

Second All India Corporate Law Moot Court Competition - 2010

CORPORATE LAW MOOT PROBLEM

BEFORE THE COMPANY LAW BOARD BENCH, NEW DELHI

(Company Petition No. 2005 of 2010)

In the matter of:

Mr. Nandan Shah	Petitioner No. 1
Mr. Ashok Kumar and other minority shareholders	Petitioner No. 2

Versus

Mr. Akhil Rao and other nominees of EBIL	Respondent No. 1
Tropical Formulations Limited	Respondent No. 2

Facts:

1. Tropical Formulations Limited (TFL) is a company limited by shares, incorporated under the Companies Act, 1956 on January 17, 1999 and having its registered office at No. 14/1, Business Arcade, KJ Road, New Delhi – 110 007. TFL is listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE), where its stocks are frequently traded. The main realm of its operations consists of the manufacture and sale of fruit juices packaged in tetra-packs, plastic bottles and cans (Business), under the brand-name ‘Surreal’. TFL engaged several famous cine actors, sports persons and models to endorse its products, and annually distributed about 50,000 units of its products to orphanages and destitute homes as part of its obligations under corporate social responsibility. Surreal was increasingly getting popular among the youth and adults alike, and as a result, TFL had the largest share in the Indian food and beverage market segment.
2. TFL was broadly and substantially controlled by 2 (two) groups of shareholders, who were also the promoters of the company (Promoters) – Mr. Nandan Shah alongwith relatives (collectively, Shah Group) and Mr. Akhil Rao alongwith relatives (Collectively, Rao Group) – jointly holding around 58% of the equity share capital in the company, in equal proportion. These 2 groups had entered into and executed a mutual collaboration agreement (MCA) in the year 2002, pursuant to which 3 individuals nominated by each of the parties were appointed to the board of directors of TFL (Board), in addition to the independent directors as required under the BSE Listing Agreement. The provisions of the MCA were duly incorporated in the articles of association of TFL (Articles).
3. Under the terms of the MCA, Mr. Nandan Shah was appointed the Managing Director while Mr. Akhil Rao was elected to act as the Chairman of TFL. In addition, the parties to the MCA had agreed as follows:

Section 11: From and following the expiration of the closing hereof, the Shah Group shall not transfer any of the shares held by them in TFL without first offering such shares (ROFR Shares) to the Rao Group, by giving them an advance notice (ROFR Notice) at a price per share set out therein, which shall be the higher of a mutually agreed upon price or the price determined in accordance with the applicable law (ROFR Price). The Rao Group or its representative/ nominee shall remit the ROFR Price to the Shah Group which shall simultaneously transfer the ROFR Shares to Rao Group or such representative/ nominee. Subject to the receipt of all requisite approvals under the applicable law, the sale and delivery

of the ROFR Shares shall be consummated within 15 days from the receipt of the ROFR Notice, subject to the provisions under the applicable law.

The aforesaid process shall apply *mutatis mutandis* to a transfer by the Rao Group, vis-à-vis the Shah Group.

Section 17: Until such time that any party's equity shareholding in the company does not fall below 14%, the decisions by the Board in the following instances shall be passed by a majority of directors; provided however that, such majority comprises of the affirmative vote by at least 1 (one) nominee of each of the parties:

- (a) Any single item of capital expenditure by the company, beyond Rs. 50,00,000/-;
- (b) Any transfer of equity interests of 5% or more of the company's paid up capital to any third parties and the terms and conditions thereof;
... Among *others*.

Section 25: This Agreement shall automatically terminate upon a change in control of the company.

4. EffBee Limited (EBL) is another company limited by shares, incorporated under the [Irish] Companies Act, 1963 on April 18, 2001 and having its registered office in Dublin. EBL is known world-over for its food and beverage products, sold under the common chain-name of 'HungerKiller'. In the month of January 2010, the management of EBL noted that the company had a considerably low profit margin in the Indian market, where although its products were marketed with the help of leading national entities, the revenues did not match the desired levels. A full-fledged survey accompanied with a commercial due diligence was undertaken, as a result of which it was revealed that the Indian consumers were more inclined to purchase the locally manufactured products. Accordingly, EBL set up a wholly-owned subsidiary in India under the name of EffBee India Private Limited (EBIL), with its registered office located at No. 27/D, The Wave Plaza, Noida (U.P.) – 201 301. The main objects under EBIL's memorandum of association comprised manufacture, storage and supply of biscuits, preserved cakes and other related confectionary items. EBIL's market for its products, distributed under the brand name 'Biscakes' was fairly widespread in India and was concentrated among the school children. EBIL deployed several advertising campaigns with the fair use of copyrights owned by producers of famous cartoon characters world over.
5. To improve its profit margins and deploy its surplus distributable reserves, EBL decided to buy a substantial stake in TFL through EBIL by way of downstream investment, and consequently executed a share purchase agreement with the Promoters (SPA) on April 20, 2010, pursuant to which EBIL would buy shares representing in the aggregate 32% of equity share capital of TFL, from the Promoters (out of which 18% would be purchased from the Rao Group) for a mutually agreed upon consideration (Consideration). In addition, as required in terms of the provisions of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, as amended, EBIL would conduct a public open offer for Twenty-Five per cent (25%), conditional upon the acquisition of at least 22% of the issued and paid-up equity share capital of TFL, at a price determined in accordance with the applicable law. Other salient points as contemplated under the SPA are set forth below.

As part of the Conditions Precedent to the Closing:

Section 4.5: The Promoters shall have executed and delivered all such consents as may be required under its charter documents and taken all such actions to allow EBIL to nominate its representatives for appointment to the Board in accordance with law, once EBIL has deposited 100% of the consideration in the Designated Escrow Account.

Section 4.9: There shall not have been or occurred any event, change, occurrence or circumstance that, individually or in the aggregate with any other events, changes, occurrences or circumstances, has had or could reasonably be expected to have a Material Adverse Effect.

In respect of the aforesaid, “Material Adverse Effect” would mean an effect on: (1) the value of the Business, such that the value is reduced by an amount equal to or more than 15% of the Consideration; or (2) the Business, such that either the prospects or the future cash flows of the Business are affected by an amount equal to or more than 15% of the Consideration, including, but not limited to, for example, in the event that TFL is blacklisted by any governmental authority.

As part of the Mutual Covenants:

Section 7.1: The Promoters shall cause their nominees to vote in favour of the resolutions tabled before the Board at the first and the second Board meetings in respect of appointment of the EBIL nominees to the Board, among other matters.

Section 7.5: For a period commencing the closing date and until the fourth anniversary thereof, the Promoters shall not, directly or indirectly through any other person, own, manage, operate or control or participate in the ownership, management, operation or control of any business, whether in corporate, proprietorship or partnership form or otherwise) any business that competes with the Business in India or abroad. The parties specifically acknowledge and agree that a remedy under applicable law for any breach of the foregoing will be inadequate and that EBIL, in addition to any other relief available to it, shall be entitled to temporary and/or permanent injunctive relief without the necessity of proving any actual damage.

In addition to the above, the Letter of Offer stated that the acquisition will not result in change in control of the company.

6. Following the closure of the public offer and consummation of the transactions contemplated under the SPA, EBIL held 56% of the equity capital in TFL. On June 4, 2010, TFL passed certain board resolutions by majority: one ratifying a supplemental letter agreement (SLA) pursuant to which certain additional shares held by the Rao Group (representing in the aggregate 6% of the paid up capital of EBIL) would be transferred in favour of EBIL and Mr. Akhil Rao would be appointed as an additional director in EBIL; and the other pertaining to disposal by sale and conveyance of certain immovable properties (land, building and permanent fixtures thereon) owned by the Rao Group to EBIL, whereby EBIL could achieve economies of scale and scope by investing in and utilizing TFL’s existing infrastructure for expansion of its business. The nominees of the Shah Group negatively voted in respect of these resolutions.
7. Mr. Nandan Shah filed a company petition before the Hon’ble Company Law Board at New Delhi (CLB) on August 25, 2010, challenging the legality of the resolutions passed at the meeting of the Board, as aforesaid. He further alleged fraudulent practices and breach of fiduciary duties by certain directors on the Board, particularly the nominees of Rao Group and EBIL. In addition and shortly thereafter, as the SPA came into operation and EBIL began taking an active role in the operations of TFL, Mr. Ashok Kumar alongwith certain other individual shareholders in TFL (collectively holding 11% of the paid up capital of TFL), complained of oppression and mismanagement in TFL, and also challenged the validity of the MCA as also the transfer of shares by Promoters in favour of EBIL, consequent to the SPA.
8. The CLB, in view of common issues involved in the aforesaid 2 (two) petitions, decided to club them up and called for evidence on submissions advanced by Mr. Nandan Shah and Mr. Ashok Kumar. A written statement was filed by Mr. Akhil Rao, and after several hearings, the

matter has now been posted for the final hearing on [November 27, 2010]. The petitions contained averments which include *but are not limited to*, the following:

- Section 7.1 of the SPA was not permissible under the Companies Act and therefore, the board resolutions passed on June 4, 2010, were *non-est* and did not bind TFL;
- TFL was not bound to register the transfer of additional shares by the Rao Group, in terms of the board resolution passed on June 4, 2010;
- The provisions of the SLA were in breach of section 7.5 of the SPA;
- The MCA had automatically terminated owing to change in control of the company;
- The nominees of the Rao Group and EBIL had not acted in the best interests of TFL, and were consequently in breach of their fiduciary duties;
- Section 11 of the MCA was in violation of the Companies Act.

Based on the above, the petitioners have prayed for appropriate direction(s) and/or order(s) be issued in respect of the above. Further, the petitioners have requested that the Respondents herein be declared guilty of mismanagement and oppression in TFL, and that the TFL open offer be re-conducted.