# Article two

**“Court is not a Meticulous Accountant”: Bombay High Court in Cadbury India’s Capital Reduction case – Analysis of Judgment**

[-CS Gaurav Pingle]

## Introduction:

Valuation of shares is one of the most debated subjects in corporate restructuring – whether, the proposed corporate action is mergers or amalgamation or demerger or reduction of share capital or delisting of shares etc. Till now, various courts have laid down important benchmark on valuation of shares and broadly speaking, in almost all cases; certain class of shareholders have either objected to a particular resolution in general meeting or opposed contents of scheme or questioned methodology of valuation of shares.

In a very recent matter of Cadbury India Limited; Bombay High Court passed a landmark judgment on valuation of shares in the matter of share capital reduction. The Author has analysed the judgment and presented in following format:

(1) Fact of Case;
(2) Summary of Objections;
(3) Position of Law;
(4) Principles in Judgment;
(5) Conclusion.

## Fact of Case

1. Cadbury India Limited (“Cadbury India”-unlisted public company) filed petition under Sections 100 to 104 of Companies Act, 1956 [Corresponding to Section 66 of Companies Act, 2013] for reduction of share capital seeking Bombay High Court’s approval;

2. Cadbury India’s promoter company is Cadbury Schweppes Overseas Limited (“Cadbury Schweppes”). Cadbury Schweppes is a subsidiary of Cadbury Plc, UK (“Cadbury Plc”).

3. Due to stringent FDI regime in India in the past, Cadbury Schweppes was required to dilute its shareholding in Cadbury India from 100% to 60% and hence, Cadbury India ceased to be WOS of Cadbury Schweppes.

4. Later, the economy opened up and Government allowed FDI up to 100% and then Cadbury Schweppes and another group company - Cadbury Mauritius Ltd. (“Cadbury Mauritius”) increased their collective holdings in Cadbury India to 90%. Later, through various open offers and buy back offers Cadbury Group increased its shareholding in Cadbury India to 97.583%;

5. In Petition for Capital Reduction filed in the year 2009, Cadbury India relied on Share Valuation Report of two Independent Valuers - M/s. Bansi S. Mehta & Co. and M/s. SSPA & Co. On the basis of valuations, Cadbury India held an Extraordinary General Meeting ('EoGM'), and Special Resolution was put to vote by Poll. Following are the details of the voting at EoGM:

| | |
|---|---|
| **Number of votes polled** | 3,03,31,248 |
| **Votes in favour for Special Resolution** | 3,03,18,464 [Representing 99.96% of the votes polled] |
| **Votes not in favour for Special Resolution** | 12,784 [Representing 0.04%] |

6. Opposition came from several sets of shareholders; of which only 2 sets of shareholders – Samant Group & Churiwala Group continued the opposition; others shareholders accepted a settlement of their claims and the Gidwani Group's claim was restricted to interest;

7. In April 2010, an Order was passed in Company Petition and objectors took exception to Valuation Report of M/s. Bansi S. Mehta & Co. and SSPA & Co. and Cadbury India agreed to obtain fresh valuation by court appointed Independent Valuer - M/s. Ernst & Young ('E&Y') and accordingly the valuation report was provided based on same material as provided to M/s. Bansi S. Mehta & Co. and M/s. SSPA & Co,;

8. E&Y submitted its Valuation Report based on Comparable Companies Multiples ("CCM") Method of valuation. Later, E&Y was directed to update its valuation report based on Discounted Cash Flow ("DCF") Method to reflect a valuation as on a particular date.

| **Valuation of Equity Shares at various intervals** | |
|---|---|
| **1st Open Offer** | Rs. 500.00/- per Equity Share |
| **Series Buy Back Offer** | Rs. 750.00/- to Rs. 1,030/- per Equity Share |
| **Valuation as per Reports of M/s. Bansi S. Mehta & Co. and M/s. SSPA & Co** | Rs. 1,340.00/- per Equity Share |
| **E&Y Report (Report 1)** | Rs. 1,743.00/- per Equity Share |
| **E&Y Report (Report 2)** | Rs. 2,014.50/- per Equity Share |

## Summary of Objections:

1. There is no disclosed basis of valuation in either of E&Y's Valuation Reports;

2. There is a lack of transparency while filing Cadbury India's share valuations;

3. Valuation of shares by E&Y is incorrect. DCF method and not CCM method ought to have been followed;

4. E&Y has given an incorrect weightage to both methods;

5. There are infirmities in the 2nd E&Y Report;

6. Valuation is depressed;

7. Cadbury India's conduct inspires no confidence;

8. Cadbury India's shares have been deliberately undervalued; and

9. Submissions in relation to what ought to be the approach of a Court in matters like these.

**Position of Law:**

1. The Sandvik Division Bench held itself to be bound by the decision of the Supreme Court in Ramesh B. Desai & Ors. V/s. Bipin Vadilal Mehta & Ors. The Division Bench held:

> *"………. In our opinion once it is established that non-promoter shareholders are being paid fair value of their shares, at no point of time it is even suggested by them that the amount that is being paid is any way less and that even overwhelming majority of the non-promoter shareholders having voted in favour of the resolution shows that the Court will not be justified in withholding its sanction to the resolution………..."*

2. Supreme Court decision in Ramesh B. Desai followed decision of the House of Lords in British & American Trustee and Finance Corporation Ltd and held:

> *"……… Vexed question of legality of purchase by a limited company of its own shares was set at rest by the decision of the House of Lords in (Trevor Vs. Whitworth), 1887 (12) AC 409, since which it has been clear law that a limited company cannot purchase its own shares except by way of reduction of capital with the sanction of the court. (See Buckley on the Companies Act, 14 the Edn.p.1499.) In the same decision it was also held that even express authority to the contrary in the memorandum is unavailing. The main reasons for this prohibition were that such a purchase could either amount to "trafficking" in its own shares, thereby enabling Company in an unhealthy manner to influence the price of its own shares on the market, or it would operate as a reduction of capital which can only be effected with the sanction of the Court and in the manner laid down in the statute (see Palmer's Company Law, 23rd Edn.p.440), in Guide to the Companies Act by A. Ramaiya (16th Edn.,.951) apart from Trevor Vs. Withworth, British & American Trustee and Finance Corporation Vs. Couper, 1894 AC 399 has also been referred to as a leading authority on the subject. ..."*

The judge relied on the above decisions stating that before a Court can decline sanction to scheme on account of valuation, an objector to scheme must first show that valuation is *ex-facie* unreasonable, i.e. valuation is so unreasonable that it cannot be accepted or it is discriminatory; or that it has not been approved by requisite majority or that substantial

number or percentage voted against it at an EoGM. Also noted that basic requirements of Section 100 of Companies Act, 1956 are as follows:

(1) Articles of Association permits reduction of share capital;
(2) Scheme must be approved as Special Resolution; and
(3) Court's sanction must be obtained to such a resolution, if passed by requisite majority.

The Court has to ensure the following:
(1) Scheme is not against public interest;
(2) Scheme is fair and just; and
(3) Scheme does not unfairly discriminate against or prejudice a class of shareholders.

**Principles in the Judgment: Final blow to Minority Shareholders:**

The judgment was based on following principles:

(1) Section 100 of Companies Act, 1956 requires provision in Articles of Association to permit reduction of share capital, Scheme must be approved as Special Resolution and Court's sanction must be obtained to such a resolution, if passed by requisite majority;

(2) One test of reasonableness might be to consider past open offers, extinguishments or buy-backs, and rate at which these were effected. Where it is found, for instance, that present offer is significantly higher than previous ones, the burden on an objector is exponentially higher to show that even this enhanced rate, price or valuation is unfair or unreasonable;

(3) Before Court can decline sanction to Scheme on account of valuation, an objector to Scheme must first show that valuation is *ex-facie* unreasonable, i.e., so unreasonable that it cannot be accepted;

(4) In considering an application for Court's sanction, minimum following tests are to be met:

   (a) Is a fair and reasonable value being offered to minority shareholders?
   (b) Have majority of non-promoter shareholders voted in favour of resolution?
   (c) Can it be said, on reading a valuation as any fair-minded and reasonable person would do, and without microscopic scrutiny, that valuation is so egregiously[3] wrong that judicial conscience will not permit it?
   (d) Has valuer gone so far off-track that results his valuation returns cannot but be wrong?

(5) Court called upon to sanction such scheme is not bound by ipse dixit[4] of majority. It must weigh scheme and look at it from all angles. It must see whether the scheme is fair, just

---

[3] Meaning 'extremely' / 'remarkably'

[4] Meaning 'dogmatic and unproven statement'

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, 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***;

(6) ***Sanctioning court has no power or jurisdiction to exercise any appellate functions over 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"***;

(7) Valuation is not an exact science. 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 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;***

(8) 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.

## Conclusion:

It was concluded that there is no valid or tenable objection to scheme relating to capital reduction. Valuation of Rs.2,014.50/- per fully paid up equity share arrived by Court-appointed valuer [E&Y] in its second (supplementary) report was accepted. The scheme for reduction of share capital was sanctioned by the High Court and rejected all the claims of the objectors on aforementioned principles.

This judgement is an eye opener for shareholder Activists that miniscule minority should not hold the corporate at ransom for their own trivial benefits.

***Feedback @ [acsgauravpingle@gmail.com](mailto:acsgauravpingle@gmail.com)***