will have no jurisdiction to sit over the commercial wisdom of the majority of the class of persons, who with their open eyes have given approval to the scheme. Merely because some other method of valuation could be resorted to and would be a bit favourable to the shareholders; that alone cannot militate against granting approval to the scheme propounded by the Company. The Court expounded that what is imperative is that the determination should not be contrary to law and/or unfair for the Shareholders of the Company which was being merged. The Court's obligation is to be satisfied that valuation was in accordance with law and it was carried out by an independent body.

(iii) Valuation though backed by research and analysis involves significant amount of judgment and hence, the Valuer needs to select the most appropriate approach or method very responsibly as there is no single

approach or method that is best suited in every situation. In the given case too, the Valuer has used three different approaches in arriving at the swap ratio.

(iv) The valuation approaches and methods shall be selected in a manner which would maximize the use of relevant observable inputs and minimise the use of unobservable inputs.

In the given case shares of RIL and RPL were listed on BSE and NSE and there were regular transactions in their equity shares with reasonable volumes. Keeping that in mind the Valuer considered the volume weighted average share price of RIL over an appropriate period for determining the value of RIL and RPL under the Market Price methodology and clearly mentioned that Discounted Cash Flow (DCF) Method was not applied in the facts of the present case.

(v) The valuation methodology adopted by the Valuer, which includes various methods under the Income, Market and Cost Approaches has to be disclosed. The rationale and appropriateness for the adoption of a particular valuation methodology or combination of methods in the context of the valuation of a business or asset should be clearly justified. The Report should disclose the rationale for exclusion of a valuation methodology.

(vi) In the case of **German Remedies Ltd.**, the Hon'ble Bombay High Court held that

"It is to be kept in mind that the exchange ratio is in the realm of commercial wisdom of well-informed equity shareholders. It is not for the court to sit in appeal over the valued judgment of the equity shareholders who are supposed to be commercial men…."

"The limited jurisdiction of the Court is only to see whether the ratio is so wrong or the error is so gross as would make the scheme unfair or unjust or oppressive to the majority of the members or any class of them...."

(vii) Key material factors include inter alia the size or number of the corporate assets or shares, their materiality or significance, minority or majority holding and changes on account of the transaction, any impacts on controlling interest, diminution, or augmentation therein and marketability or lack thereof; prevailing market conditions and government policy in the

specified industry should be described in the report. Here it will be relevant to mention that disclosure of projected financial information should be done taking into consideration aspects of confidentiality, regulatory requirements, purpose of valuation, and potential of misuse by users and competitors.

Case No. 11
Sanction to the Scheme of Amalgamation - Shrey Promoters Private Limited with EMAAR MGF Land Private Limited (DEL HC) (2006)

IN THE HIGH COURT OF DELHI

In the matter of the Companies Act, 1956
under Sections 391(2) to 393 of the Companies Act, 1956

Scheme of Amalgamation of
Shrey Promoters Private Limited
with
EMAAR MGF Land Private Limited

CP No. 134/2006

Date of Decision: October 9, 2006

1. Brief Facts of the Case

- A petition under Section 391(2) to 393 of the Companies Act, 1956 (hereinafter referred to as the Act) was filed by M/s Shrey Promoters Private Limited (hereinafter referred to as the transferor company) and M/s EMAAR MGF Land Private Limited (hereinafter referred to as the transferee company).
- Both the transferor and transferee companies were owned and controlled substantially by the same group of shareholders. The transferor company and transferee company were private limited companies and had two and three shareholders respectively as on 15th Dec 2005.
- The transferor company was incorporated on 6th Oct 2005 and the transferee company was incorporated on 18th Feb 2005. The transferee Company was incorporated in terms of joint venture agreement dated 18th Feb 2005 between Emaar Properties PJSC Dubai and MGF Group Ltd.

- The transferee company had transferred huge funds to the tune of Rs. 1,617 Crores to the 31 subsidiaries of the transferor companies before 6th Dec 2005 i.e., within about two months, when the transferor company was incorporated.
- The transferor company itself did not own any land and the land was owned by 31 subsidiaries of the transferor company who were flushed with money and funds provided by the transferee company.
- The investment/advances given by the transferee company of Rs. 1,617.82 crores as on 15th December, 2005 was much more than the paid-up share capital of Rs. 7 crores of the transferor company. This paid-up share capital was utilized by the transferor company for purchase of shares in the 31 subsidiary companies at cost price of Rs. 6.60 crores. Thus, the 31 subsidiary companies of the transferor company used advance/investment made by the transferee company to purchase land.
- Total net value of investments made by the 31 subsidiary companies on or before 15th December, 2005 was Rs. 6.93 crores (the specific dates on which these investments have been made have not been stated). Within about two months from incorporation of the transferor company on 6th October, 2005 till 15th December, 2005, the market value of the said investments of Rs. 6.93 crores made by the 31 subsidiary companies is stated to have increased to Rs. 1,662.80 crores.
- On the basis of the market value of the investments made by the 31 subsidiary companies as per the valuation report, within about two months, value of each issued share of the transferor company went up from Rs.10/- to Rs. 2376/- per share.
- After 15th December 2005, the transferee company had issued 2,96,00,000 shares of Rs.10 each @ Re.1 paid up value to two foreign companies and 30,00,000 shares of Rs.10 each to Mr. Shravan Gupta at paid up value of Re.1. It was not stated that the said shares have been issued at premium, though earlier the joint venture partner had agreed to purchase shares of the transferee at premium of Rs. 540/- per share and another investor had agreed to purchase shares at a premium of Rs.1547.84 per share.
- The post-merger shareholding pattern shows that the two foreign companies held about 45% shares and the Indian group about 60% shares in the transferee company.

2. Objections raised by the Regional Director and Official Liquidator

The official liquidator was of the view that the affairs of the transferor company were/are not being conducted in a manner which is prejudicial to the interest of public. The Regional Director raised the following objections: -

- The first objection raised by the Regional Director was with respect to increase in authorised share capital of the company, which is possible only as per the prescribed procedure under the Act and on payment of requisite fee and stamp duty. However, the said objection was overruled by the Hon'ble court in view of its decision in the case of ***Hotline Hol Celdings Pvt. Ltd. and Ors.*** Further, the transferee company agreed to give an undertaking to that and any allotment and paid-up share capital shall be within the authorised share capital as per the scheme and the allotment, if any, shall be made in accordance with the law.
- The Second objection raised was with respect to the issues arising out of the balance sheet of the company. The transferee company had given advances of Rs.1,617.82 crores to the 31 subsidiary companies of the transferor company for the joint venture projects and the said companies have, therefore, used the share application money for business purpose for purchase of land.
- The next contention was on Valuers Report. As per the Valuer each issued and paid-up equity share of Rs 10/- of the transferor company was valued at Rs. 2,376/-per share. This was on account of the value of land purchased by the 31 subsidiary companies of the transferor company. The Valuer in his Valuation Report expressed as under which is not correct: -
    - "The ultimate test of value is the willingness of the parties to enter into the contract at an agreed price"

3. Submission by the Applicant Companies

- With regards to the second objection on advances given by the transferee company to the subsidiary of transferor company, it has been stated that these advances have been given in normal course of business and are in conformity between the understanding and arrangement between the transferor company and the transferee company.

- It was further submitted that both the transferor and transferee companies were owned and controlled substantially by the same group of shareholders and, therefore, valuation of share and determination of share exchange ratio has to be considered in light of same. Reference was also made to the unequivocal and unanimous consent letters given by the shareholders to the scheme of amalgamation and the exchange ratio mentioned therein.
- In respect of the third objection, it was submitted that the valuer had acted on the basis of land valuation report of a government-approved valuer. It was also submitted that the valuer determined the value of each share of the transferor company at Rs.2,376/- by following an accepted method of valuation and has furnished cogent reasons for adopting the said valuation. With regard to the share exchange ratio, it was also submitted that the shareholders of transferor company and transferee company are substantially the same persons and, therefore, the share exchange ratio cannot be a valid ground to object to the scheme of amalgamation.

4. Key Observations in the Case

(i) The transferor is a shell company doing no activity of its own. The entire paid-up capital of Rs. 7 Crores stands transferred as subscribed and paid capital of the 31-subsidiary company.

(ii) It is also quite apparent that there is a tacit understanding between the two joint venture partners, the exact details and particulars have not been brought out and have been hidden under the veil of secrecy. Why and for what reason funds from the transferee company were transferred to the 31 subsidiaries remains unknown. Nothing prevented and it defies logic why the transferee company did not float and incorporate these 31 subsidiary companies or purchase land on its own?

(iii) It is also not explained why one promoter/joint venture partner of the transferee company did not invest and purchase shares in the transferor company itself? This has not been done but a cumbersome and difficult procedure to obtain the sanction of this Court with the proposed scheme has been resorted to. It is obvious that the transferor company and the transferee company seek, seal of approval from this court on the scheme. They have in mind the proposed initial public offering.

(iv) The dates on which subsidiary companies were incorporated have not been stated and how and when the said 31 companies became subsidiaries of the transferor company is also not mentioned. The dates on which subsidiary company purchased land have also not been mentioned.

(v) The valuer had justified valuation of shares of the transferee company on book value basis as the said company was passing through a transitional phase. Value of each issued share of the transferor company on 15th December 2005 has been done on market value of investments made by the 31 subsidiary companies. The valuer probably overlooked that the transferor company was incorporated two months back only on 6.10.2005 and the transferee company was incorporated earlier on 18.2.2005 and was the joint venture vehicle as per the terms of the joint venture agreement.

(vi) The Valuation report is a well-guarded and evasive document, which neither affirms nor negates the valuation made. The Report and the "limitations" mentioned by the Valuer have been quoted below.

In the course of valuation, Valuer was provided with both written and verbal information, including market, technical, financial and operating data. "*We have evaluated the information provided to us by the management of Emaar through broad inquiry, analysis and review. We have not independently investigated or otherwise verified the land valuation reports. Through the above valuation, nothing has come to our attention to indicate that the factual information provided was materially misstated/incorrect or would not afford reasonable grounds upon which to base our report. We do not imply, and it should be construed that we have verified any of the information provided to us, or that our inquiries could have verified any matter, which a more extensive examination might disclose. The terms of our engagement were such that we were entitled to rely upon the information provided by the managements of Emaar/Shrey/MGF without detailed inquiry. Also, we have been given to understand by the management that it has not omitted any relevant and material factors and it has checked out relevance or materiality of any specific information to the present exercise with us in case of any doubt. Accordingly, we do not express any opinion or offer any form of assurance regarding its accuracy and completeness. Except where specifically stated otherwise, our conclusions are based on the assumptions, forecasts and other information given by/on behalf of the company. Emaar MGF has indicated to us that it has*

understood that any omissions, inaccuracies or misstatements may materially affect our valuation analysis/results. Accordingly, we assume no responsibility for the technical/financial information furnished by Emaar/MGF/Shrey and believed by us to be reliable."

5. Court's Decision and Judgement

- The Hon'ble High Court held that it would not have gone into all these aspects knowing fully well the jurisdiction of this Court, but it cannot close its eyes especially in view of the fact that the transferee company is, in the near future, going to invite public to invest in its shares at a premium.
- It was held that a valuer is required to give fair, objective and an independent report as he is fully aware that the report shall form basis of the order for sanction of the scheme. In view of the reservations and limitations expressed by the approved valuer, the valuer himself is uncertain and full of skepticism about his own valuation. A hesitating report is meaningless.
- It is difficult to act on this report and accept that within two months from October, 2005 to December, 2005 the value of each share of the transferor company increased from Rs. 10/- to Rs.2376/-. It is like hitting repeated jackpots in derbies or winning series of lottery tickets.
- The Hon'ble High Court further placed reliance on its decision in the case of ***Mihir Chakarborty V/s Multi tech Computers Pvt. Ltd. and Ors. (2001)*** and held that normally Courts accept Valuation Reports given by experts, but this cannot be done in an impetuous manner unconcerned and oblivious of the reservations expressed and the guarded language used in the Report.
- The Hon'ble High Court held that it is conscious of the role of the Court under section 391 -394 of the Act, while deciding the question whether a scheme should be sanctioned. Opinion of the shareholders and creditors have to be given due weight. Their collective wisdom should not be substituted. However, such opinion is not conclusive. The court not only has inquisitorial or supervisory role but has to also ensure that the scheme is genuine, bonafide and in good faith. Without acting as a carping critic and being fastidious, the court can independently apply its mind to satisfy itself that the scheme is prima facie reasonable as a whole. The scheme must be such, as a reasonable man of business

would approve. The Hon'ble high court also cited the words of the Hon'ble Apex Court in the case of ***Employees' Union V/s Hindustan Lever Ltd. (1995)*** that the scheme shall pass the "prudent business management test".

- The Court relied upon the decision of Hon'ble Apex Court in the case of Miheer H. Mafatlal v. Mafatlal Industries Ltd., (1997) and held that it is in the public interest to over-ride the scheme. Public policy can have many connotations but in the present case, it is contrary to justice, detrimental to commercial morality and interest of public at large.
- The Hon'ble High Court lastly held that the scheme is also rejected for failure to disclose all material facts. Pursuant to the Daphtry Sastry Committee report, proviso to section 391(2) of the Act was inserted. The petitioners must candidly place all relevant facts before the court to judge the scheme on its own merits.

6. Key Learnings for Valuers from the above Case

(i) In the given case the Hon'ble High Court held that *"**a Valuer is required to give fair, objective and an independent report** as he is fully aware that the Report shall form basis of the order for sanction of the scheme."*

Further in Para 17-18 of **Framework of ICAI Valuation Standards, 2018** it has been stated that:-

"17. To be reliable, the information presented in a valuation report must represent faithfully what it purports to represent. Faithful representation has three characteristics, namely, error-free, neutrality and completeness.

18. Sometimes the information in the valuation report is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias but may arise due to inherent difficulties either in identifying the appropriate method, approaches or techniques to be applied in valuation."

A Valuer shall always remember that the right to practice a profession carries a duty to protect the society and is not a privilege for the benefit of the professional. A professional should not only be competent to practice, but he must also enjoy the trust and respect of his stakeholders.

(ii) In the above case the respondents contended that the valuer had acted on the basis of land valuation report of a government approved valuer. But nowhere in his report the Valuer provided the reason as in how within two months from October, 2005 to December, 2005 the value of each share of the transferor company increased from Rs. 10/- to Rs.2376/-.

While **relying upon the work of an expert** a valuer shall evaluate the skills, qualification, and experience of the other expert in relation to the subject matter of his valuation.

Further Para 40-43 of **ICAI Valuation Standard 201-** Scope of Work, Analyses and Evaluation clearly lays down the guidelines for valuers while placing reliance upon the work of other experts.

"40. A valuer shall evaluate the skills, qualification, and experience of the other expert in relation to the subject matter of his valuation.

41. A valuer must determine that the expert has sufficient resources to perform the work in a specified time frame and also explore the relationship which shall not give rise to the conflict of interest.

42. If the work of any third-party expert is to be relied upon in the valuation assignment, the description of such services to be provided by the third-party expert and the extent of reliance placed by the valuer on the expert's work shall be documented in the engagement letter. The engagement letter should document that the third-party expert is solely responsible for their scope of work, assumptions and conclusions.

43. A valuer shall specifically disclose the nature of work done and give sufficient disclosure about reliance placed by him on the work of the third-party expert in the valuation report."

(iii) In the above case the Hon'ble high Court held that "*normally courts accept valuation reports given by experts, but this cannot be done in an impetuous manner unconcerned and oblivious of the reservations expressed and the guarded language used in the report."*

"The Valuation report is a well-guarded and evasive document, which neither affirms nor negates the valuation made."

Hence, a valuer shall always remember that a Valuation Report should not carry a disclaimer or limitation which has the potential to dilute the

responsibility of the Registered Valuer or makes the valuation unsuitable for the purpose for which the valuation was conducted. In this regard one can also refer to the Guidelines issued by the Insolvency and Bankruptcy Board of India (IBBI) on Use of Caveats, Limitations and Disclaimers by the Registered Valuers in Valuation Reports.

Case No. 12
Dinesh Vrajlal Lakhani Vs. Parke Davis (India) Ltd. (BOM HC) (2003)

IN THE HIGH COURT OF BOMBAY

Appellant: Dinesh Vrajlal Lakhani
Vs.
Respondent: Parke Davis (India) Ltd.

Appeal No. 261 of 2003 and Company Application No. 894 of 2002

Decided On: 23.07.2003

1. Brief Facts of the Case

Under the Scheme of Amalgamation, the undertaking of Parke-Davis (India) Ltd. were transferred and vested in Pfizer Ltd. pursuant to the provisions of Section 394 of the Companies Act, 1956, (now substituted by the Companies Act, 2013) as a going concern with effect from 1st December, 2001.

Pfizer, the transferee was incorporated on 21st November, 1950 with the object of carrying on the business of the manufacture of and of a dealer in pharmaceutical, medical, chemical, industrial, and other preparation and articles.

Parke Davis, the transferor, was incorporated on 18th April, 1958, with the main object to manufacture, refine, import, export, buy, sell and deal in drugs, medicines and chemicals, pharmaceutical, herbal, bacteriological and biological products and the preparation of all kinds of toilet articles and cosmetic articles.

- **The benefits of the amalgamation were cited as under:**
  - (i) Since both the transferor and transferee are manufacturers of pharmaceutical formations, and of nutritional and supplementary products the amalgamation would provide synergistic linkages and economies in cost by combining the total business functions and related activities;

(ii) As a result of enhanced capabilities and resources, the amalgamated Company will have greater flexibility to market and meet customer needs and will be able to compete more effectively thereby strengthening its market position;

(iii) The amalgamated Company will have the benefit of the combined reserves, manufacturing and other assets, manpower and cash flows of the two companies;

(iv) The Scheme will make available the benefit of financial resources, as well as the managerial, technical, distribution and marketing expertise of each of the Companies;

(v) The amalgamated Company will be able to source and absorb new technology and its capacity to spend on Research and Development will be enhanced;

(vi) A larger and growth-oriented company will mean enhanced financial and growth prospects for the people and organisations connected with the Company and will be in public interest; and

(vii) The amalgamated Company will have a balanced portfolio of products, thereby insulating the business from dependence on one or two product areas.

2. Scheme of Events

(i) The Scheme of Amalgamation was proposed and approved by the Boards of Directors of the transferor and transferee in separate meetings held on 27th June, 2002.

(ii) The proposed Scheme of Amalgamation provided for a share exchange ratio wherein the Transferee was required to issue and allot 4 equity shares of Rs.10/- each to every equity shareholder of the Transferor whose name appears in the Register of Members on the record date for every 9 equity shares of Rs.10/- each held in the Transferor. The Board of Directors of the Transferor and the Transferee accepted the suggested ratio worked out by the two Valuers.

(iii) On 21st August, 2002, a meeting of the equity shareholders of the transferor was convened. 53 shareholders representing in the aggregate 55,43,479 shares or 99.94% in terms of the total percentage/value, voted

in favour of the resolution, 46 shareholders representing 2872 shares voted against the resolution. There were 15 invalid votes.

(iv) Before the Learned Company Judge, there were 16 objectors who opposed the Scheme of Amalgamation. The objections raised by the objectors were:

a) The swap ratio proposed in the Scheme of Amalgamation was unfair to the shareholders and against the interest of minority shareholders of the Transferor;

b) The detailed valuation report of the Chartered Accountant was not made available to the objectors;

c) Shri Lakhani had moved a resolution for amendment of the swap ratio but the amendment was rejected by the Chairman without putting it to vote;

d) The Chairman had not conducted the proceedings properly; he was the Chairman of the Board of Directors of the Transferor and an alternate Director of the Transferee, besides being a partner of Solicitor of both the Transferor and Transferee. It was contended that the Chairman had a vested interest in the Scheme of Amalgamation and his acting as Chairman of the meeting was prejudicial to the interest of the members of the Company;

e) The Chairman had not disclosed in his report to the Court that 18 persons had spoken against the resolution, nor did he mention that the amendment to the resolution had been moved;

f) There were discrepancies in the report of the scrutineers and several votes had been shown as invalid without assigning any reason;

g) Several persons had voted more than once in the Meeting which was impermissible under the law;

h) Objections had been filed that there were workmen of the Transferor whose services had been terminated and on whose behalf, proceedings were pending before the Deputy Commissioner of Labour.

(v) The Learned Single Judge has allowed the Company Petition and sanctioned the proposed amalgamation.

3. The Hon'ble High Court's Observations and Decision

- The swap ratio or exchange ratio that forms the basis of the compromise or arrangement is a matter of expert determination. The judgments of the Supreme Court in Hindustan Lever Employees Union's case (supra) and in Miheer H. Mafatlal v. Mafatlal Industries Ltd. [1996] (supra) held that the swap ratio is an expert determination, often made by Chartered Accountants of repute by which the valuation which is adopted is reflected in the exchange ratio.
- It is entirely for the members in their commercial wisdom to determine whether the Scheme of Amalgamation as proposed should be accepted or rejected. The members are entitled to determine as to whether the swap or exchange ratio ought to be accepted or rejected. The members have to decide whether the exchange ratio which forms the basis of the Scheme of Amalgamation is or is not in their interest. That is a matter of their commercial wisdom.
- The swap ratio is an integral part of the proposal which is before the meeting and an amendment to the swap ratio will operate to nullify the basis of the Scheme of Amalgamation. Whether the Scheme of Amalgamation should or should not be accepted is for the members of the Company to decide but, there can be no gain saying that an amendment to the swap ratio would nullify basis and foundation of the Scheme of Amalgamation. Consequently, the Chairman of the meeting was justified in his ruling that the amendment to the swap ratio that was proposed by Shri Lakhani had to be ruled as not in order.
- In so far as the objections filed by the workers were concerned, the Learned Judge noted that they were no longer in the employment of the Company and their matters were pending either before the appropriate Court or the Commissioner of Labour. There was an averment in the petition that all pending litigation of the transferor would be contested by the transferee and all liabilities that may be incurred by the transferor would be taken over by the transferee.
- In view of the above, it was held that the interests of these workers were duly protected. Having regard to these facts and circumstances, the Learned Single Judge had allowed the Company Petition and sanctioned the proposed amalgamation.

- It was ruled that the Court will not for instance interfere only because the valuation adopted by the valuer may have been improved upon had another method been adopted. The Court is neither a valuer nor an appellate forum to re-appreciate the merits of the valuation. What the Court has to ensure is that the determination should not be contrary to the law or unfair to the shareholders of the company which has been merged.
- The Court held that the Learned Company Judge was correct in sanctioning the Scheme of Amalgamation. There is no merit in the objections raised by the Appellant.

4. Key Learnings for Valuers from the above Case

i) The Scheme of Amalgamation has received an overwhelming support of 99.94% of the shareholders. The shareholders in their commercial wisdom have thought it fit that the Scheme should be approved.

ii) The jurisdiction of the Court in such matters is not appellate in nature but is founded on fairness. The Court will not interfere only because the valuation adopted by the Valuer may have been improved upon had another method been adopted. The Court is neither a valuer nor an appellate forum to reappreciate the merits of the valuation.

iii) What the Court has to ensure is that the determination should not be contrary to law or unfair to the shareholders of the Company which has been merged. In Hindustan Lever Employees Union s case (supra), the Supreme Court held that it is not a part of the judicial process in such a matter "to examine entrepreneurial activities to ferret out flaws".

iv) Where more than 95 per cent of the shareholders had agreed to the valuation determined by the Chartered Accountant, the procedural irregularities which were present in it could not vitiate the determination.

v) In the case of Miheer H. Mafatlal vs. Mafatlal Industries, the Supreme Court has laid down that the sanctioning Court has to consider whether:-

   a. the requisite statutory procedure has been complied with;

   b. the scheme is backed up by the requisite majority;

   c. the creditors or members had the relevant material to enable the voters to arrive at an informed decision;

d. the requisite material is placed before the Court by the applicant seeking sanction;

e. the proposed scheme is violative of law and contrary to public policy; and

f. the majority of creditors or members is acting bona fide and in good faith and is not coercing the minority in order to promote any interest adverse to the latter.

Once the requirements of the law are fulfilled, the Court has no further jurisdiction to sit in appeal over the commercial wisdom of the creditors or as the case may be the members of the Company.

Case No. 13
Sanction to the Scheme of Amalgamation - Brooke Bond Lipton India Ltd. and Hindustan Lever Ltd. (CAL HC) (1996)

IN THE HIGH COURT OF CALCUTTA

Appellant: In Re: Brooke Bond Lipton India Ltd.

Company Petition No. 288 of 1996 connected with Company Application No. 285 of 1996

Decided On: 09.12.1996

1. Brief Facts of the Case

Application for approval of the scheme of amalgamation between Brooke Bond Lipton India Ltd., the transferor-company and Hindustan Lever Ltd., the transferee-company was filed before the Bombay High Court and the Calcutta High Court.

Both the transferor and the transferee were subsidiaries of Unilever plc. Further, both the transferor and the transferee were under a common management and had several common directors.

The scheme of amalgamation was approved by the Bombay High Court which also recorded no objection on the part of the Regional Director.

In the meeting of the transferor Company, out of the members present at the meeting 99.5 per cent of the members present and voting, voted in favour of the amalgamation while 105 members holding 15,933 shares (0.02%) voted against the amalgamation and 1,661 members holding 2,50,939 shares (0.40%) did not vote. Hence the amalgamation was approved by an overwhelming majority both in number as well as in voting strength. Further, it is worth noting that the financial institutions held approximately 22% shares in the company.

Five shareholders holding 298 shares objected to the scheme before the court at a very belated stage. None of them had shown any interest or had any correspondence with the company on the subject seeking any clarifications on any queries or doubts they may have had on any aspect of the proposed

amalgamation. None of them inspected the Valuation Report when the same was offered for public inspection prior to the Court convened meeting. None of them attended the Court convened meeting to present their point of view and in the event of their having a difference of opinion, moving an appropriate amendment resolution for consideration by other members so that a decision on their objections was taken by the totality of shareholders in the meeting in keeping with the spirit of shareholders' democracy.

None of the objectors attended the meeting or for the inspection of the Valuation Report which showed a total lack of interest in the scheme. In fact, no shareholder asked for an inspection of the Report.

2. Issues Raised by the Objectors

The main objections urged/raised by the objectors were as follows:

a) In view of the overwhelming shareholding majority held by Unilever, they should be placed in a different class and accordingly the shareholders as a class, have not been properly represented.

b) Since without the consent of the landlord tenancies cannot be transferred, the scheme is prejudicial.

c) The exchange ratio has not been properly or fairly determined.

d) The Valuation Report does not value the assets of the Company properly in that the value of the brands has not been taken into account.

The objectors also filed an application for appointment of an Independent Valuer and took the following points to challenge the Valuation Report:-

(i) The said Report does not disclose the value per share of either the company or Hindustan Lever Ltd. and as such the basis of arriving at the exchange ratio referred to in the said Valuation Report and in the scheme has not been disclosed. From the purported Report it does not appear whether any such valuation was at all made.

(ii) Neither the said Report nor the Scheme of which the sanction has been sought from the Court disclosed the value of per share of either the company or Hindustan Lever Ltd. either on "book value basis" or "yield value basis" or "stock exchange quoted value basis" and as such the basis for arriving at the exchange ratio has not been disclosed.

(iii) The Valuation Report also records that for the purposes of valuation of shares, the said Valuers have not carried out any audit or other tests to verify the accuracy of the audited financial statements of both the said companies and information and explanations given by the said valuer which clearly shows that no independent exercise was undertaken by the said valuers.

(iv) The said valuation report clearly shows that no valuation has been conducted "on assets basis". The company is the owner of a large number of well-known and popular trademarks and brand names which are valuable assets. The market value of the said trademarks and brand names will be running into several hundred crores of rupees. In fact, some brands like Kwality, Anikspray etc. have been acquired by the company from third parties upon payment of massive sums of money. The value of such trademarks and brand names are not reflected in the audited accounts of the company.

(v) No provision has been made in the scheme with regard to the shareholding of the company in Hindustan Lever Ltd.

(vi) The disputed premium of Rs. 595 per share amounting to Rs. 17,758 lakhs cannot be said to belong to Hindustan Lever Ltd. As the same is lying in an "escrow" account yet the same has been taken into consideration in arriving at the exchange ratio which has caused prejudice to the shareholders of the company.

(vii) The scheme of which sanction has been sought provides that the shareholding of Hindustan Lever Ltd. and its subsidiaries in the company are to be cancelled. Yet the value of such shares had been taken into consideration in arriving at the exchange ratio.

3. The Hon'ble High Court's View & Decision

Point No. 1: In view of the overwhelming shareholding majority held by Unilever, they should be placed in a different class and accordingly the shareholders as a class, have not been properly represented.

The objection raised for the respondent/ objectors that the class of shareholders has not been properly represented does not appear to be of much significance in view of the fact that, it does not appear from the Scheme also that the position of Unilever in any way changed as a result of the scheme

of amalgamation. It appears from the facts on record that the proposal would have been passed by overwhelming majority, even without voting by Unilever.

Point No. 2: Since without the consent of the landlord tenancies cannot be transferred, the scheme is prejudicial.

That the proposed scheme of compromise and arrangement was not found to be violative of any provision of law and was not contrary to public policy.

Point No. 3: The exchange ratio has not been properly or fairly determined.

- In a Scheme of amalgamation, if the ratio of exchange has been fixed by an experienced and reputed firm of chartered accountants, then in absence of any charge of fraud against them, Court will accept such valuation and ratio of exchange.
- A mere allegation of fraud is not enough; it must be a proper charge of fraud with full particulars.
- Once the exchange ratio of the shares of the transferee-company to be allotted to the shareholders of the transferor-company has been worked out by a recognised firm of Chartered Accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the Court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest.

Point No. 4: The valuation report does not value the assets of the Company properly in that the value of the brands has not been taken into account.

With respect to non-consideration of the brand value, the Court noted that the transferee-company owns many more valuable brands than the transferor-company. Moreover, it is well-recognised that the brands are part of the goodwill of the business and cannot be valued separately. It is also well settled that if a business is closed or transferred the brand goes with it. Separate mention of the mark in Schedule VI only takes place when a brand is acquired in which case the cost is mentioned. It may also be noted that even then once acquired it becomes part of the goodwill of the business and is valued accordingly.

4. Key Learnings for Valuers from the above Case

- If the stake of the objectors is very small then it is difficult to appreciate what benefits they would derive by opposing the scheme when the large majority of shareholders have approved the scheme at the meeting held pursuant to the order of the Court.
- The Supreme Court clarified, "Once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor-company has been worked out by a recognized firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest."
- That the scheme as a whole was also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them, for whom the scheme is meant.
- It was held that "if the ratio of exchange has been fixed by an experienced and reputed firm of chartered accountants, then in the absence of any charge of fraud against them, the court will accept such valuation and ratio of exchange."
- It is well-settled that if the statutory formalities have been complied with and the scheme is fair, and reasonable and there is no fraud involved, then the Court would proceed to give effect to the business of the decision of the shareholders of the company. In other words, unless the Court finds that the scheme is fraudulent or unreasonable, the Court would proceed to sanction the scheme. A mere allegation of fraud is not enough and it must be a proper charge of fraud with complete details and particulars.

Orders passed by the Ld. Appellate Tribunals and Tribunals

Case No. 14
Simpson and Company Limited (NCLT) (2021) - Consolidation and Reduction of Share Capital

IN THE NATIONAL COMPANY LAW TRIBUNAL CHENNAI BENCH

In Re: Simpson and Company Limited

CP/1409/2019, CP/1408/2019, MA/1366/2019 in CP/1408/2019 and MA/1367/2019 in CP/1408/2019

Decided On: 13.07.2021

1. Brief Facts of the Case

- The Applicant Company, M/s. Simpson & Company Limited was an Unlisted Public Limited Company, which was originally incorporated on 03.02.1925. The Applicant Company wanted to consolidate its share capital into shares of a larger amount by increasing the nominal value of the equity shares from 10/- per share to Rs. 2500/- per share so that every 250 equity shares with nominal value of Rs. 10/- held by a member are consolidated into 1 (One) equity share. It also applied for consequential reduction of capital in respect of the fractions, if any, held by any shareholder on consolidation of shares as no shareholder were to be issued any certificate for resulting fractional entitlement of a share as a result of consolidation of shares.
- The Applicant Company engaged two renowned valuers, a Chartered Accountant, Registered under the IBBI and a SEBI Registered Category 1 Merchant Banker for valuations of shares. The Valuers arrived at the fair value of each share of face value of Rs. 10 at 14,860/- per share.
- The Company resolved that the eligible fractional shareholders shall be paid at the rate of Rs. 14,860/- per share of the pre-consolidated equity share of Rs. 10 each.
- The applicant submitted that neither Section 61 nor 66 of the Companies Act, 2013 or the relevant Rules mandated valuation by Registered Valuer

as per Section 247 of the Companies Act, 2013. However, the Applicant Company in all fairness and also in the interest of the shareholders has obtained the valuation from such Valuer to ascertain the value.

- The petitioner submitted that 12 shareholders constituting 99.86% being the overwhelming majority have approved the said resolutions while the 47 shareholders holding 10,492 shares constituting 0.14% have voted against the said resolutions.
- In compliance with the procedural requirements, the Regional Director filed a common Report dated 16.09.2020 submitted that the scheme of consolidation of shares and consequently reduction of share capital has been examined and it has been decided not to make any objections except for the observations made by them with respect to the three complains received.

2. Objections raised by the Minority Shareholders

Around 30 shareholders holding 7000 shares filed their common written objections through their Counsel at the hearings before the Tribunal alleging that the management of the Company wielding brute majority has forcefully expropriated the shares of the minority at a value fixed by them, which is unfair, oppressive and unreasonable.

- It was alleged that the majority of the Public Shareholders present and voted in the meeting have actually voted against the resolution and Promoter shareholders and their relatives have voted "for" the resolution. Since the number of shares held by the Public Shareholders is negligible, the resolution could not be defeated. It clearly depicts the intention of the Minority Shareholders that they were against this proposed consolidation.
- Their main objection was that the valuation given by the Company at INR 14860/- is grossly undervalued and is arbitrary and abysmally low as the fair value cannot be less than Rs. 50,000/-.
- One of the Subsidiary Companies of Simpson & Co where the company held 76% stake was TAFE, with an EPS of Rs. 505/- for the year ended 31st March 2019. A comparable peer for TAFE in the listed market segment was Escorts which was trading at a PE multiple of 36 times. A peer valuation analysis translates to a value of INR 13,816/- per share of Simpson & Co for just one company i.e., TAFE.

- The Objectors submitted that the Valuation is not in accordance with the Provisions of Section 247 of the Companies Act, 2013 and the relevant Registered Valuer Rules i.e. the Companies (Registered Valuers and Valuation) Rules, 2017, as the Valuer in his Report has stated the valuation analysis has been carried out without a detailed "Due diligence" based on full, fair and complete disclosure by Simpson on all matters that affect the Valuation exercise.
- The valuation exercise undertaken by the Registered Valuer suggests that several illiquidity discounts have been applied. Any aggressive assumptions would result in a substantial reduction in the final value arrived at for the purpose of consolidation.
- Discounted Cash Flow method which is one of the more robust valuation approaches has been discarded completely.
- The other objection raised was that the Valuation Report has not been provided by the Petitioner Company.
- Assets of the Company which are used for business have been taken at book value and not fair value. An example is the fact that the Company has its manufacturing facility in Mount Road, Chennai spread across at least 10 Acres on a conservative estimate. This asset alone will give a fair value of Rs. 700 Crore for the company. The subsidiary companies also have enormous assets which have not been properly valued. Apart from this, the company has a huge manufacturing facility at Sembiam and many such business assets across subsidiaries which have been valued at book value or historical purchase costs which are irrelevant now.

3. Observations of the Ld. Tribunal

- Price Earnings Ratio signifies the relationship between Price and Earnings (Market Price divided by Earnings Per Share), evidently in the case of listed shares. It is not so in the case of equity shares of unlisted Public Limited Companies for which there is no regular or assured market in which case the determinants of value per share cannot be attributed to P/E Ratio.
- In the instant case, the equity shares of this Applicant Company are unlisted and accordingly, it does not carry a demand from the public investors to invest in the Rs. 10/- equity shares of this company by offering a higher value or esteem value which could be the one projected by the objectors, falling in the range of Rs. 50,000/- to Rs. 5,00,000/- per equity share of Rs. 10/- each in the Applicant Company.

- The equity shares of the Applicant Company being unlisted, do not carry liquidity as there can be no takers to acquire these shares for a price of Rs. 14,860/- or even below since the higher the price demanded the greater will be the illiquidity discounting factor.
- Valuation of the shares has been done by a renowned Registered Valuer and the appropriateness of the value has been confirmed by a SEBI approved Category-I Merchant Banker.
- It is a well-accepted principle that DCF is a direct valuation technique that values a Company by projecting its future cash flows and then using the Net Present Value Method to value those cash flows. The task of projecting future cash flows of any Corporate Entity is based on a series of assumptions about how the business will perform in the future and then forecasting how this business performance translates into the cash flow generated by the business. Even this is also challengeable and according to the view of this Tribunal, by anyone who wants to challenge this. Further, by applying Discounted Cash Flow Method, the discounting factor is based upon the weighted average cost of the capital which in the case of the Applicant Company may be a theoretical weighted average cost owing to minimal borrowed fund having regard to the size of owned fund; there can be only a notional weighted average cost of capital the ascertainment of which is also disputable by the objector. Therefore, this Tribunal is unable to discern the contention of the objectors pertaining to disregarding of the Discounted Cash Flow Method.

4. Decision of the Ld. Tribunal

The Tribunal relied upon the judgement rendered by the Hon'ble High Court of Karnataka in the matter of ***Vijay Kumar D. Shah vs Hewlett Packard Global Soft Ltd.*** and held that:

- The consolidation of shares as prayed for by the Petition is free from any legal infirmities and falls within the contours of Section 61(1)(b) of Companies, 2013 and in such circumstances, the relief as prayed for stands allowed.
- In order to safeguard the interest of those who are in the dissenting minority category, who would otherwise not be willing to accept the price of Rs. 14,680/- per share offered by the petitioner company in consideration of cancellation of their shares and reduction, the petitioner company shall facilitate constituting a trust in which the fractional shares shall be vested for benefit of the dissenting shareholders.

- In order to safeguard the interest of the dissenting shareholders, who do not offer the shares to the company for cancellation of the shares held by them by accepting price of Rs. 14,680/- per share, the petitioner company shall facilitate constituting Trust, in which fractional shares of the dissenting shareholders shall be vested for their benefit arising thus shares through an appropriate deed, delineating and rights and entitlement of the beneficiaries and other matters incidental or ancillary thereto.
- The reduction in the paid-up share capital can be allowed to the extent of the equity shares held by the objecting minority shareholders as are offered to the Applicant Company for cancellation and consequential reduction by accepting the price offered by the Applicant Company.

5. Key Learnings for Valuers from the above Case

(i) Section 102(3) of the Companies Act 2013 (the Act) only requires that where any item of business refers to any document, which is to be considered at the meeting, the Time & Place where such document can be inspected must be specified in the explanatory statement.

(ii) Provisions of Section 66 (1) of the Act (and also earlier provisions of section 100 of erstwhile Companies Act, 1956) states that subject to confirmation of the Tribunal, a company "may reduce the share capital in any manner". The emphasis is on "in any manner". However, said provision, after any manner also states that such reduction "and in particular may" include the methods provided under Section 66 (1)(a) or (b) of the Act.

(iii) A discount is normally applied to the whole company value when determining the market value of a minority shareholding but the question of how much discount should be applied is a matter of careful judgement on the part of the valuer and is based on a number of factors.

(iv) One of the first things to ask for when valuing a minority stake is the legal documentation including the Articles of Association, the shareholder agreement and any other document which sets out the rights, obligations and protections which apply to the shares being valued. Most Articles of Association and/or shareholder agreements will contain provision for the sale of shares by the company's shareholders and will typically contain some direction as to how the shares are to be valued.

(v) The availability of a liquid market for the minority shareholder to sell his or her stake is a distinct advantage. Conversely, the holder of a small shareholding in a private company with no internal market mechanism may have more difficulty realising value for those shares and this is likely to lead to the value of the shares being discounted.

Case No. 15

Dr. Vijay Radhakrishnan vs. Bijoy P Pulipra, Resolution Professional (NCLAT) (2021)

IN THE NCLAT, CHENNAI BENCH

Appellant: Dr. Vijay Radhakrishnan
Vs.
Respondent: Bijoy P Pulipra, Resolution Professional

Company Appeal (AT)(CH)(INS) No. 90 of 2021

Decided On: 09.07.2021

1. Brief Facts of the Case

The Appellant has filed the present Appeal being dissatisfied with the Order dated 22.02.2021 passed by the NCLT.

The Appellant/Applicant is a Doctor by Profession who was working with "PVS Memorial Hospital" (Corporate Debtor) and was the 'Power of Attorney Holder' of 46 Doctors who were also working with the 'Corporate Debtor'.

The Respondent is the Resolution Professional of the Corporate Debtor.

The Resolution Professional, after according requisite approval from the Committee of Creditors has filed the Resolution Plan submitted by the Resolution Applicant 'M/s. Lissie Medical Institutions' for approval of NCLT.

Conversely, the Appellant being discontented on the grounds inter alia as specified below has filed the appeal before NCLT and has sought the rejection of the recommended Resolution Plan and of the Valuation Report.

- Valuation Report submitted by the two Registered Valuers had a variance of 15.62%.
- Inequitable provisions were made in the Plan by way of discriminating the employee doctors and consultant doctors. The "Employee Doctors" were entitled to 99.29% of the claims whereas the "Consultants Doctors" were entitled to only 2.34% of their admitted claims.

However, the NCLT dismissed the said Appeal and approved the application filed by the Resolution Professional.

The Applicant being still dissatisfied had filed the present Appeal before NCLAT.

2. Order Passed by the Ld. NCLT

The NCLT had dismissed the Application filed by the Appellant on the following grounds:-

(i) The Resolution Professional has filed the Resolution Plan before the NCLT, on a Caveat Petition. However, the applicant approached with this IA only on 12.2.2021 (after curing the defects), i.e., the last moment when the Plan is to be approved.

(ii) Accordingly, it seems that this is only a delaying tactics putting hurdle in the process of approval of Resolution Plan by the Adjudicating Authority, which cannot be accepted.

(iii) The NCLT in view of the pronouncements of the Hon'ble Supreme Court of India and the Hon'ble NCLAT, cannot entertain the claim put forward by the applicant for rejection of the Resolution Plan at this stage and consequently dismissed the 'Application' without costs.

3. Key Grounds of appeal and argument presented by the Appellant

The Appellant has challenged the impugned order on following grounds and arguments:-

(i) The NCLT had not appreciated the fact in a proper perspective to the effect that the 'Resolution Plan' prepared was based on 'faulty Valuation Report' with variance of 15.62% amounting to a difference of Rupees Seven Crores and is in violation of Section 30(2) of the Insolvency and Bankruptcy Code, 2016 and 35(1)(a), 35(1)(b) and 35(1)(c) of the (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

(ii) Inequitable provisions were made in the Plan by way of discriminating the Employee Doctors and Consultant Doctors.

- It had failed to take into account the important fact that by holding the 99.2% to the 'Employee Doctors' under the category of 'Operational Creditor' – Employees – 2.35% to 'Consultant Doctors'

under 'Operational Creditor' – except employee), the balancing of interest as envisaged in the preamble of the Insolvency and Bankruptcy Code and guided in the decision of Hon'ble Supreme Court in Committee of Creditors' of Essar Steel India Ltd. v 'Satish Kumar Gupta' dated 15.11.2019 was not followed.

- An error has been committed in considering that the 'Operational Creditors were paid a bare minimum of 2.34% of their dues although their nature of work precedents against the 'Operational Creditor' being taken in a ride.
- The claim of the Appellant 'Doctors' were filed under 'Form-B' only because of the technicality that the 'Appellants' were not on the pay role of the 'Corporate Debtor', however, thus insisting the need to file under Form-B instead of the proper Form-D. As a matter of fact, the nature of work and service rendered by the Appellant 'Doctors' who are paid a Professional/Retainership Fee and those rendered by Doctors who had submitted 'Claim Forms' as employees though they are termed as 'Full-time Consultants' are similar.

(iii) The two 'Registered Valuers' had adopted different valuation methods and the same was not questioned by the 'Resolution Professional' nor was a 'Third Valuer' appointed. In fact, the Respondent had not complied with Section 30(2)(e) and Section 30(2)(f) of the IBC, 2016 and Regulation 35 1(a), 1(b), 1(c) of the (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

(iv) The difference in adopting varying methods of valuation had led to a difference in the value which technically paved the way for the appointment of a third Valuer as provided in Regulation 35(1)(a), (b) and (c) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. However, for the reasons best known to the Resolution Professional, the third Valuer was not appointed and as such, the 'CIRP' was not conducted as prescribed by the IBC, 2016

(v) Can the 'Committee of Creditors' make decisions for the portion and amount in 'Resolution Plan' which is beneficial only to them or the 'Resolution Applicant', ignoring the other 'Creditor's interests?

4. Arguments presented by the Respondent

The Respondent has presented the following counter replies/arguments:

(i) The discrepancies in the 'Valuation Report' submitted by one of the Registered Valuers identified by the appellant were merely clerical errors caused due to inadvertence. The inadvertent clerical errors crept in, while typesetting the 'Valuation Report' are not material in nature and had no material impact on the Fair Value as well as the Liquidation Value.

(ii) The variance of 15.62% in the value of the land in the two reports is not a significant variation as the Fair Value and Liquidation Value has been arrived at based on many other factors. As a matter of fact, variance in Fair Value between the two Valuation Reports is only of Rs.2.76 Crores (that is 1.71%) and the variance in Liquidation Value between the said two reports is only of Rs. 2.89 Crores (2.37%) and therefore the minor variations of 1.71% and 2.37% are only to be ignored.

(iii) 'Valuation Report' is only an estimate to assist the Committee of Creditors to take a commercial decision and the same is not mandatory document to be relied upon by the committee to take a decision on the 'Resolution Plan' in front of it. ***[Civil Appeal No. 4242 of 2019 of Maharashtra Seamless Limited v Padmanabhan Venkatesh and Ors.]***

(iv) The 'Consultant Doctors' were not engaged on a monthly salary and were not bound by any 'Service Rules and Regulations' of the Hospital and in fact, they were discharging only 'Professional Services' against the payment of 'Consultancy Fees'. In fact, there is 'no discrimination', or 'arbitrariness' among the said two categories of 'Doctors', since the 'Claims' were admitted purely on the basis of 'Claim Forms' submitted by the respective claimants.

(v) He also referred to the Judgment of the Hon'ble Supreme Court of India in the matter of ***Swiss Ribbons Private Limited & Ors. Vs. Union Bank of India & Ors*** which has dealt with the aspect of equality as specified in Article 14 of the Constitution.

It stated that *"Since equality is only among equals, no discrimination result if the Court can be shown that there is an intelligible differentia which separates two kinds of creditors so long as there is some rational relation between the creditors so differentiated, with the object sought to be achieved by the legislation"*

5. Decision of the Ld. NCLAT

The NCLAT dismissed the appeal in light of the foregoing arguments and held as under:

(i) The difference of 15.62% between the two Registered Valuers in regard to the Valuation made is not a substantial/material one so as to warrant an appointment of a 'third Valuer' as per Regulation 35(1)(a)(b) and (c) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

(ii) Neither the 'Adjudicating Authority' nor the 'Appellant Tribunal' can substitute its 'Wisdom' over the 'Commercial Wisdom' of the 'Committee of Creditors'. In fact, the 'Appellate Tribunal' has no jurisdiction to question the distribution made by the 'Committee of Creditors' as per section 30(4) of the IBC, 2016. It is to be noted, that section 30(2)(b) of the IBC, 2016 refers to Section 53 of the IBC, 2016 not in the context of priority of payment of Creditors, but only to provide for a minimum payment to the 'Operational Creditors'. [***Judgment of Hon'ble Supreme Court in Maharashtra Seamless Limited V Padmanabhan Venkatesh and Ors and in the case of Essar Steel India Limited vs. Satish Kumar Gupta, decided on 15th November, 2019]***

(iii) One cannot ignore a vital fact that 'Guarantee of Equality' before the law is a positive concept. The principle of equal pay for equal work has to be granted only if there is a total and complete identity between two employees. It is to be remembered that the 'burden of proving' the 'right and parity' in an 'employment' is only on the individual claiming such right. Moreover, it cannot be lost sight of that in respect of the concerned employees 'functions' may be same but skills and responsibilities may be really and substantially different. Viewed in that perspective, in the instant case on hand, there is a clear difference and defined arena between the 'Employee Doctors' and the 'Consultant Doctors' of the 'Corporate Debtor'. As such the contra plea taken on behalf of the Appellant(s) is not worthy of acceptance. Further, the NCLAT upheld the view of the Adjudicating Authority (NCLT) stating that it came to a correct conclusion on 22.02.2021 that the 'Appellant'/'Applicants' claim for rejection of 'Resolution Plan' could not be entertained at the stage when 'Resolution Professional' had filed the 'Resolution Plan' before it, and also when the Plan was to be approved. Only at the last moment, the application was

filed, especially when the pronouncement of approval of the 'Resolution Plan' was scheduled on 22.02.2021.

Accordingly, NCLAT dismissed the Appeal without costs.

6. Key Learnings for Valuers from the above Case

(i) The value made by the Registered Valuers are only 'estimates' and certainly, there will be a minor difference in each 'Valuer's Report' which is acceptable.

(ii) One cannot brush aside a primordial fact that the Estimated Values as furnished by the Registered Valuers can at best be an aid to the 'Committee of Creditors', to take a call on 'Commercial Decision', which cannot anyway stifle them in any manner.

(iii) There is no need to appoint third Valuer in case the difference between the Valuation Report of two Valuers is not significant and the Valuer has prepared the Valuation Report in accordance with the applicable Valuation Standards.

(iv) It is well settled that it is not open to re-open the reasons for rejection of 'Resolution Plan' passed with 100% voting shares for adjudication. No wonder, approval for 'Resolution Plan' is to be judged with diligence and 'satisfaction' in regard to the 'Approval of plan' in writing with reasons to be recorded, of course, with due application of mind.

(v) Neither the 'Adjudicating Authority' nor the 'Appellant Tribunal' can substitute its 'Wisdom' over the 'Commercial Wisdom' of the 'Committee of Creditors'. In fact, the 'Appellate Tribunal' has no jurisdiction to question the distribution made by the 'Committee of Creditors' as per Section 30(4) of the IBC, 2016. The scope of interference by the Authority is limited judicial review. [Essar Steel India Limited vs. Satish Kumar Gupta, decided on 15th November, 2019]

(vi) Section 30(2)(b) of the IBC, 2016 refers to Section 53 of the IBC, 2016 not in the context of priority of payment of Creditors, but only to provide for a minimum payment to the 'Operational Creditors'.

(vii) It is a vital fact that 'Guarantee of Equality' before the law is a positive concept. The principle of equal pay for equal work has to be granted only if there is a total and complete identity between two employees.

Case No. 16
TSI Yatra Pvt. Ltd. Vs ACIT, Range-25 (ITAT) (2020)

IN THE ITAT, NEW DELHI BENCH, NEW DELHI

Appellant: TSI Yatra Pvt. Ltd.
Vs.
Respondent: ACIT, Range-25

I.T.A. No. 1068/DEL/2019

Decided On: 14.12.2020

1. Brief Facts of the Case

TSI Yatra Pvt. Ltd, Appellant Assessee, was engaged in the business of providing travel-related services by way of air ticket booking, hotel booking, etc to travel agents. It primarily catered to B2B segment of Yatra group with its main customers being tour and travel agents. It was a wholly-owned subsidiary of M/s. Yatra Online Private Limited ('YOPL'), which provided similar services to direct customers and end-users.

During the year under consideration, the appellant company had issued 1,059,153 equity shares to its holding company, that is, to M/s. YOPL.

For the year under consideration, appellant assessee filed its return of income declaring loss. However, as against the returned loss, Ld. Assessing Officer passed the assessment by making a cumulative addition after invoking the deeming provisions of section 56(2)(vii)(b) of the Income Tax Act, 1961.

In response to the show-cause notice by the Ld. AO, it was stated by the appellant that the Fair Market Value (FMV) of shares issued was in accordance with the provisions of Rule 11UA of the Income Tax Rules, 1962 and that FMV was certified by Valuation Reports dated 03rd April 2013 and 31st March 2014 issued by an expert, i.e. a Chartered Accountant. It was stated that the Valuer has estimated the FMV using the Discounted Cash Flow Method (DCF) which is one of the prescribed methods under section 56(2)(vii)(b) of the aforesaid Act read with Rule 11UA(2)(b).

Date of Issue	No. of shares Issued	Face Value Per Share	Premium per Share	Issue Price Per Share	Total Premium Received	Total Amount Received
4th Nov 2013	5,20,830	10	182	192	9,47,91,060	9,99,99,360
31st Mar 2014	5,38,323	10	264	274	14,21,17,272	14,75,00,502
Total	**10,59,153**	**20**	**446**	**466**	**23,69,08,332**	**24,74,99,862**

Assessing Officer, however, was unimpressed by the valuation technique adopted by the Valuer and held that the Valuer had prepared the Valuation Report based on projections provided by the management. The Assessing Officer had thereafter taken recourse of provisions of Rule 11UA of the IT Rules, 1962 and the estimated value of shares by adopting NAV Method as negative.

2. Order Passed by the Ld. AO

AO rejected use of DCF Method by Valuer and carried out valuation of shares of the Appellant as per Net Assets Value ('NAV') method and ascertained a negative valuation. He concluded as under:-

- It is seen that the Valuer has taken projected revenue, future cash flow and other information as certified by the management. No verification, whatsoever of projections and assumptions adopted by management was done by CA, thereby making the report as per the convenience and requirement of the management.
- The Chartered Accountant considered 25% growth rate in the revenue; he did not consider the average growth rate of industry which is approximately 16% available on various sources on internet. Even while issuing the report on 31st March, 2014, growth rates of the year ending 31st March 2013 was not considered.
- Exorbitant estimate of sales and free cash flow was used in valuing shares by the DCF method. Based on the statement of the Valuer, it is clear that he has used the projection figures and also the different discount rates for the purpose of valuation of the share solely on the input of the assessee company who is the beneficiary of the Valuation Report. He has not applied his mind whether these projections can be correct/reasonable or not.

- The 'Technical Guide on shares valuation' published by the Institute of Chartered Accountants of India (ICAI) wherein three key factors viz., cash flow projections, discount rate and terminal value for computing DCF were discussed. It is observed that none of the above factors as mandated by ICAI has been considered by the said CA issuing Valuation Rport while computing fair value of the unquoted equity shares of the assessee company.

3. Order Passed by the Ld. CIT(A)

Ld. CIT (A) upheld the additions made by the Ld. AO and dismissed the appeal after concluding as under:

- The appellant has been completely unjustified in adopting a growth rate of 25%, while the AO has been able to duly prove and support the stark contrast in the actual figures vis-à-vis its estimation.
- While it is true that not every estimate is required to be correct or that it may be accurate, however, it also remains a crucial aspect that such estimations need to be congruence with the actual figures, i.e., the estimation ought to be as closely accurate as possible. Further, calculation needs to be supported and substantiated by some basis or some evidence, which the appellant has outrightly failed to provide.
- The estimation used by the appellant is nowhere close to the reality from the very beginning. This in turn means that the appellant has simply overstated its values, with the intent of inflating the share value. However, such inflation has been rightly shown to be unsustainable.
- Valuer has failed to carry out any due diligence w.r.t projection for future growth and earnings provided by the appellant, hence the AO is eligible to reject the method of computation as used by the appellant and apply another method.
- Extending the above deliberation, the Ld. CIT(A) held that the AO has rightly used and calculated the FMV and hence, the addition is sustained and the ground of appeal is dismissed.

4. Relevant sections of the Income Tax Act, 1961

"Income from other sources.

56. (1) Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E.

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely:--

(viib) "where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

Provided that this clause shall not apply where the consideration for issue of shares is received--

(i) by a venture capital undertaking from a venture capital company or a venture capital fund or a specified fund; or

(ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf:

Provided further that where the provisions of this clause have not been applied to a company on account of fulfilment of conditions specified in the notification issued under clause (ii) of the first proviso and such company fails to comply with any of those conditions, then, any consideration received for issue of share that exceeds the fair market value of such share shall be deemed to be the income of that company chargeable to income-tax for the previous year in which such failure has taken place and, it shall also be deemed that the company has under reported the said income in consequence of the misreporting referred to in sub-section (8) and sub-section (9) of section 270A for the said previous year.

Explanation.--For the purposes of this clause,--

(a) the fair market value of the shares shall be the value--

(i) as may be determined in accordance with such method as may be prescribed; or

(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of

its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, whichever is higher".

As per clause (i) of the Explanation (a), the FMV of shares issued is to be determined in accordance with such method as may be prescribed. Method to determine this FMV is further provided in Rule 11UA (2) of the IT Rules, 1962. The relevant extract of the applicable Rules is reproduced below:

"11UA. [(1)] For the purposes of section 56 of the Act, the fair market value of a property, other than immovable property, shall be determined in the following manner, namely,--

(2) Notwithstanding anything contained in sub-clause (b) of clause (c) of sub-rule (1), the fair market value of unquoted equity shares for the purposes of sub-clause (i) of clause (a) of Explanation to clause (viib) of sub-section (2) of section 56 shall be the value, on the valuation date. of such unquoted equity shares as determined in the following manner under clause (a) or clause (b), at the option of the assessee, namely:--

(a) net asset method, or

(b) the fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow method."

5. Key Grounds of appeal and argument presented by the Appellant Assessee

The Appellant-Assessee challenged the impugned order on following grounds and arguments:-

(i) The Ld. CIT(A) has erred on facts as well as in law in confirming action of the Ld. AO by rejecting valuation reports dated 03.04.2013 and 31.03.2014 determining fair market value of shares of the appellant as per Discounted Cash Flow ('DCF') method as prescribed under Rule 11UA(2)(b) of the IncomeTax Rules, 1962 ('the IT Rules') at INR 192 per share and INR 274 per share respectively.

(ii) That the Ld. CIT(A) has erred on facts and in law in confirming the action of Ld. AO of carrying out valuation of shares of the Appellant as per Net Assets Value ('NAV') method.

(iii) The Ld. CIT(A) as well as Ld. AO have failed to appreciate provisions of Rule 11UA(2)(b) of the IT Rules, 1962 which provide for an option to the Appellant to choose a method of his choice for valuation of its shares for the purposes of Section 56(2)(vii)(b) of the Act. The act of rejection of Valuation Reports and carrying out valuation of shares of Appellant as per NAV method is therefore ultra-vires the Act and the Rules as well as the principle laid down by Hon'ble Supreme Court in the case of ***Bharat Hari Singhania & Others vs. Commissioner of Wealth Tax & Others. (1994) 207 ITR 1 (SC)*** wherein it was held that it is not an option of an Assessing Officer to either follow or not to follow the prescribed method of valuation but that he is bound to follow the Rules of valuation made under the Act.

(iv) The Ld. CIT(A) erred in confirming the action of Ld. AO of carrying out comparative analysis of projected revenue from operations and actual revenue from operations and is against the rule of Hon'ble Delhi Tribunal in case of ***M/s. Stryton Exim India Pvt. Ltd. (ITA No. 5982/2018)*** wherein the Hon'ble Tribunal had held that it was incorrect to assume that the projected cash flows should have equalled the actual cash flows for the purpose of valuation of shares using a DCF method.

(v) Without prejudice, that the Ld. CIT (A) and Ld. AO gravely erred in holding that year-on-year growth rate estimated by Appellant is arbitrary and self-serving without appreciating close proximity between projected cash flows considered as per Valuation Reports and actual cash flows from operations and the fact that variation between the two cash flows were sometimes as low as 4%-6%.

(vi) The legislative intent behind the insertion of Section 56(2)(vii)(b) in the Income Tax Act, 1961 was to tackle a menace of the black money and literal interpretation should not be applied and one has to see the purpose of introduction of this section that is, purposive construction should be given while interpreting the said section. It was submitted that the aforesaid deeming provision was brought in the statute as an anti-abuse provision where a company receives any consideration for issue of shares that exceeds the face value of shares, then the excess value is deemed to be the income of that company.

6. Decision of the Ld. ITAT

(i) It is a well settled law that the construction of the statute must be taken from the bare words of the Act. One should not look at what could have been the intention of the legislature behind the legislating section and if a legislature did intend in this way, then it has to be expressed clearly in the language of the Section. The purposive construction can only be resorted to when there is ambiguity or the contradiction in two provisions for the same statute. Here, no such ambiguity or contradiction is there nor has been pointed out before us.

(ii) Section 56(2)(vii)(b) of the Act is a deeming provision and one cannot expand the meaning of scope of any word while interpreting such deeming provision. If the statute provides that the valuation has to be done as per the prescribed method and if one of the prescribed methods has been adopted by the assessee, then AO has to confine to the choice made by the assessee. The Method once adopted thus cannot be changed. In absence of there being some enabling provision allowing AO to change the method of valuation the choice of method adopted by the assessee cannot be disturbed.

(iii) In case, the AO is not satisfied with any of the parameters adopted in estimating the value, then subject to the material being available on record, the Ld. AO can adopt his own valuation in DCF method or get it valued by some different Valuer.

(iv) At the time when valuation is made, it is based on reflections of the potential value of business at that particular time and also keeping in mind underline factors that may change over the period of time and thus, the value which is relevant today may not be relevant after certain period of time.

(v) The Ld. ITAT relied on the following judgements which clearly endorsed its above views.

   i) Securities & Exchange Board of India & Ors. [2015 ABR 291 - (Bombay HC)]

   ii) Rameshwaram Strong Glass Pvt. Ltd. v. ITO [2018-TIOL-1358-ITAT-Jaipur]

   iii) DQ (International) Ltd. vs. ACIT (ITA 151/Hyd/2015)

(vi) Under the DCF method, the information to be considered should be as on date of valuation. In the instant case, Ld. AO has erred in comparing estimated projections with the actual audited revenues. This issue has also been considered by Tribunal in case of *Innoviti Payment Solutions ((2019) and VBHC Value Homes (ITA No. 2541 & 37/Bang/2019).*

(vii) Lower Authorities have not properly adjudicated upon the contentions raised by the appellant. Appellant narrated the reasons for variation in estimated projections in Valuations Reports dated 3rd April 2013 and 31st March 2014. It was also submitted by the appellant that estimated projections as per valuation report dated 31st March 2014 are within a range of 4% to 6% of the actual audited revenues and therefore, there is no material variance. Appellant further elaborated that it had considered a growth rate of 25% in Total Transaction Value ('TTV') of reservations to be handled by it and not on revenues and that corresponding growth on revenues as per the first and second Valuation Reports was in the range of 16-25% and 14-25% respectively, which is reasonable even as per the independent search conducted by the Ld. AO himself.

(viii) Ld. CIT(A) has in a laconic manner upheld the addition made without considering the above factual issues. These are crucial factual issues which have to be considered by the Authorities below and in absence of a definite finding being expressed in this regard it is difficult for us to render a definite final conclusion.

7. Key Learnings for Valuers from the above Case

(i) Section 56(2)(vii)(b) of the Income Tax Act, 1961 is a deeming provision and one cannot expand the meaning of scope of any word while interpreting such deeming provision. If the statute provides that the valuation has to be done as per the prescribed method and if one of the prescribed methods has been adopted by the assessee, then AO has to confine to the choice made by the assessee.

(ii) The AO can scrutinize the valuation report and if he is not satisfied with the explanation of the assessee, he has to record the reasons and basis for not accepting the valuation report submitted by the assessee and only thereafter, he can go for own valuation or obtain the fresh valuation report from an independent valuer and confront the same to the assessee. But the basis has to be the DCF method and he cannot change the method of valuation which has been opted by the assessee.

(iii) For scrutinizing the Valuation Report, the facts and data available on the date of valuation only has to be considered and actual result of future cannot be a basis to decide about reliability of the projections

(iv) A Court of Law has nothing to do with reasonable or unreasonableness of a provision of a Statute except as it may hold in interpreting what the legislature has clearly stated. If the language of the Statute envisages only one meaning then it must be continued to mean and intended what it has been clearly expressed.

(v) A critical aspect under the Valuation process is selection of the source of information. A Valuer should exercise professional judgement while selecting the Source as it can immensely impact the Valuation. If the Valuer relies on the information available in public domain, the Valuer should assess the credibility/reliability of such information taking into account, inter-alia, the purpose of valuation, and materiality vis-à-vis the valuation conclusion.

(vi) In a DCF method, the value is based on estimated future projection. These projections are based on various factors and projections made by the management and the Valuer, like growth of the company, economic/market conditions, business conditions, expected demand and supply, cost of capital and host of other factors. These factors are considered based on some reasonable approach and they cannot be evaluated purely based on arithmetical precision as value is always worked out based on approximation and catena of underline facts and assumptions.

Case No. 17
In Re: Syngenta India Limited (NCLT) (2020) - Application for reduction of Share Capital

IN THE NCLT, MUMBAI BRANCH
Appellant: In Re: Syngenta India Limited

C.P No 771 of 2017

Decided On: 27.10.2020

1. Brief Facts of the Case

Brief about the Petitioner Company:

- The Petitioner Company was incorporated on 23.03.2000 in Mumbai, Maharashtra, as "Novartis Agribusiness India Private Limited".
- The name of the Company was changed to Syngenta India Private Limited, consequent to the fresh Certificate of Incorporation dated 05.09.2000 issued on Change of Name.
- It was then converted into a Public Company and was listed on Bombay Stock Exchange (BSE).
- In June 2007, the equity shares of the Company were delisted from BSE Limited under the Securities and Exchange Board of India (Delisting of Securities) Guidelines, 2003.
- The Company is engaged in the business of manufacturing and trading of agrochemicals and processing and selling of seeds. The Company manufactures and formulates pesticides, herbicides and fungicides and processes field crops and vegetable seeds.

Certain public shareholders of the said company expressed their desire to tender and/or surrender their equity shares held in the Petitioner Company. Therefore, the company decided to reduce its issued, subscribed and paid-up share capital by cancelling and extinguishing, in aggregate, 3.59% of the total

issued, subscribed and paid-up share capital of the Petitioner Company held by the Public Shareholders i.e. the Reduction u/s 66 of the Companies Act, 2013.

The Company after complying with the requirements of section 66 of the Companies Act, 2013 has applied to NCLT for approval of the Reduction. The Company has determined the fair value of the shares on the basis of Valuation Report of Independent Valuer.

However, the ROC Pune filed its two reports on the proposed Scheme of Reduction of Capital dated 25.06.2018 and 29.06.2018, on which the Regional Director, MCA has filed its observation, brief of which are as under-

(i) As per ROC Pune report dated 25.06.2018: One Complainant has stated that Syngenta is paying only 43.4 % of Fair Market Price and cheating the small shareholders.

(ii) As per ROC Pune report dated 29.06.2018: 23 complaints are received against reduction. On perusal of shareholding pattern of the petitioner company, Prima facie it appears that the reduction is to bump of entire 12,373 Public Shareholders/11,81,036 Equity Shares consisting of 3.59% at an offer price Rs. 2,445/- per share. Such selective reduction of capital is not within the letter and spirit of Section 66 of the Companies Act, 2013. This is against the public interest as the present value/status of the company is also due to public participation. The selective reduction is detrimental to the public participation in equity market. Further, the fair value of the assets/shares is not made available. Hence, the Scheme deserves to be rejected.

2. Submissions made by the Petitioner Company (Syngenta India Limited)

The Syngenta India Limited inter alia has made the following submissions while filing its application for Reduction of Capital before NCLT:

- The Articles of Association of the Company authorize it to reduce its capital in any way authorized by applicable law.
- The Company has engaged two Independent Valuers to undertake separate independent valuations of the equity shares of the Company to determine the fair value of the shares for the purpose of the Reduction.

- In addition, the Company also appointed a SEBI registered Merchant Banker to provide a fairness opinion on the valuation of the equity shares of the Petitioner Company, as determined by the two aforesaid independent valuers.
- The Board of Directors of the Company after duly considering the Valuation Reports submitted by the Independent Valuers and the Fairness Opinion determined that the higher of the two valuations arrived at i.e. Rs. 2444.70 per equity share represented the fair value of the equity shares of the Petitioner Company.
- Accordingly, the Board considered and rounded off the value to Rs. 2445/- and passed the requisite resolution approving the reduction of share capital of the Petitioner Company subject to approval by Shareholders and NCLT.
- Special Resolution of the shareholders of the Company approving the same was also duly passed in accordance with Section 66(1) of the Companies Act, 2013, at the EGM held, after due notice as provided in the Companies Act, 2013, on 8th December, 2017.
- The Company does not have any deposits as covered under the provisions of Sections 73 to 76 of the Companies Act, 2013 and the Rules made thereunder. Hence, it has no arrears in the repayment of any deposits. The certificate of Chartered Accountant further confirms that there are no deposits issued by the Company.
- The Company does not have secured creditors as on 8th December, 2017. It has unsecured creditors with an aggregate outstanding of Rs. 2,79,28,59,006/- as on 8th December, 2017. The interest of the creditors is not prejudicially affected in any manner and they will be paid off in the ordinary course of business.

3. Brief About the Valuation Report and Fairness Report

a) First Independent Valuer's Report:

The Report is based upon market approach, income approach and asset approach method. A detailed report entails the method adopted to come to a conclusion as follows:

"In view of the above, and on consideration of the relevant factors and circumstances and discussed and outlined hereinabove, value per equity share of SIL of INR 5/- each fully paid up as on date of this INR 2,444.7/-.

b) Second Independent Valuer's Report:

The Valuation approaches adopted by the above Valuer are cost approach, market approach and income approach. The valuer concluded as follows:

"Further, we are of the opinion that the Market Approach is the most appropriate for the current valuation exercise since it would best reflect the expectations of minority shareholders for the proposed transaction. Thus, we have assigned 100% weight to the Comparable Companies Method and under the market approach for current valuation.

On consideration of all relevant factors and issues discussed herein, in our opinion, the total equity value of SIL as per CCM method is arrived at INR 76,870 Mn and a per share value of INR 2,33.36/."

c) Fairness Value Report:

"On the basis of and subject to the foregoing, it is our view that, as of the date hereof, the valuation of shares provided by the Valuation Agencies is fair and reasonable from a financial point of view."

4. Issues raised vis-a-vis Decision made by the NCLT

i. First Issue: It was objected that a separate meeting of only minority shareholders should have been conducted.

Decision: The aforesaid objection is untenable in law. Section 66 of the Companies Act, 2013 does not contemplate holding of a separate class meeting of only minority shareholders for a reduction of capital. The concept of majority of minority shareholders is neither recognized by law nor under any principles laid down in judgments of Supreme Court.

ii. Second Issue: It was with regard to the legitimate expectation of minority shareholders as a whole to be adequately compensated with regard to valuation of shares and regarding the method of valuation and assumptions carried out by the Valuers.

The Minority shareholders were objecting to the said scheme on three basic grounds that the petitioner company after a lapse of 10 years and post delisting is opting for reduction of capital, that the China Chem company is buying out the petitioner company and the scheme is sanctioned by CCI and finally their legitimate expectation of receiving

certain amounts in lieu of rights attached to the shares in comparison to the price offered by Buyer.

Decision: The NCLT examined the Reports submitted by the two Valuers and after relying on various landmark judgements passed by the Hon'ble Courts, held that:

The objector to the Scheme has not shown that the valuation is ex-facie unreasonable, i.e., so unreasonable that it cannot on the face of it be accepted, the valuation method adopted by the valuers are unacceptable, or are based on patently erroneous assumptions and lastly that the Valuations are vitiated by fraud or malafides. Also, the minority shareholders have neither obtained an independent Valuation Report nor have they pointed out the defects of the valuation reports and fixation of share price looking at the past values and projected values for the next ten years.

The Court has no power or jurisdiction to exercise any appellate functions over the scheme. It is not a valuer nor does it have the necessary skills or expertise. It cannot substitute its own opinion for that of the shareholders. Its jurisdiction is peripheral and supervisory, not appellate.

The Petitioner Company having carried out the valuation exercise and complied with the requirement of approval by absolute majority and therefore the Reduction of the Capital is in compliance with the requirement of Section 66 of Companies Act 2013.

Cases relied upon:

➢ **Mumbai High Court in *Re Cadbury India Limited***

The Court held as follows:

- Before a Court can decline sanction to a scheme on account of a valuation, an objector to the scheme must first show that the valuation is ex-facie unreasonable, i.e., so unreasonable that it cannot on the face of it be accepted. That unreasonableness must exist on the face of the valuation: one so apparent that "he who runs can read."
- To upset a valuation, a wrong approach must be demonstrated clearly and unequivocally, and the result must be plainly invidious.

A plausible rationale provided by a Valuer is not to be readily discarded merely because an objector has a different point of view.

- In considering an application for sanction will ask itself if, at a minimum, these tests are met: Is a fair and reasonable value being offered to the minority shareholders? Have the majority of non-promoter shareholders voted in favour of the resolution? Can it be said, on reading a valuation as any fair-minded and reasonable person would do, and without microscopic scrutiny, that the valuation is so egregiously wrong that the judicial conscience will not permit it? Has the Valuer gone so far off-track that the results of his valuation returns cannot but be wrong?
- A court called upon to sanction such a scheme is not bound by the ipse dixit of a majority. It must weigh the scheme and look at it from all angles. It must see whether the scheme is fair, just and reasonable, not unconscionable and is not contrary to any provisions of law and it does not violate any public policy. But it must also balance the commercial wisdom of the shareholders expressed at a properly convened meeting against the desires and fancies of the few. The court will take into account, but not be bound by, the views of the majority. In particular, the court will see what the views are of most of the non-promoter (minority) shareholders at the meeting. If the bulk of them have voted in favour, the court will not lightly disregard this expression of an informed view, one that lies in the domain of corporate strategy and commercial wisdom
- The unfairness must apply to a class, even if that class is of one. This class is not to be identified not by a shared ire against the petitioning company or even an ideological animosity, but by the character or nature of their holding, and by the way that class is sought to be singled out for differential, unfair treatment.
- The sanctioning court has no power or jurisdiction to exercise any appellate functions over the scheme. It is not a valuer. It does not have the necessary skills or expertise. It cannot substitute its own opinion for that of the shareholders. Its jurisdiction is peripheral and supervisory, not appellate. The Court is not "a carping critic, a hair splitting expert, a meticulous accountant or a fastidious

counsel; the effort is not to emphasize the loopholes, technical mistakes and accounting errors".

- Valuation is not an exact science. Far from it. It is always and only an estimation, a best-judgment assessment. The fact that a particular estimation might not catch an objector's fancy is no ground to discredit it. All valuations proceed on assumptions. To dislodge a valuation, it must be shown that those assumptions are such as could never have been made, and that they are so patently erroneous that the end result itself could not but be wrong, unfair and unreasonable. The court must not venture into the realm of convoluted analysis, extrapolation, and taking on itself an accounting burden that is no part of its remit or expertise, and no part of a statutory obligation. In particular, the court must guard against the seductiveness of a proposition that suffers from the fallacy of the undistributed middle: all x is z; some y is z; ergo, all y is z. The errors and consequent unreasonableness must be shown to be patent and self-evident

- It is impossible to say which of several available valuation models are "best" or most appropriate. In a given case, the CCM method may be more accurate; in another, the DCF model. There are yet others. No valuation is to be disregarded merely because it has used one or the other of various methods. It must be shown that the chosen method of valuation is such as has resulted in an artificially depressed or contrived valuation well below what a fair-minded person may consider reasonable.

➢ **The Hon'ble Apex Court in the case of *Miheer H. Mafatlal v. Mafatlal Industries Ltd***

"The court neither has the expertise nor the jurisdiction to delve into the deep commercial wisdom exercised by the creditors and members of the company who have ratified the scheme by the requisite majority. Consequently, the Company Court's jurisdiction to that extent is peripheral and supervisory and not appellate. The Court acts like an umpire in a game of cricket who has to see that both teams play their game according to the rules and do not overstep the limits. But, subject to that, how best the game is to be played is left to the players and not the umpire"

iii. **Third Issue:** Whether the proposed scheme has the effect of wiping out entirely a class of shareholders, namely, the non-promoter shareholders, though on payment of certain compensation in view of the objection raised by them and whether such selective reduction can be allowed?

Decision: Section 66 of the Companies Act, 2013 expressly permits companies to undertake reduction of their share capital in any manner, i.e. including by way of selective reduction of share capital, as laid down by numerous High Courts.

Cases relied upon:

- ***Re: R.S. Live Media Pvt. Ltd***

  The mode, manner and incidence of reduction have been regarded as a matter of domestic concern and there is no restriction under the Act which curtails the discretion of a company in adopting the manner in which the company chooses to reduce its capital.

- ***Re: Elpro International Ltd.***

  The Court must first and foremost have regard to the well-established position that a selective reduction of share capital is legally permissible.

- ***Re: Indrama Investment Pvt. Ltd. & Ors.***

  The Court held that merely because the arrangement results in extinguishing some shares and resulting into 100% shareholdings in the hands of a particular group cannot be treated improper per se

- ***Wartsila India Limited v. Janak Mathuradas***

  The Hon'ble Bombay High Court upheld the reduction of share capital as undertaken by the company therein which resulted in the extinguishment of non-promoter shareholding of the company. The Hon'ble Court further held answering in the question "whether the special resolution which proposes to wipe out a class of shareholders after paying them just compensation can be termed as unfair and inequitable" in the affirmative, observed that "...In our opinion, once it is established that non-promoter shareholders are being paid a fair value of their shares...the court will not be justified in withholding its sanction to the resolution."

iv. **Fourth Issue:** Objection has been raised by RD while submitting its observation on the report of ROC, Pune which states that Mr. Punit Kumar has complained that the company is paying only 43.4 % of Fair Market Price and cheating the small shareholders, therefore the company is seeking to bump of entire 12,373 Public Shareholders/11,81,036 Equity Shares consisting of 3.59% at an offer price Rs. 2,445/- Per Share. Such selective reduction of capital is not within the letter and spirit of Section 66 of the Act. This is against the public interest as the present value/status of the company is also due to public participation. The selective reduction is detrimental to the public participation in equity market.

Decision: The objections are untenable in view of the ratio laid down by the Hon'ble Supreme Court and the Hon'ble High Courts quoted in the aforesaid paragraphs.

Other cases on which the NCLT has relied

- **Re: HCL Infosystems Limited and Ors**

  It is also settled position of law that once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies....

- **Ratan Housing Development Ltd**

  The Regional Director in his objection has not contended that the valuer has played a fraud. The Regional Director only contended that one method of valuation should have been adopted. As stated earlier, the Supreme Court has held in Hindustan Lever's case [1995], that different methods of valuation could be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies. Thus, in the absence of fraud or mala fides, the mere fact that the determination of the exchange ratio of the shares of the two companies could be done by a slightly different method

which might have given a different exchange ratio could not justify interference unless it was found to be unfair."

- **Reckitt Benckiser (India) Limited (2005)**

  The principles, which can be distilled from the aforesaid judicial dicta, are summarized as under:

  - The question of reduction of share capital is treated as matter of domestic concern, i.e. it is the decision of the majority which prevails.
  - If majority by special resolution decides to reduce share capital of the company, it has also the right to decide as to how this reduction should be carried into effect.
  - While reducing the share capital company can decide to extinguish some of its shares without dealing in the same manner as with all other shares of the same class. Consequently, it is purely a domestic matter and is to be decided as to whether each member shall have his share proportionately reduced, or whether some members shall retain their shares unreduced, the shares of others being extinguished totally, receiving a just equivalent.
  - The company limited by shares is permitted to reduce its share capital in any manner, meaning thereby a selective reduction is permissible within the framework of law (see Re. Denver Hotel Co., 1893 (1) Chancery Division 495).
  - When the matter comes to the Court, before confirming the proposed reduction the Court has to be satisfied that (i) there is no unfair or inequitable transaction and (ii) all the creditors entitled to object to the reduction have either consented or been paid or secured."

Decision

Ld. NCLT allowed the application for reduction of share capital of the Company subject to adherence to the directions given by it.

5. Key Learnings for Valuers from the above Case

i) Section 66 of the Companies Act, 2013 does not contemplate holding of a separate class meeting of only minority shareholders for a reduction of capital. The concept of majority of minority shareholders is neither recognized by law nor under any principles laid down in judgments of the Supreme Court.

ii) Section 66 of the Companies Act, 2013 expressly permits companies to undertake reduction of their share capital in any manner, i.e. including by way of selective reduction of share capital.

iii) The question of reduction of share capital is treated as matter of domestic concern, i.e. it is the decision of the majority which prevails.

iv) The Court has no power or jurisdiction to exercise any appellate functions over the scheme. It is not a valuer nor does it have the necessary skills or expertise. It cannot substitute its own opinion for that of the shareholders. Its jurisdiction is peripheral and supervisory, not appellate.

v) Before a Court can decline sanction to a scheme on account of a valuation, the objector to the scheme has to show that the valuation is ex-facie unreasonable, i.e., so unreasonable that it cannot on the face of it be accepted, the valuation method adopted by the valuers are unacceptable, or are based on patently erroneous assumptions and lastly if the Valuations are vitiated by fraud or malafide.

Case No. 18

Vodafone M-Pesa Ltd. Vs. DCIT, Circle 8(3)(2) (ITAT) (2019)

IN THE ITAT, MUMBAI BENCH, MUMBAI

Appellant: Vodafone M-Pesa Ltd.
Vs.
Respondent: DCIT, Circle 8(3)(2)

I.T.A. No(s). 1073 and 2032/Mum/2019

Decided On: 13.12.2019

1. Brief Facts of the Case:

- The assessee company was engaged in operation of the mobile wallet business. During the year under consideration, the assessee company had issued shares of face value Rs. 10/- each at a premium of Rs. 14.70/- per share, and accordingly received a share premium of Rs. 148.78 Crores. During assessment proceedings, assessee was asked to furnish the working of premium and Valuation Report in respect of the intrinsic value of shares issued during the year under consideration.
- The AO observed that the Valuer has recorded the following in the Valuation Report:-

  "In particular, it may be noted that we have relied upon the information provided by the management. We have been given to understand that the information provided is correct and accurate......"
- From the above statement, he observed that the Valuer had relied on company specific information with respect to various projections and this information was provided to the Valuer by the Management of the assessee. The AO hence asked the assessee to furnish the information provided to the Valuer in order to conduct the valuation.
- On scrutiny of these documents, AO came to the conclusion that Valuer had not independently valued the prospects of the assessee company and had merely relied on information supplied by the assessee. By using

the phrase *"We have been given to understand"* the Valuer has avoided to comment on the correctness of the information.

- The Assessee submitted his contentions as under:-

  (i) the above clause is a standard clause used in all Valuation Reports and there is nothing unusual or atypical about it.

  (ii) a Valuer is required to rely on the information provided by the Company in terms of its historical data and projections, and is not required to verify the authenticity of the data unlike an Auditor who is required to examine and verify the details in an Audit process.

  (iii) a Valuer, basis the future projections of earnings provided by a company, is required to compare it to general industry/economy trends and associated risks and accordingly, arrive at a discounting factor that needs to be applied to future net cash flows.

  (iv) a Valuer is not required to verify the authenticity of the historical and future projections of the company submitted but undertake a scientific exercise of determining the correct 'discounting factor' which indicates the minimum return from the asset being valued had the investor invested in the next best alternative.

  (v) the services/facilities offered are still at a nascent stage and are likely to grow exponentially with the growth of the economy and as and when Indian customers start using such services/facilities on a large-scale basis. Therefore, while the projections prepared by **Vodafone M-Pesa Ltd** (VMPL) at the time of obtaining the Valuation Report may be different from how the first few years have actually unfolded as a result of the uncertain business environment, there are strong future prospects and VMPL is likely to grow rapidly and exponentially with the various digital initiatives invading the economy.

- After considering the above submission, AO came to the following conclusion that

  (i) Assessee has tried to underplay the important disclosures by the Valuer as being standard or routine.

(ii) the cash flow from operations is not positive and there is no basis to make reliable forecast. The prediction of sales and operating expenses have been done by the assessee without any rationale.

(iii) the Valuer has clarified in his report that the forecast regarding future revenues was made by the management and further they stated that company specific information was provided by the Management either verbally or in written form.

(iv) the projections made by the assessee are nowhere near to the actual state of affairs and he came to the conclusion that the management has provided the Valuer, figures in projections as are suitable to their own requirement of charging premium on shares and further observed that the predictions/forecast made by the assessee are not based on any scientific calculation based on the faulty predictions.

(v) Further, the Valuer has stated that the valuation is based on the unaudited balance sheet of the company as provided by the Management and the Management has not provided them detailed assumption and back-up information.

- AO himself calculated the value of shares based on Net Assets Value method and determined the value at Rs. 4.15 per share. Assessee has received an amount of Rs. 24.7 per share for the face value of Rs. 10/-. Hence the excess received by the assessee was Rs. 20.55 per share. This was treated as excess received under the provision of section 56(2)(vii)(b) of the Income Tax Act, 1961 to make addition to the total income of the assessee
- On appeal, Ld. CIT(A) accepted the contentions of the assessee with regard to valuation of the shares based on fair market value on the basis of provisions of section 56(2)(vii)(b) read with rule 11UA of the Income Tax Rules, 1962 and rejected the contention of the AO to value the shares based only on Net Asset method. As per the above valuation rule, the assessee has an option to select the valuation method i.e., net asset or DCF method and assessee can adopt higher of the two-value arrived based on the above said two methods.
- Further Ld. CIT(A) rejected the Valuation Report submitted by the assessee as erroneous by adopting the DCF method, but accepted the

DCF valuation only to the extent of actual performance in the subsequent years and accordingly, partly allowed the ground raised by the assessee.

2. Decision of the Ld. ITAT

- Since Ld. CIT(A) has already addressed the issue of method of valuation which has to be adopted, therefore we do not intend to go into which method has to be adopted and accordingly, we notice that the Department is in appeal against Ld. CIT(A) and in our considered view, Ld. CIT(A) has properly rejected the method adopted by the AO and proceeded to accept the DCF method adopted by the assessee.
- Any valuation is itself a projection of future events or activities and no doubt it has to be done with some accuracy, however, no person in the world at the time of projecting events can project with 100% accuracy and actual events are highly volatile and highly dependent on many factors.
- Assessee has projected based on the fact that software of wallet and association of ICICI bank will increase the market share and accordingly, they have projected the figures. Further, the Valuer has adopted the projection figures provided by the assessee and it is left to the wisdom of Valuer to accept or reject or to carry out independent investigation raised with the Valuer.
- In this case, the valuation was used for the issue of rights shares. The AO or Ld. CIT(A) is trying to evaluate the accuracy of the valuation at the time of assessment, this is not proper and also the factuals are based on so many factors subsequent to adoption of projection and valuation. Accordingly, we are not in a position to accept the method adopted by Ld. CIT(A).
- The Ld. ITAT relied on the following judgements:
  - *Securities & Exchange Board of India & Ors. (Bombay HC)*
  - *Rameshwaram Strong Glass Put. Ltd. v. ITO (ITAT-Jaipur)*
  - *DQ (International) Ltd. vs. ACIT (ITA 151/Hyd/2015)*

3. Key Learnings for Valuation Professionals from the Case

(i) ICAI Valuation Standards, 2018 place the onus on the Valuers to identify the most suitable method of valuation under any assignment. The

valuation approaches and methods shall be selected in a manner which would maximise the use of relevant “observable inputs” and minimise the use of “unobservable inputs”.

(ii) Under DCF method, a valuer shall necessarily: -

a) Analyse the assumptions.

b) test reasonableness of assumptions in context of historical records and current market conditions.

c) Mere estimations without substantiation do not facilitate independent valuation of fair value.

(iii) Valuation, other than rule based, is an estimation and hence, the forecasts and projection cannot match the actual performance. Valuation at two different dates cannot be same due to change in the various internal and external socio-economic factors that impact the concerned asset. However, a valuer and assessee both shall analyse the variance between the actual and projections and prepare a just and proper reason to justify their valuation assumptions to AO.

(iv) A valuer shall maintain documentation which provides:

a. sufficient and appropriate record of the basis of the Valuation Report; and

b. evidence that the valuation assignment was planned and performed in accordance with the ICAI Valuation Standards, 2018 and applicable legal and regulatory requirements.

(v) DCF Method is essentially based on the projections (estimates) only and hence Income Tax Authorities cannot adopt a hindsight view and compare these projections with the actuals to expect the same figures as were projected.

(vi) ICAI Valuation Standard 201- clearly spells out

“The judgments made by the valuer during the course of assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported.”

“The valuer shall carry out relevant analyses and evaluations through discussions, inspections, survey, calculations and such other means as may be applicable and available to that effect.”

(vii) ICAI Valuation Standards 2018 also states that a Valuer is expected to exercise Professional Skepticism in all his Valuation Assignments.

"An attitude of professional skepticism means the valuer makes a critical assessment, with a questioning mind, of the validity of information obtained and is alert to information that contradicts or brings into question the reliability of documents or representations by the responsible party."

(viii) Any valuer when working on any projections and estimations, works with some inherent limitations. A valuer can use various tools and analysis like regression analysis or trend analysis to limit risks of these assumptions and to determine the fairness of projections.

(ix) Consequently, Valuer needs to critically evaluate reasonableness of management developed prospective financial statements.

Case No. 19
Ankit Mittal Vs. Ankita Pratisthan Ltd and Ors (NCLAT) (2019)

IN THE NCLAT, NEW DELHI

Appellant: Ankit Mittal
Vs.
Respondent: Ankita Pratisthan Ltd and Ors

Company Appeal (AT) No. 238 of 2018

Decided On: 29.11.2019

1. Brief Facts of the Case

In the year 2017, seven company petitions were filed by 1st to 6th Respondents to be amalgamated with 9th Respondent under a Scheme. The Scheme further contemplated proposed transfer of identified undertakings in Keshav Power Ltd. and Shree Nirman Ltd. (7th and 8th Respondents) to 9th Respondent.

Learned NCLT vide order dated 30.06.2017 directed 1st, 2nd and 8th Respondent to convene, hold and conduct meetings of equity shareholders thereof on 17.08.2017. Meetings were convened and the report was submitted.

After considering the report the amalgamation scheme was approved by Learned NCLT.

Being aggrieved by the said scheme the appellant has preferred the instant appeal. The case of the appellant is that Mr. Laxman Das held and still holds 450 equity shares in 1st respondent and 685 equity shares in 2nd Respondent.

The appellant is the constituted Power of Attorney holder of Mr. Laxman Das.

The appellant prayed that the impugned order dated 12.04.2018 passed by the Ld. Tribunal is bad in law and therefore shall be quashed and set aside.

2. Key Grounds of appeal and argument presented by the Appellant

The Appellant has challenged the impugned order on the following grounds and arguments:-

- The sanctioned scheme is impermissibly promoter-oriented and anti-minority/public shareholders and is illegal, unlawful, unjust and against the public policy in India.
- The Valuation Report of the Scheme has not been prepared by a Registered Valuer and is a completely unreasoned document.
- The swap ratio of shares as contemplated under the scheme is absolutely illegal, unjust and one-sided. While deciding the swap ratio the intrinsic/market value of the individual shares were not considered.
    - The Valuation Report and the swap ratio qua 1st and 2nd respondent with 9th respondent has arrived at market value approach but the market value of 1st, 2nd and 9th respondent is neither mentioned nor discussed nor compared in the Report.
    - The Valuation Report does not indicate any nexus between the market value of 1st, 2nd and 9th respondent and their inter se swap ratio.
    - The Report is unreasoned and the only basis for the Share Entitlement Ratio is representation made by the management which the Valuer considered to be fair.
    - The following swap ratio recommended by the Valuer is unjustified, as 9th Respondent is the worst performer financially:-

        i) 4 fully paid up equity share of INR 100 each of 9th respondent shall be issued and allotted by every 907 fully paid up equity shares of INR 10 each held in 1st respondent.

        ii) 5 fully paid up equity share of INR 100 each of 9th respondent shall be issued and allotted for every 1541 fully paid up equity share of INR 10 each held in 2nd Respondent."

        And therefore, the less valuable shares of 9th respondent are being given in lieu of more valuable shares of 1st and 2nd Respondent.

- The main assets of the 1st and 2nd respondent are the Investments in the Dalmia Bharat Ltd which has been ignored by the Valuer while arriving at the swap ratio.

    i) 1st and 2nd Respondent held 7.20% and 21.82% shares respectively of Dalmia Bharat Ltd. (DBL in short) in 2016-17 and the net worth of DBL is Rs. 5578 crores and the market capital of DBL was Rs. 17,488 crores. 7.20% of Rs. 5578 crores and 21.82% of Rs. 5578 crores is Rs. 401.61 crores and Rs. 1217.1 crores respectively.

    ii) As per Merchant Banker's Valuation (based on Net Asset Value method which 9th respondent admitted to be the most appropriate valuation method for companies having no significant business), each share of 1st and 2nd Respondent are worth Rs. 20,677.11 and Rs. 14,885.22 respectively.

    However, the book value of 1st and 2nd Respondent was merely Rs. 173.38 and Rs. 280.51 respectively. Therefore, the book value comes out to be 0.83% of its market value in respect of 1st Respondent and 1.8% of its market value w.r.t 2nd Respondent, which is extremely low.

- The Scheme contemplates reduction of capital in violation of Section 66 of the Companies Act, 2013. The appellant represented one of the shareholders of 1st and 2nd respondent; however, he was not served with the Notice convening EGM on 17th August, 2017 by 1st and 2nd respondent and some other companies.

- The Regional Director Southern Region, Ministry of Corporate Affairs Chennai has also filed its objections against the scheme. Still, the NCLT has approved the scheme subject to minor interventions despite the objections of the appellant and the Regional Director not being satisfactorily addressed by the Companies.

3. Arguments presented by the Respondent

The Respondent has presented the following counter replies/arguments:

- The present appeal is not maintainable as the appellant does not have any locus standi to file the present appeal as the appeal has been filed by the appellant in his personal capacity and neither as a shareholder in

any of the Respondent companies nor as a Power of Attorney holder of any of shareholder in any of the Respondent companies.

- Proviso to Section 230(4) of the Companies Act, 2013 envisages that any objection to the compromise or arrangement shall be made only by persons holding not less than 10% of the shareholding or having an outstanding debt to not less than 5% of the total outstanding debt as per the latest audited financial statement and that the appellant in the instant case is not a shareholder but a Power of Attorney of shareholder, whose shareholding is evidently less than 10% and thus the objector is not entitled to oppose the Scheme and his objections are not required to be considered.
- It is a well-settled position of law as interpreted and enshrined in Section 230(6) of the Companies Act, 2013 that once a scheme is approved by the majority and subsequently sanctioned by a Tribunal by an order, then the same shall be binding on the company, its creditors, class of creditors, members, class of members, as the case may be. Therefore, in the instant case, it has become statutorily binding on the appellant and thus, no appeal, could lie therefrom.
- Pursuant to the NCLT order dated 30th June, all members were despatched notice of the meeting individually as well as through public notice. The publication of the notice had been done in Business Standard in English and Malai Malar in the vernacular language on 15th July, 2017, as earmarked by learned NCLT. Therefore, the directions given by the NCLT have been duly complied with both as to publication in the newspapers as well as notices to the shareholders.
- Rule 6 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 posits and clarifies that the service of notice of meeting shall be deemed to have been effected in case of delivery by post, at the expiration of forty-eight hours after the letter containing the same has been posted.
- The Scheme provides for capital repayment for all its shareholders, however, the problem only arose with respect to a handful number of shareholders, whose share value upon re-organisation would be rounded off to zero, as their number of shares would have not met the minimum threshold. However, the NCLT has rightly directed the respondent to

make payment to the shareholders whose shares had been cancelled at the book value rate as on 1.4.2016.

- The Scheme is not a standalone capital reduction under Section 66 of the Companies Act. Further, the Scheme does not violate the provisions of Section 66 of the Act and that a company is entitled to reduce its share capital in a different manner from those envisioned and embedded in Section 66 of the Act.
- Valuation and the process adopted by an expert to arrive at a value or the swap ratio is in the wisdom of commercial experts and the Valuation Report along with the swap ratio are correct and have been arrived at keeping the due principles of equity and valuation in consideration.
- Valuation in the instant case has been arrived at and determined based on the market value approach.

4. Observations raised by the Regional Director, MCA

- The divesting of the shares/investment from the demerged companies (1)(2) pertaining to cement business of the Dalmia group companies is only a transfer of shares and not transfer of a business or business undertaking and hence could not be considered as a Scheme of demerger/arrangement u/s. 230-232 of the Companies Act, 2013 as well under the provisions of Section 2(19AA) of the IT Act, 1961.
- How the minority equity and pref. shareholders in the second demerged company will be issued with shares or compensated for the fractional holdings i.e. who holds less than 1636 equity shares and also the minority Pref. shareholders who are holding less than 4,44,255 has not been stated. Hence the scheme is not complete in all respects as required under the law and may be considered for rejection.
- By not issuing shares or issuing shares less than the value of the Pref. shares redeemed, the transferee company is making deemed profit which has to be notified to the Income Tax authorities for assessing the tax liability.
- The entire share capital of the 2nd transferor company is cancelled which is not permissible under the law. Further, the 2nd transferor has allotted 400 shares which is not forming part of the scheme and hence could not be considered in the scheme and for this purpose alone the scheme of

demerger between the 2nd demerged company and the transferee/resulting company may be considered for rejection.

- Taking into consideration the above submission it is felt that the scheme is not giving complete information in various aspects and hence may be considered for rejection.

5. Decision of the Ld. NCLAT

The Ld. NCLAT dismissed the order passed by the Ld. NCLT dated 12.04.2018 in light of the foregoing arguments and held as under:

(i) The Respondent has not raised the issue w.r.t alleged Power of Attorney Holder before the Learned Tribunal. Therefore, this issue cannot be taken up for the first time in appeal and thus rejects the same.

(ii) As regards the objection raised by the Respondent regarding 10% shareholding or having an outstanding debt less not than 5% of the total outstanding debt is concerned, NCLAT has opined that the law prescribes that the objectors must have 10% limit but when matter is before the Tribunal it is duty bound to see that all the procedures are duly followed and the scheme is conscionable. The issue raised by anybody even if not eligible or even otherwise the Tribunal will have a duty to look into the issue so as to see whether the scheme as a whole is also found to be just, fair, conscionable and reasonable inter alia from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.

(iii) The Valuer made a valuation disregarding the methodology, methods or share entitlement ratio even as stated by him in his Valuation Report.

(iv) Valuation of share of every company has not been done to arrive at the exchange ratio and therefore NCLAT is of the view that only the guess work has been done to arrive at share exchange ratio.

(v) The swap ratio inter se 2nd respondent and the 9th respondent as proposed in the scheme is erroneous on the face of it as the 2nd Respondent is the promoter of Dalmia Bharat with 21.82%. Dalmia Bharat is a listed company on the Stock Exchange having net worth of around Rs. 50 billion.

(vi) The Regional Director of Chennai has also raised certain concerns over the merit of the Scheme.

(vii) A very cavalier approach has been adopted by the Respondents which is unprofessional, devoid of due diligence expected of them.

In view of the other reasons as recorded above and on the basis of this Valuation Report, the amalgamation cannot be termed as fair to all stakeholders.

Accordingly, the Impugned order dated 12th April, 2018 was quashed and set aside and the Respondent was charged a sum of Rs 10,00,000/-.

6. Key Learnings for Valuers from the above Case

(i) Section 247 of the Companies Act, 2013 was notified w.e.f. 8.10.2017. Therefore, the compliance of Section 247 would arise only after this date.

However, the duties of the valuer as all along is necessitated that as a professional he will do his work i.e. Make an impartial, true and fair valuation of any assets which may be required to be valued; Exercise due diligence while performing the functions as Valuer; Make the valuation in accordance with such rules as may be prescribed.

(ii) Valuation of share of every company is a starting point to determine the exchange ratio of the shares of the transferor and transferee company.

(iii) Share exchange ratio has to be outcome of the share value determined for an individual company to ensure that the exchange ratio is fair.

(iv) Valuation Report should justify the figures being arrived at and should not be merely based on guess work.

(v) Scheme cannot be approved where a Valuation Report is not credible.

(vi) Though the law prescribes that the objectors must have 10% limit, however when the matter is before the Tribunal it is duty bound to see that all the procedures are duly followed and the scheme is conscionable even if the issue has been raised by anyone whether eligible or not, the Tribunal will have a duty to look into the issue so as to see whether the scheme as a whole is also found to be just, fair, conscionable and reasonable inter alia from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant.

CASE STUDY

Case No. 20
Kingfisher Airlines – A case study on Brand Valuation

1. King of Good Times – The Beginning

Kingfisher Airlines Limited was launched in 2003 by United Breweries Group (UB), a Bengaluru-based conglomerate well-known for its brand Kingfisher. The brand 'Kingfisher' had created a name for its beverages and was associated with extravagance and style. The chairman of the United Breweries Group was also a famous personality often covered in media for his affluent lifestyle, glamour and vibrancy. Hence from the day of launch itself, the airline was clearly intended to be built on halo of the already existing and globally recognised beverage brand "Kingfisher" and it aimed to provide its customers a similar experience that can be associated with opulence, vibrancy and style.

The Chairman of the company was also a member of the Rajya Sabha in 2002 and again re-elected in 2010. He once had said that "My own lifestyle got intertwined with brand personality and so without really planning it that way I became almost my brand ambassador of and that's just the way it's kept on developing". And this indeed was true and led to the creation of a brand image for Kingfisher Airlines and as the future events unfolded, also to its ultimate decline.

The Airline started its operations in May' 2005 and was known for many of its market first incentives for domestic flyers like flying kit, in-house personalised entertainment, highly paid cabin crew with focus on glamour quotient, lavish airport lounges and exquisite cuisines on its menu which were mostly seen in international flights. Most of these were never known to an economy class flyer and hence they completely redefined flying experience. All these factors set the Kingfisher Brand apart and ahead of its competitors because of which the customers were also ready to pay a premium over and above the competitor's pricing.

Kingfisher Airlines entered Indian Civil Aviation market at the time when the aviation industry was rapidly increasing its market penetration with introduction of low-cost airlines. Air travel was no longer a luxury or privilege that could be afforded by only a few but was now being conceived as a mode of transportation for common people too. A substantial boom in the tourism

industry, together with a growing cash-rich middle-class population and strong government support helped the industry immensely. With growing private involvement and foreign investment, India's civil aviation passenger growth was amongst the biggest in the world.

During this time, when the competitors were looking at ways of reducing their operational cost, Kingfisher airline pampered its flyers with in-flight entertainment and exotic food, which cost crores, but it helped them to create a niche for themselves and develop their brand that was reckoned with luxury and high-end lifestyle.

Soon the airline achieved a five-star status and the brand was reckoned with by the high-class air-travellers who did not mind spending that extra premium for the high-quality service. Kingfisher Airlines was the first and only Indian airline operator to order five A380, Five Airbuses A350-8–aircraft, and five airbuses A330-200 aircraft worth $3 billion. By 2007, it was a significant player and one of the leaders in the Indian domestic aviation sector. The company had the widest reach covering more destinations than any other domestic carrier with its fleet of 41 aircraft and a route network covering 61 destinations. It was now the second biggest airline in India and soon was to become the biggest domestic carrier in the country.

2. King of Bad times – The Downfall of the Magnum Opus

Inspite of high revenue growth and revenue market leadership, Kingfisher Airlines incurred losses all throughout its life until it went bankrupt in 2012. The Airline suffered several severe financial and regulatory setbacks, including year-on-year losses, mounting debt and freezing of its bank accounts at the behest of tax authorities. In October 2012 all Kingfisher flights were suspended and the company's flying license was revoked. Let us look into what went wrong with the Airline inspite of such high revenue growth and market presence.

In 2007, Kingfisher Airlines acquired 46% stake in Air Deccan, in three phases, for a whooping sum of more than ₹1000 Crores and subsequently in December 2007, Air Deccan was merged with Kingfisher Airlines. While this merger helped the company to increase its customer market share and its count of aircraft but since Air Deccan was already a loss-making entity, it impacted bottom-line of the company immensely. Kingfisher Airlines suffered a loss of more than 1000 crores for three consecutive years after it acquired Air Deccan.

Post-merger the airline decided to phase out Brand "Air Deccan" and started offering three classes of travel services: -

1) Kingfisher First – Premium Business Class of service
2) Kingfisher Class – Premium Economy Class of service
3) Kingfisher Red – Low fare basic class of service

This strategy couldn't benefit airlines and only led to confusion in the mind of its customers. It couldn't help the Airline to attract the no frill customers for Kingfisher Red rather it impacted the brand strength as it was no more the premium brand reckoned by high-class travellers.

The merger only added to the financial woes of the company by adding to higher debt and financing costs of the company.

In 2008, the domestic aviation industry continued to witness capacity expansion by all airline operators and the competition grew stiff amongst operators putting pressure on the pricing, the top line and ultimately the profitability of the company. In addition, an increase in crude prices during this period resulted in surge in the price of Air Turbine Fuel Cost which further impacted the profitability. The rising fuel cost along with rampantly increasing operating cost combined together in cascading operating losses for Kingfisher Airlines. Given the global financial meltdown and economic downturn during this period; there was slow-down in the air travel market too and hence, profitability remained a concern for airlines given the high cost of operations. In 2008, the company also started international operation of business by connecting Bengaluru with London.

Post 2009, major steps were taken by the Airline with respect to distribution costs, fuel management systems, aircraft utilisation and general contracts in order to enforce cost competitiveness. However, many finance professionals believed that it was too late as the way its Chairman was building up the brand for the airline was never connected with business and commercial sustainability. A customer might pay extra for beverages but not for transport because transport is a type of a necessity and not a luxury. It is because of this the cost per seat for Kingfisher Airlines was still higher than its competitors and hence the profitability of the company continued to be in red, that was also an infamous corelation to the aura of glowing red that the Airline used to project.

The low-cost airlines like Indigo and Spice Jet were also able to erode the customer base of Kingfisher Airlines with their attractive fares during this period and hence impacting the revenue and ultimately the bottom line for Kingfisher Airlines. The fleet size of the airlines was also reduced significantly over the next few years to keep the airline afloat.

The company started raising loans to overcome its weak financial condition, but because of the loans the company had a huge burden of interest and debt that further added to its woes.

To reduce the burden of heavy debt and interest, Board of Directors decide to undertake debt restructuring later.

Things went out of control for the Airlines also because the company never had a stable professional management in place, who had experience of working in Airline Industry. When Kingfisher Airlines was launched in 2005 Nigel Harwood was appointed as the CEO but he left after a year and then the Airline did not have a CEO till 2010. The frequent change of CEO and incorrect strategic decisions by the top-level management seemingly also led to the downfall of the Airlines.

3. Comparative year-on-year Financials of the Company

Source: Annual Reports

Kingfisher Airlines Ltd.

Profit & Loss

Amount ₹ In Crores

Particulars	**Jun-06**	**Jun-07**	**Mar-08**	**Mar-09**	**Mar-10**	**Mar-11**	**Mar-12**	**Mar-13**
Sales	**1,234**	**1,618**	**1,439**	**5,163**	**4,919**	**6,281**	**5,469**	**495**
Expenses	1,691	2,624	2,203	7,247	5,919	6,292	7,615	3,274
Operating Profit	**-457**	**-1,006**	**-764**	**-2,083**	**-1,000**	**-11**	**-2,146**	**-2,778**
Other Income	166	670	178	840	-152	44	318	152
Depreciation	13	18	18	133	163	241	342	239
Interest	32	62	78	779	1,103	1,313	1,276	1,436
Profit before tax	-337	-416	-683	-2,155	-2,418	-1,521	-3,446	-4,301
Tax	4	3	-494	-546	-771	-493	-1,118	-
Net profit	**-341**	**-420**	**-188**	**-1,609**	**-1,647**	**-1,027**	**-2,328**	**-4,301**

As can be seen from above, the company was never in profits since its inception inspite of good growth in its revenue. Further since 2008, post-merger with Air Deccan, the net loss for the company was more than Rs. 1000 Crores till it went defunct. During this period the debt and the loan amounts for the company also increased significantly as can be seen hereunder. By 2012, the Airline had negative reserves of more than ₹6000 Crores with Borrowings of almost ₹9000 crores in its Balance Sheet.

Source: Annual Reports

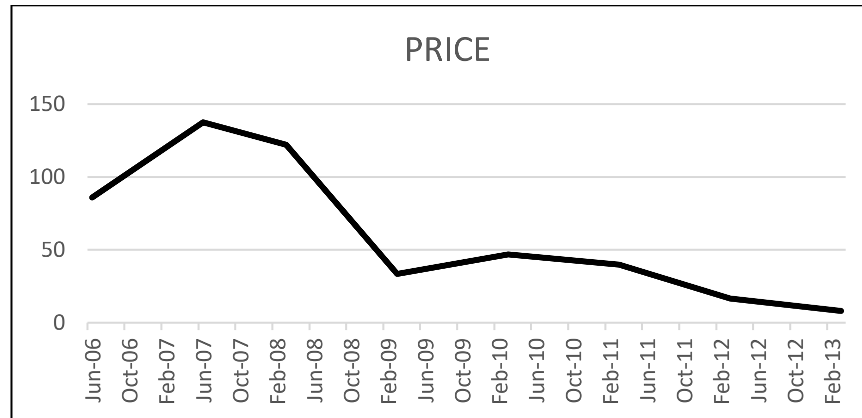
Kingfisher Airlines Ltd.

Balance Sheet

Amount ₹ In Crores

Particulars	Jun-06	Jun-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13
Equity Share Capital	98	135	136	266	266	498	578	809
Reserves	118	238	53	-2,496	-4,241	-4,002	-6,213	-14,282
Borrowings	452	917	934	5,666	7,923	7,026	8,719	9,407
Other Liabilities	383	493	677	3,645	3,659	4,737	6,036	6,903
Total	**1,051**	**1,784**	**1,800**	**7,080**	**7,607**	**8,259**	**9,120**	**2,837**
Net Block	231	307	279	1,576	1,555	1,572	1,443	712
Capital Work in Progress	287	358	346	1,631	981	-	-	-
Investments	0	0	-	0	0	0	0	0
Other Assets	533	1,119	1,175	3,874	5,072	6,687	7,676	2,126
Total	**1,051**	**1,784**	**1,800**	**7,080**	**7,607**	**8,259**	**9,120**	**2,837**

Pricing Trend Kingfisher Airlines Ltd.



4. Issues with Corporate Governance leading to Ultimate Failure

Owing to its business model and several incorrect strategic decisions the Airline was incurring losses right from its launch inspite of high revenue growth. By 2012, the Airline had accumulated loss of more than Rs. 6000 crores due to its operational inefficiency combined with the impact of economic downturn. The company started funding its losses by drawing loans from various banks and by the year 2012, it has an outstanding loan of more than Rs. 7,500 crores towards a consortium of Banks out of which SBI had the maximum exposure of Rs. 1600 crores. The company soon started defaulting in paying back its lenders leading to a series of legal and regulatory actions against the company.

The company not only defaulted in paying back its lending Banks but also failed to pay back its creditors and outstanding government dues. The company used to buy Air Turbine Fuel from BPCL which was one of its key creditors, but since the airlines repeatedly defaulted in payments, it stopped supplying fuel to the Airline and the company switched to other vendors. Due to its repeated failure in payment of bills to the new vendors too, it was soon put on cash and carry mode by these companies as well.

Employees are the backbone of any company and Kingfisher Airlines had a strength of more than 5000 employees. When the company started facing financial difficulties the company delayed payment of salary to its employees for several months because of which many of them resigned while others went

on strike to recover their dues. The company not only defaulted in paying their salary but also Tax Deducted at Source (TDS) and the PF contributions were not deposited with the Government. These actions of the company affected lives of its employees badly and nothing was done to amend it. All this not only impacted the business tremendously but also tarnished the image of the brand.

The company also defaulted on payment of several statutory dues to the Government and other Regulatory Authorities. This led to freezing of its bank accounts at the behest of Tax Authorities and the Carrier lost its flying license as the Directorate General of Civil Aviation (DGCA) refused to renew its Air Operator Permit (AOP) in December 2012.

The Auditors of the company were also issuing qualifying reports for several consecutive accounting years but same was being disagreed by the management and justification for accounting policy adopted was given in their Director's Report. Some of the key Accounting Policies for which the reports were qualified by the Auditors are as under:-

a) Auditors were of the view that the receipt of subsidy from aircraft manufacturers should have been recognised as income on a systematic basis over the period necessary to match them with related cost, while the company accounted the subsidy received from the aircraft manufacturer as income in the year of accrual and receipt itself and hence inflating their Income to that extent.

b) The Fair Market Value of the Aircrafts considered by the company was based on the Valuation Report received from a leasing company and same was higher than the sale price of these Aircrafts.

c) Cost of repairs and maintenance was amortized by the company while same should have been expensed off according to the Auditors.

5. Valuation of the Brand of the Company and Issues around it

The term 'brand' refers to names, signs, symbols, colours, logos etc. that help customers to identify goods, services, or companies. It is something that a consumer associates itself with and considers as a promise by the brand that they will conform to the expectations they have created in the minds of their customers.

Hence, Brands are the interface between a business and its customers. It is the Brand through which the customers interact with business owners. Brand Value is the monetary worth of the Brand if it was sold and represents financial value attributable to the brand equity for a given purpose.

Kingfisher Airlines Brand was valued at ₹4,100 crores in the year 2008 by valuer XYZ when the Kingfisher Airline was a market leader with more than 30% market share. Based on this Valuation, the company was able to raise loans from banks by making its Brand the single largest collateral for these loans. Post the downfall of the company the Brand Valuation done by XYZ was questioned and it came under the scanner of the investigating agencies. Serious Fraud Investigation Office (SFIO), which comes under the purview of the Ministry of Corporate Affairs, started investigating the ₹4,100 crore valuation attached by the Valuers to the Kingfisher Airlines brand.

Questions were raised on the Brand Valuation Methodologies used and how the brand can be valued at such a whopping amount when the company had been making losses since its inception. Further, when the company started defaulting, the lenders appointed a second valuer who estimated the value of Brand at ₹160 crore which was less than 95% of the original valuation done by XYZ Valuer.

In April 2014, SBICAP Trustee Co. Ltd, a wholly-owned subsidiary of SBI Capital Markets Ltd, attempted to sell the Kingfisher Airlines brand and called for an expression of interest in acquiring trademarks linked to the grounded Kingfisher Airlines.

The list of trademarks offered included “fly kingfisher” (label), “fly kingfisher”, “flying models”, “fly the good times”, “fun liner”, “kingfisher” and “flying bird device”. Unfortunately, there were no takers for these brands as by that time the controversy surrounding Kingfisher had damaged the brand so badly that no airline came forward to take it.

The episode has put a question mark on the working of Valuers undertaking brand valuation, but it is important to understand that valuation is done as on a particular date and is based on the circumstances existing as on the date of Valuation. Further, valuation is an opinion that a Valuer express based on his professional judgement and on a hindsight, everyone can be an expert and question the projections and valuation, but as on the date of valuation, no one can project the future accurately as there are multiple assumptions that a

Valuer undertakes with respect to the company, industry and various micro and macro-economic factors.

Having said that, it is also important that a valuer carry out sufficient analyses and evaluation to justify his assumptions and projections. Reference is made to para 26-28 of ICAI Valuation Standard 201- Scope of Work, Analyses and Evaluation, which states as under:

"Analyses and Evaluation

26. The extent of analyses to be carried out by the valuer in relation to the engagement shall be based on the purpose of the valuation assignment and the terms of engagement.

27. The judgments made by the valuer during the course of assignment, including the sufficiency of the data made available to meet the purpose of the valuation, must be adequately supported.

28. The valuer shall carry out relevant analyses and evaluations through discussions, inspections, survey, calculations and such other means as may be applicable and available to that effect."

In the case of Kingfisher Airlines it is perceived that, while the Valuer XYZ considered the Market Share of the company that was generated in a short time, preference of the brand over the nearest competitor and its ability to command premium over competition and the perception and the hype around the brand and its promoters but what they didn't consider was the ability of the brand to consistently command premium and ability to perform in case of Disruption. The traditional method of valuation holds good only when a stable environment is expected to continue however, if the business associated with the brand undergoes a disruption, the brand needs to be valued on a revised estimated future cash flow basis.

The biggest example of the impact of disruption on a brand valuation is that of Nokia. While Nokia had the largest market share in mobile handsets and was always amongst the top names on brand valuation lists but it was not future-ready and couldn't perceive the change in industry that was about to come post the smartphone launch.

According to one of the leading brand valuation firm, brand value is attributable to three components – financial performance, the role of the brand, and brand strength.

1) **Financial Factors –** The future expected revenue/profits to be earned out of the brand name is the first factor that impacts the brand value.

2) **Role of Brand –** It is the second factor and is determined from the fact that whether the purchase of the product is based more on an emotional decision or a rational one. For e.g.: - electricity and petrol are some of the products wherein the role of brand is very low while luxury items like Gucci or Dior belongs to a very high role of brand category as 75% of its sale is impacted by the brand itself. So higher the role of a brand, higher is the premium that can be charged against the same.

3) **The Strength of brand vis-à-vis competition –** There are 10 internal and external factors that are investigated to determine the strength of a brand against its competition. Higher the strength of brand means lower risk associated with the brand. Hence a high strength score reduces the discounting rate in brand valuation. There are four internal factors and six external factors that needs to be considered and they are as under: -

Internal assessment looks into following factors: -

(i) **Direction –** It tests whether the management is clear about the future direction for the company.

(ii) **Alignment –** Are all the stakeholders and internal decision makers aligned and pulling the entity in the same direction.

(iii) **Empathy –** How good is business in listening and responding to customer's requirements and also their unspoken needs.

(iv) **Agility –** How quickly an Organisation can respond to changing customer needs and also how proactive it is in leading the change in customer perception.

External assessment on the other hand are more customer and competition facing: -

(i) **Distinctiveness –** How distinct is the customer experience for the brand in comparison to the competitors and the biggest example for it is Apple.

(ii) **Coherence –** How coherent/consistent is customer experience under different markets and channels.

(iii) Participation – Is there a one-way communication or a two-way dialogue between the customers and the brand. In today's age, this factor is gaining significant importance as customers are using brands to build up their own individual brands.

(iv) Presence – It is not just physical presence but how top of mind is the product in customer's everyday conversation, is there a positive buzz surrounding the brand. E.g. – electric vehicles, which have a positive buzz around them in the current scenario.

(v) Trust – It is the most basic criteria i.e., does the customer trust the brand to deliver its promise?

(vi) Affinity – Does a customer feels that the brand plays a positive and meaningful role their life.

"Brand is a living business asset that can either be enriched or killed everyday by thousands of small gestures by the business."

The above statement by Michael Eisner, ex-CEO of Disney holds completely true in this case as the Kingfisher brand too was significantly impacted due to the reputation of its Chairman who was known for his particularly extravagant lifestyle and was also known to have fled the country when the airlines became defunct. Further, the Brand was no longer an attractive prospect for its potential buyers as it underwent immense turbulence and negative publicity due to the bad corporate governance exercised by the company and every-day actions of its management.

6. Conclusion

The role of Bankers and Regulators in the entire case was also questioned and investigation was carried out by SFIO. The most pertinent question asked was how can the Banks issue loans against Brand as a single largest collateral. It is known that one needs to be very cautious while granting loans against a Brand and rather they should have relied on the collateral that can be sold or enchased at a later stage. The banks should have asked on what basis is the trademark value sustainable and how would the business have to perform to make it as valuable as claimed. Also, banks should monitor the brand's value on a regular interval as there can be impairment on account of deterioration in financial performance.

While no one could be expected to behave in tralfamadorian way; this rather infamous case has brought to fore the role of valuation and more particularly the valuation of intangibles and to this date offers a case study arising out of Crisis of Value.

Sources:-The data for the case study has been taken from various sources such as newspapers, annual reports of the company and published reports.