

**BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI**

Appeal No. 136 of 2008

Date of decision : 15.9.2009

Tata Tea Limited
1, Bishop Lefroy Road, Kolkata

..... Appellant

Versus

1. Securities and Exchange Board of India
SEBI Bhawan, Bandra-Kurla Complex, Bandra,
Mumbai

2. DSP Merrill Lynch Limited
Mafatlal Centre, 10th Floor, Nariman Point,
Mumbai

..... Respondents

Mr. Janak Dwarkadas, senior Advocate with Mr. Rohan Rajadhyaksha and Mr. Mihir Rale Advocates for the Appellant.

Mr. Kumar Desai, Advocate with Ms. Daya Gupta and Ms. Chloris John, Advocates for Respondents.

Coram : Justice N.K. Sodhi, Presiding Officer
Samar Ray, Member

Per Justice N.K. Sodhi, Presiding Officer

Has the Securities and Exchange Board of India erred in directing the appellant to add to the offer price, the non-compete fee as paid to the promoter sellers is the short question that arises for our consideration in this appeal. Facts giving rise to the appeal are these.

2. Mount Everest Mineral Water Limited, a public limited company incorporated under the provisions of the Companies Act, 1956 is the target company and Foresight Holdings Private Limited and Mr. Vinod Sethi are its promoters. They shall collectively be referred to hereinafter as the promoters. Tata Tea Limited, another company registered under the Companies Act is the appellant before us. On June 1, 2007, the appellant executed, among others, a share subscription agreement, a share purchase agreement and a shareholders agreement, inter alia, with the promoters. In terms of the share subscription agreement, the appellant agreed to subscribe to 50,99,396 equity shares of the target company of Rs.10 each at a price of Rs.140 per

share (including premium) aggregating to a total consideration of Rs.71,39,15,440 against the preferential allotment of the said shares. As per the share purchase agreement, the appellant also agreed to purchase from the promoters 31,10,440 equity shares of the target company of Rs.10 each at a price of Rs.140 per share amounting to an aggregate consideration of Rs.43,54,61,600 for the said purchase. Pursuant to the said subscription and purchase, the collective acquisition by the appellant came to 24.15 per cent of the post issue paid up equity share capital of the target company. Since the acquisition was in excess of 15 per cent and the appellant was also acquiring control over the target company, the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter called the takeover code) got triggered. Accordingly, the appellant made a public announcement on June 4, 2007 under Regulation 14 read with Regulations 10 and 12 of the takeover code to acquire 20 per cent share capital of the target company at the offer price of Rs.140 per share. The share purchase agreement entailed payment of non-compete consideration of Rs.3 crores to the promoters in lieu of the promoters' obligation not to compete with the target company after the appellant made its investment in the target company. Clause 9.2 of this agreement containing the non-compete obligations is reproduced hereunder for facility of reference :

“9.2 Non-competition and non-solicitation

9.2.1 The Sellers hereby agree and undertake that, from the date of execution of this Agreement and for a period of one (1) year from the termination of the Shareholders Agreement (after which period, the obligation under this Article 9.2 shall cease to be in full force and effect), neither of them shall, nor shall they cause any of their Affiliates to, on their own or together with any other Person, engage, co-operate with, establish, or participate directly or indirectly in any Competing Business. In any event, it is agreed that the aforesaid provisions of non-compete shall not be applicable to:

- a) any business activity undertaken by the Sellers in relation to the manufacture, distribution, import, export and trading of the “Power Horse Energy Drink.”
- b) passive minority investments in any company made by the Sellers without exercising any management rights, or having the right to appoint a director, or observer to any governing body or any committee of such company.
- c) any venture undertaken by the Sellers with Uludag Maden Sulari Turk As, having its offices at Yeni Yalava Yolu, 3, K.M. 16200, Bursa, Turkey in relation to the

manufacture distribution import, export and trading of natural carbonated water and carbonated drinks.

- 9.2.2. The Sellers agree that from the date of execution of this Agreement and for a period of one (1) year from the termination of the Shareholders Agreement (after which period, the obligation under this Article 9.2 shall cease to be in full force and effect), and shall cause their Affiliates not to solicit or entice away or endeavour to solicit or entice away any director...”

This obligation was also stipulated in clause 20 of the shareholders agreement.

3. DSP Merrill Lynch Limited, the second respondent herein is the merchant banker and it filed on June 15, 2007 on behalf of the appellant, a draft letter of offer with the Securities and Exchange Board of India (for short the Board) which is respondent no.1 It was pointed out in the draft letter that in addition to the negotiated price, the appellant had agreed to pay to the promoters a non-compete consideration aggregating Rs. 3 crores and that the promoters, Mr. Salim Govani, the then managing director of the target company and their persons directly or indirectly controlled by them shall not engage in any competing business with the target company. The issue of payment of non-compete fee to the promoters was first questioned by one Shri. Arun Kumar Goenka whose complaint of June 13, 2007 was received by the appellant through the merchant banker on June 15, 2007. The complainant was not then a shareholder of the target company though he purchased some shares on that date presumably to become an interested person and he challenged the payment of the non-compete consideration to the promoters on the ground that the same was being paid to them not because they were having any particular expertise but because of their selling the shares that they own. A meeting took place between the representatives of the merchant banker and the Board on June 22, 2007 in which the draft letter of offer was discussed including the issue of non-compete fee that was proposed to be paid to the promoters. The Board advised the appellant to send an appropriate reply to the complainant which was sent on June 29, 2007. The Board issued on July 11, 2007, its observations under Regulation 18(2) of the takeover code on the said draft letter of offer with a direction to the appellant to revise the offer price by including the amount paid to the promoters as non-compete consideration and disclose the revised offer price on the cover page and at all places where the same appeared. The merchant banker on behalf

of the appellant urged the Board that the non-compete consideration paid by the appellant to the promoters was within the scope of Regulation 20(8) of the takeover code and requested the Board to reconsider its advise/direction contained in the letter dated July 11, 2007. By letter dated July 24, 2007, the appellant also made a request to the Board to reconsider its decision. It appears that the matter regarding the payment of non-compete fee was being reconsidered by the Board and pending reconsideration, the merchant banker sought the consent of the Board to allow the appellant to proceed with the open offer at the offer price of Rs.140 per share and without prejudice to its rights to agitate the matter further, it undertook that the additional amount per share (assuming that the non-compete payment was also to be made to the shareholders tendering in the open offer) amounting to Rs.9.64 per share and aggregating to Rs. 6.56 crores would be kept in an escrow account and shall continue to remain until the final determination of the issue in question. The Board granted its consent and the appellant proceeded with the open offer and the additional amount as undertaken is lying in an escrow account. While this issue was still pending with the Board, it took a decision on January 14, 2008 in the case of Cementrum IB.V. which had similar facts and in that case also, non-compete fee had been paid to the sellers and called upon the acquirers in that case to pay the non-compete fee proposed to be paid to the promoter sellers of the target company to its public shareholders as well. That decision was challenged before this Tribunal in Appeal no.28 of 2008 which was decided on July 8, 2008 holding that the acquirers in that case were justified in negotiating non-compete fee with the promoter sellers and that the same was not required to be paid to the public shareholders. The merchant banker, the second respondent herein then moved an application on August 21, 2008 bringing to the notice of the Board the decision of this Tribunal in Cementrum's case (supra) and urged the Board to follow the same. It was also pointed out that the non-compete fee in Cementrum's case (supra) was close to the outside limit of 25 per cent as envisaged by Regulation 20(8) of the takeover code whereas in the present case it was far less than that. The Board then took a view that the decision of this Tribunal in Cementrum's case (supra) was case specific and could not be applied in all cases where non-compete fee was paid to the sellers and by its letter dated September 11, 2008 reiterated its earlier decision that the appellant should pay the

amount paid as non-compete consideration to the promoters to other shareholders as well who have tendered their shares in the open offer alongwith interest @ 10 % for the delay in making the payment. After the receipt of this letter, the appellant through its merchant banker sought a personal hearing with the competent authority with a view to explain its position in regard to the payment of non-compete fee to the promoters. Personal hearing was granted on September 24, 2008 and by its letter dated December 11, 2008, the Board directed the appellant in the form of an advice to pay the non-compete fee as paid to the promoters to the other shareholders as well whose shares had been accepted in the open offer along with interest @ 10% per annum for the delay. It is against the communications dated September 11, 2008 and December 11, 2008 that the present appeal has been filed.

4. We have heard Shri Janak Dwarkadas learned senior counsel on behalf of the appellant and Shri Kumar Desai advocate on behalf of the Board. The sole question that arises for our consideration is whether, in the facts and circumstances of the case, the appellant is liable to pay to the public shareholders as well, the non-compete consideration as paid to the promoters.

5. The takeover code, as originally framed, did not contain any provision governing the payment of non-compete fee by the acquirers to the sellers of the business. The matter was referred to the Bhagwati Committee, which, on a consideration of the issue, recognised that an acquirer may legitimately pay non-compete consideration to the promoter shareholder(s) and made the following recommendations:-

“Parameters for determining offer price

On non-compete payment the Committee noted that there is a need to address the situation specially where the acquirer passes on a significantly large portion of the consideration to the out going promoter in the form of non-compete fee and only a token amount is shown as negotiated price for acquisition of shares under the agreement. The Committee felt that in such cases the offer price does not truly reflect the actual consideration paid and this could be used as a ploy for reducing the cost of acquisition through public offer.

The Committee recommends that

Any payment in respect of non-compete agreement in excess of 25% of consideration paid to persons other than the target company shall be deemed to form part of the consideration paid for acquisition of shares and should be factored in for the purpose of reckoning offer price.”

These recommendations were accepted by the Board and Regulation 20 of the takeover code was recast in September 2002 providing, inter alia, for a regulatory framework for payment of non-compete fee. Clause (8) of Regulation 20 was introduced for the first time with effect from 9.9.2002 and the same reads as under:-

“(8) Any payment made to the persons other than the target company in respect of non-compete agreement in excess of twenty five per cent of the offer price arrived at under sub-regulation (4) or (5) or (6) shall be added to the offer price.”

A bare reading of the aforesaid provision makes it clear that any payment made to persons other than the target company in respect of non-compete agreement in excess of 25 per cent of the offer price shall be added to the price to be offered to all the shareholders. While looking into the justification for the non-compete consideration, scrutiny by the Board cannot be ruled out though in inquiring into the rationale for allowing such fee to the promoter sellers, it would hardly have any role to play. To elaborate, if the non-compete fee is 25 per cent or less, the question whether it could be added to the offer price or not will have to be determined by the Board in the light of the facts of each case. Supposing, the fee is paid to a person who cannot compete, the Board may be entitled to say that it is only a device to reduce the offer price. In such a case the Board may justifiably direct its addition to the offer price. On the other hand, if the payment is made to an outgoing seller who can offer competition to the business of the target company, the Board shall have no occasion to interfere.

6. The recommendations made by the Bhagwati Committee clearly recognise the legitimacy of the non-compete fee payable to the outgoing sellers. Regulation 20(8) based on these recommendations puts a cap on such payments so that an acquirer could not reduce the cost of acquisition through public offer thereby depriving the public shareholders of their legitimate dues. When examining the validity of the non-compete fee, the question to be addressed is whether the outgoing sellers are capable of providing competition to the business alone or in association with third parties and not whether the business was dependent on the outgoing sellers. When an acquirer takes over a business from the outgoing seller(s), it is obvious that the sellers have specific knowledge of that business and have access to and are in possession of crucial trade secrets of the target company which if disclosed or misused would be detrimental to and

could cause irreparable harm to the target company and its continuing shareholders and by virtue of their association with that business, they (out going sellers) are capable of offering competition to the business being taken over. In such cases, it would be legitimate for the acquirer to enter into a non-compete agreement with the promoter sellers if he feels threatened by a lurking fear of competition from them. It is neither for the Board and not even for this Tribunal to analyse the threat perception of the acquirer. We are of the view that a non-compete agreement would then protect not only the target company but also its continuing shareholders. An acquirer has a right to protect his investment/business from competition by a seller of the business and this right is a long standing customary element in business sale transactions and is even recognised by law. Section 27 of the Contract Act recognises that non-compete agreements are not in restraint of trade if the restrictions placed are reasonable. The Law of Contract (Treitel, Sweet & Maxwell) 11th Edition at page 455 after relying on *Connors Bros. Ltd & Ors. vs. Connors* succinctly states the law as under:-

“A person who sells shares in a company which he controls may covenant not to compete in respect of the business carried on by the company. Such a covenant may be valid if it was in substance the seller who, through his control of the company, carried on the business”.

Again, the terms of the non-compete agreement have necessarily to be decided between the acquirer and the outgoing promoter sellers and based as they are, on business considerations, the Board and this Tribunal have no role to play. However, if they agree to fix the non-compete fee in excess of 25 per cent of the offer price as determined under sub-regulations (4) or (5) of Regulation 20 of the takeover code, the amount in excess of 25 per cent of the offer price shall be added to the offer price which shall be offered to all the public shareholders. It is common ground between the parties that in the case before us, the amount of Rs.3 crores which the appellant as the acquirer has agreed to pay to the promoters as non-compete fee comes to Rs.9.64 per share which is only 6.96 per cent of the offer price as worked out under Regulation 20(4) of the takeover code. This is far less than the maximum prescribed by Regulation 20(8) and is in compliance with the takeover code. We are satisfied that this payment of non-compete fee is not an attempt on the part of the appellant to reduce the cost of acquisition to discriminate against the public shareholders.

7. We are also in agreement with Shri Janak Dwarkadas learned senior counsel appearing on behalf of the appellant that the payment and quantum of the non-compete consideration is based on strong business rationale. It is not in dispute that the target company is in possession of a unique source of water and is engaged inter alia in the business of sourcing, manufacture, bottling and distribution of natural mineral water and are owners of the "Himalayan" brand, a premium luxury brand of natural mineral water. It was rightly argued on behalf of the appellant that the knowledge and expertise of the promoters in managing and exploiting the said source is critical to the operations and the worth of the target company. The appellant as the acquirer is a new entrant to the business as a strategic player and hence it requires support and not competition from the promoters to realise its commercial objectives. It is not disputed that as on the date of the filing of the appeal, the appellant held 34.29 per cent of the equity share capital of the target company and being in control of the target company it was important for it to ensure that the promoters, who continue to hold a much smaller stake in the target company, do not compete with it in any manner. A reference to the non-compete provision which has been reproduced in the earlier part of our order would show that it is an obligation that binds not only the promoters but also their affiliates and, therefore, the obligations are quite extensive. A sum of Rs.3 crores has been paid as non-compete consideration to the seller promoters for not competing for a period of one year from the termination of the shareholders agreement executed on June 1, 2007 and it can be presumed that during this period the acquirer would stabilize in the business.

8. Shri Kumar Desai learned counsel appearing for the Board strenuously contended that the promoters are on the board of directors of the target company and hold a minority stake therein and, therefore, in the very nature of things they could not offer any competition to the business of the target company. According to the learned counsel, the appellant was not justified in paying non-compete fee to the promoters without paying the same to the public shareholders. Shri Desai referred to the judgment in *Boulting vs. Association of Cinematograph, Television and Allied Technicians* (1963) 2 QB 606 and urged that directors of a company act as its agents and cannot enter into engagements in which they have a personal interest conflicting with the interest of the company. He relied upon the following words of Lord Cranworth L.C. in

Aberdeen Railway Co. vs. Blaikie Brothers which were quoted in Boulting's case (supra):-

“The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal, and it is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.”

It is true that the directors of a company discharge a fiduciary duty and cannot allow their own interest to conflict with that of the company but such duties cease to exist the moment they resign from the directorship of the company. In the case before us, there is nothing to prevent the promoters from resigning from the directorship of the target company and setting up a rival business. It is with a view to safe guard against this possibility that the appellant as the acquirer entered into the non-compete agreement with the promoters with a view to protect the interest of the target company and its continuing shareholders. Equally, there is nothing that prevents the promoters from divesting their minority stake in the target company if that were to become necessary.

9. It was then argued by Shri Kumar Desai that Vinod Sethi who was one of the promoters was a finance man and had no special expertise so as to entitle him to receive the non-compete fee as he was not in a position to offer any competition to the target company. This argument appears to us to be misplaced and over stretched. Shri Vinod Sethi is said to be a chemical engineer from I.I.T with a strong financial acumen and expertise. This fact, too, may not be very relevant but the fact that he was a promoter seller from whom the appellant acquired the target company is what matters and it cannot be disputed that the promoters had specific knowledge including the client database of the target company taken over by the appellant.

10. Shri Desai also submitted that the appellant had acquired a US based flavoured water maker “Glaceau” which is in a similar line of business as the target company and, therefore, the appellant cannot claim that it had no knowledge and expertise in the business of bottled water. He also contended that it was the target company and not the promoters who were in possession of the unique source of water. We have already

observed that the promoters who have been in the management of the target company had comprehensive knowledge of how the source of water available to the target company could be exploited. The appellant has pointed out and which fact could not be disputed that it had only one minority financial investment with no management rights in the water supply business of Glaceau and that the appellant divested that investment within a year of making the same which clearly shows that the investment was purely financial and cannot be construed that the appellant was in the same business as that of the target company. There is, thus, no merit in the argument of the learned counsel for the Board.

For the reasons recorded above, we answer the question posed in the opening part of our order in the affirmative and allow the appeal and set aside the directions issued by the Board in its letters dated September 11, 2008 and December 11, 2008 directing the appellant to pay to the shareholders whose shares have been accepted in the open offer non-compete fee as paid to the promoters. The parties shall bear their own costs.

Sd/-
Justice N.K.Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

15.9.2009
Prepared and compared by
BK/RHN