



Unfair share exchange ratio – NCLAT set aside the scheme

The Hon'ble National Company Law Appellate Tribunal ('NCLAT'), in its recent decision¹ set aside the order passed by the National Company Law Tribunal, Chennai Bench² ('Tribunal'), thereby rejecting the scheme of amalgamation and arrangement ('Scheme') amongst promoter group entities ('Respondents') holding shares in a listed entity. Questioning the basis and fairness of the valuation report, the NCLAT allowed the appeal by minority shareholders ('Appellants') (holding less than 1%) involved in the Scheme.

Background

- The Scheme involving amalgamation and demerger of promoter group entities was filed before the Tribunal.
- Two of the transferor companies (i.e. disclosed promoters) held 7.20% and 21.82% in a listed group entity. The market capitalisation of the listed group entity as on the appointed date was INR 17,488 crores.
- The valuation report recommended the share exchange ratio for the amalgamation and demerger based on the book value/ net asset value of the shares of the respective transferor companies.
- Objections were raised by minority shareholders regarding the fairness of the valuation report. However, due to the absence of locus under section 230(4)³ of the Companies Act 2013 ('the Act'), the Tribunal overruled the objections of the minority shareholders.

¹Order dated 29th November 2019 passed by the National Company Law Appellate Tribunal, Delhi in Company Appeal [AT] No. 238 of 2018

²Order dated 12th April 2019 passed by National Company Law Tribunal, Chennai Bench in relation to Company Petition CP/159/CAA/2017

³Section 230(4) of the Act provides that an objection to a scheme shall be made only by a person holding not less than 10% of the shareholding.



- Aggrieved by the said order of the Tribunal, the minority shareholders preferred an appeal before the NCLAT.

Contention of the Appellants

The contentions put forth by the Appellants are summarised below:

- The valuation report mentioned that the share exchange ratio has been arrived at through the book value approach/net asset value approach. The valuer relied on the representation provided by the management to arrive at the basis for the share exchange ratio.
- The market value of underlying investments in the listed entity was not considered by the valuer in the valuation report.
- Therefore, the share exchange ratio is unjust and unfair to the minority shareholders and is beneficial only to the promoter shareholders.

Submissions of the Respondents

- The Appellants do not hold the requisite number of shares as envisaged under section 230(4) of the Act, and therefore do not have a locus standi for filing objections to the Scheme.
- The preparation of a valuation report is the function of experts, which involves various factors; even if the correct principles are applied, different valuers may arrive at different valuations.
- Since the transferor companies have no significant business, valuation of the shares at book value ought to be the most appropriate method.
- Further, as per section 230(6) of the Act, once a scheme is approved by the majority of shareholders and creditors and sanctioned by the Tribunal, it shall be binding on all the stakeholders.

Observations of the NCLAT

The NCLAT set aside the order of the Tribunal sanctioning the Scheme and held the following:

- Since the value of shares in the listed entity held by the transferor companies is not considered, the share exchange ratio proposed in the Scheme is prima facie erroneous.
- Even though the shareholders did not have a '*locus standi*' as per section 230(4) of the Act, the Tribunal is duty bound to see whether the Scheme as a whole is just, fair, conscionable, reasonable and not opposed to public interest.
- Section 247 of the Act provides that it is the duty of the valuer to make an impartial, true and fair valuation of any assets required to be valued.
- Due to the lapses in the valuation process, the Scheme could not be termed to be fair to all stakeholders.



Dhruva Comments

It is interesting to note that there are various judicial precedents wherein the Courts/Tribunals have upheld the requirement of '*locus standi*' as provided under section 230(4) of the Act for objecting to a scheme. However, the NCLAT has upheld the objections of the minority shareholders on principles of fairness and natural justice. The NCLAT has also put onus of true and fair valuation on the valuer as provided under the Act.



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