

## SECURITIES AND EXCHANGE BOARD OF INDIA

## ORDER

**Under Sections 11(1), and 11B of Securities and Exchange Board of India Act, 1992 and Regulations 32 and 35 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, in the matter of United Spirits Ltd.**

<b>Sr. No.</b>	<b>Noticees</b>	<b>Address</b>	<b>PAN</b>
1.	Relay B.V.	Molenwerf 10-12, 1014 BG, Amsterdam, The Netherlands	N.A.
2.	Diageo Plc.	Lakeside Drive, Park Royal, London, NW 10 7HQ United Kingdom	N.A.

*The aforesaid entities are hereinafter referred to by their respective names/serial numbers or collectively as "the Noticees".*

1. United Spirits Limited, (hereinafter referred to as "**the Target Company**")/"**USL**") is a company having its registered office at UB Tower Level 6 #24, Vittal Mallya Road UB City, Bengaluru, Karnataka, 560001 and its securities are listed on the Bombay Stock Exchange('BSE') and National Stock Exchange ('NSE').
2. Pursuant to execution of three agreements, namely Preferential Allotment Agreement (PAA), Share Purchase Agreement (SPA) and Share Holding Agreement (SHA) all of them dated November 09, 2012, the Noticees and three other related entities made a public announcement in compliance with the provisions of regulations 3(1) and 4 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SAST Regulations**") to acquire shares in USL. The Share Holding Agreement was entered into between the Noticees and United Breweries Holding Ltd. ("**UBHL**") and KFinvest ("**KFIL**"). The public offer arising from the execution of the aforesaid agreements was completed on May 13, 2013 (being the date when the payment to shareholders/return of rejected shares took place) and is hereinafter referred to as "**the First Open Offer**". Subsequently, a voluntary open offer was made to

acquire additional shares amounting to 26% of USL's voting capital, which was completed on July 02, 2014 (being the date when the payment to shareholders/return of rejected shares took place) and is hereinafter referred to as "**the Second Open Offer**").

3. One of the obligations cast on UBHL and KFIL by the SHA was for all members of the UB Controlled Group to exercise their respective voting rights in relation to USL so as to vote in favour of persons nominated or recommended by Relay B.V. i.e. Noticee No.1 (also hereinafter referred to as "**Relay**") to be directors on the board of USL. However when Relay had recommended the appointment of certain independent directors on the board of USL in the annual general meeting held on November 24, 2015, UBHL and KFIL voted against those resolutions, thereby breaching their respective obligations under the said SHA. Relay recorded the said breach by UBHL and KFIL vide its letter dated December 11, 2015. Therefore, it was observed that UBHL's limited veto rights under the SHA ceased to exist with effect from November 24, 2015.
  
4. On February 25, 2016 a settlement agreement (hereinafter also referred to as "Disengagement Deed") was entered between Diageo Plc. (Diageo) and Dr. Vijay Mallya under which Dr. Vijay Mallya resigned from his position as chairman and non-executive director of United Spirits Limited (USL) and from the boards of other group Companies and Diageo agreed to:
  - (i) Pay \$75 million to Dr. Mallya
  - (ii) Relieve Dr. Mallya from any personal liability to Diageo in relation to finding of inquiry by USL (certain matters referred to in financial statements) and
  - (iii) Relieve Dr. Mallya from his personal obligation to indemnify the Diageo group entities (Diageo Plc and Relay B.V) for loans taken by Companies affiliated to him.
  
5. For the purposes of this Order, the Noticees and their related parties are also collectively referred to as the "**Diageo Group**" and UBHL, KFIL and their related parties are also collectively referred to as the "**UB Group**".
  
6. Accordingly a notice dated May 12, 2017 (hereinafter referred to as "**the Show cause notice**" / "**the SCN**") was issued by SEBI to the noticees alleging that the

status of USL had changed from being an entity jointly controlled by the UB Group and the Diageo group, to a solely controlled entity of Diageo group on November 25, 2015, and that the noticees had violated regulation 4 of the SAST Regulations since no public announcement had been made by the noticees. Consequently the SCN directed the noticees to show cause why suitable directions under Sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 and Regulations 32 and 35 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 should not be issued for the alleged violations referred to hereinabove.

7. Replies to the SCN were received vide letters dated July 14, 2017 and September 26, 2017. Opportunity of personal hearing was granted to the noticees on September 19, 2017 for which representatives of the noticees appeared. The legal representatives from Bharucha & Partners- Advocates & Solicitors, were Advocates M P Bharucha, Yashasvi M, Senha Jaisingh, Sunandan Majumdar, Kunal Katariya, N P Lashkini and Swagata Ghosh (Trainee). Shri P.N. Modi, Senior Advocate made submissions on behalf of the noticees. Summary of the noticees' written and oral submissions are as follows:

(i) The Diageo group had sole control over USL since July 4, 2013 for the following reasons:

(a) As per the provisions of Clause 3.6 of the SHA, the Diageo group had the express right to nominate the Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Head of Internal Audit of USL; the Diageo group had the right to appoint a majority of the directors to the boards of each subsidiary of USL. The Diageo group also had the right to require the UB group shareholders to exercise their respective voting rights and take other necessary steps for the appointment of the Diageo-nominated persons to the aforesaid positions. Since the end of April 2015, out of nine directors on USL's board, eight directors were either nominated or recommended by the Diageo group. Further, USL's Managing Director and CEO (who is also a member of the Executive Committee of Diageo), CFO, General Counsel and Company Secretary were all Diageo's nominees. On the other hand as per the SHA, the UB group only had the right to nominate one non-independent non-executive director and

recommend one independent non-executive director to the Board of USL. As of 25 November 2015, the UB group had only one nominee on the board of USL, and such nominee of the UB group did not hold any executive position in USL.

- (b) While clause 3.2 of the SHA required the presence of a director nominated by Diageo to be present in order to constitute a valid quorum at Board meetings of USL, there was no similar provision requiring the presence of any UBHL-nominated director.
- (c) On the date of Completion of the First Open Offer (i.e. 4 July 2013), the Diageo group had effected the replacement of the signatories to various bank accounts of USL with, *inter alia*, nominees of the Diageo group in USL.
- (d) Following Completion of the First Open Offer on 4 July 2013, Diageo put in place a new statement of authorities for USL (in line with Diageo group companies worldwide) and aligned USL's code of business conduct and ethics to Diageo's global practices.
- (e) Following the Diageo group's acquisition of the majority shareholding in USL in July 2014, Diageo consolidated USL's accounts into Diageo's accounts.
- (f) Clause 7.1(i) of the SHA, expressly stipulates that from the date of Completion (i.e. 4 July 2013), "... *the UB group shall cease to be in control of the company...*" (i.e. USL). Even the letter of offer dated 27 May 2014 as vetted and approved by SEBI in respect of the second open offer for USL made by the Diageo group, *inter alia* recorded as follows: "*Pursuant to the SHA coming into effect, Relay and Diageo took control of the Target Company and open offer was made to the public shareholders of PDL in accordance with Regulation 3(1), Regulation 4 and Regulation 5 of the SEBI (SAST) Regulations*" (paragraph 5 on pages 44 and 45 of the letter of offer). Thus, SEBI had accepted and admitted that the Diageo group had in fact taken control of USL.
- (g) Pioneer Distilleries Ltd. ("**PDL**") is a subsidiary of USL, and therefore, pursuant to the SHA coming into effect whereby the Diageo Group had taken control of USL, an open offer was also made by the Diageo Group to the public shareholders of the said subsidiary PDL vide a Letter of Offer dated 22.8.2013. This open offer was also expressly made under Regulation 4. The Letter of Offer dated 22.8.2013 for the said open offer

(as vetted and approved by SEBI), expressly records that the Open Offer was made under Regulation 4, pursuant to the SHA coming into effect on 4.7.2013 and Diageo and Relay becoming promoters of USL. It is therefore clear beyond doubt that the change of “control” took place since 4.7.2013.

- (h) As per the terms of Clause 6 of the SHA, the UB group had to exercise their voting rights in USL in accordance with Diageo’s instructions. Hence, effectively, even the limited voting rights remaining with the UB group were under the sole control of the Diageo group.
- (i) Since the UB group would become minority shareholders without any control and had to vote as per the directions of the Diageo group, the SHA provided certain limited protections to the UB group by way of the veto rights. These limited veto rights pertained only to specified extraordinary matters which would adversely affect the UB group members as minority shareholders of USL, such as change in the terms of the shares held by the UB group, voluntary solvent winding up or voluntary delisting etc. These were merely protective rights for exceptional situations and did not give the UB group control over the day to day running or management or policies of USL. The veto rights were not “participative” but merely “protective” in nature. The same only protected the UB group as a minority shareholder which had no control, since the Diageo group had sole control of USL.
- (j) Justification for the limited Veto Rights is explained in the following table:

<b>Veto Matters (provided in Schedule II of SHA)</b>	<b>Nature of right</b>
<p>“Any pre-emptive issue of Shares at a discount of over 25 per cent to the volume-weighted average price for the 30 trading days ending the day before the date on which the issue is announced. For the avoidance of doubt, nothing in this Agreement grants any right of veto with respect to, or imposes any restriction on, any other issue of shares or change to the capital of any member of the Company’s Group.”</p>	<p>This was a protective right which would have applied only if and when USL proposed a rights issue of USL shares at a huge discount of more than 25% as compared to the market price, which obviously would adversely affect the market price of USL shares, including the UB Group’s minority shares, and would diminish the effective value thereof. The said clause was therefore only intended to protect the value of the UB Group’s tiny minority stake in USL against undue or excessive dilution. It is most pertinent to note that this veto right did <u>not</u> apply to:</p> <ul style="list-style-type: none"> <li>• rights issues which were not at a discount of more than 25%;</li> <li>• further preferential issues to Diageo;</li> </ul>

<b>Veto Matters (provided in Schedule II of SHA)</b>	<b>Nature of right</b>
	<ul style="list-style-type: none"> <li>• issuance of a strategic stake in USL to any third party;</li> <li>• issuance of shares to a party selling assets to USL;</li> <li>• any other issue of shares by USL; or</li> <li>• any issue of any shares by a subsidiary of USL.</li> </ul>
<p>“A change to the terms of the Shares held by any member of the UB Group, other than changes which apply to all Shares of the same class. For the avoidance of doubt, nothing in this Agreement grants any right of veto with respect to, or imposes any restriction on, any issue of Shares.”</p>	<p>This was a protective right which could apply only if there was any attempt to change the rights attached only to the shares held by the UB Group in USL, for instance, to take away their voting rights or the right to receive dividends. This limited right would apply only if there was any attempt was to take away rights only of the UB Group and not if the same was proposed to be done for all shareholders of the same class.</p>
<p>“A voluntary solvent winding-up or dissolution of the Company (save in the context of a merger transaction).”</p>	<p>This was a protective right which could apply only if and when Diageo chose to attempt to have USL wound up on a voluntary basis despite being fully solvent, since obviously the same would nullify the UB Group’s minority shares in USL.</p>
<p>“A voluntary delisting of the Company from a Stock Exchange.”</p>	<p>This was a protective right which would apply only if and when the Diageo Group attempted to voluntarily delist USL from a stock exchange, since obviously the same would take away an available market for the UB Group’s shareholding in USL.</p>
<p>“An amendment to the Articles which prejudices in any material respect any right of UB under this Agreement.”</p>	<p>This was a protective right only to ensure that the UB Group’s limited rights under the SHA were not nullified by an amendment to the articles of association of USL.</p>

(k) The said allegations of “joint” and “sole” control in the Show Cause Notice, are attempted to be founded on an allegation that there was a “...commonality of objective for exercising control over USL in a manner agreed between the parties.....” and that “.....the Diageo group entities exercised control over USL in a coordinated manner along with the UB group entities.....”. The said allegation is totally incorrect and misconceived. For all the reasons as herein above stated and as set out in our said previous correspondence, there was no such “...commonality of objective” at all. In fact, the objective was to acquire and takeover the management of USL, and this was achieved on 4 July 2013 at Completion. On the other hand, the UB group was exiting from the control and management, and again this took place on 4 July 2013 at

Completion. The noticees became majority shareholders with control of the Board of Directors of USL, while the UB group became minority shareholders with only a token representation on the Board, and therefore was only given very limited protection by way of the said restricted veto rights. The Show Cause Notice does not identify even a single incident where there was any such “coordinated” control, and the said allegation is a vague generalisation without any factual particulars at all.

(l) It is a matter of record that post the Second Open Offer which was completed on 2 July 2014, the Diageo group’s total holding (shares and voting rights) in USL was 54.78%, whereas the UB group’s holding was only a little over 4% (shares and voting rights). Therefore, the sole control of the Diageo group was such that the voting arrangement was no longer relevant and therefore ceased as per the agreed terms.

(m) The UB group companies continued to be disclosed as a part of the promoter group of USL even after Completion on 4 July 2013 only because of historical reasons and as per the applicable legal requirements. Further, there is nothing under the Takeover Regulations or the ICDR Regulations which provides that only parties in control of the target company should be disclosed as “promoters”.

(ii) With further reference to paragraph 2(i) of the Show Cause Notice, it may be clarified that only \$40 million was paid to Dr Mallya on 25 February 2016. Due to various reasons, including breaches committed by Dr Mallya, Diageo believes that it is very unlikely to ever become liable to pay any further amounts to Dr Mallya. Further, Diageo and other group companies have demanded from Dr Mallya the repayment of \$40 million which was paid by Diageo on 25 February 2016, and also sought from him compensation for various losses incurred by the relevant members of the Diageo group on account of the breaches committed by him.

**8.** Since more than six months had elapsed from the last date of hearing and receipt of written submissions, vide letter dated April 16, 2018, the noticees were afforded an opportunity to make additional submissions, if any, on the SCN. The noticees vide letter dated April 25, 2018 replied to the aforesaid communication from SEBI and confirmed that they had no additional submissions to make on the matter.

## **ISSUES FOR CONSIDERATION**

9. Based on the facts and allegations stated in the show cause notice and replies received from the Noticees, the issues for determination in the instant case are listed as follows:

- I. Whether the Noticees exercised joint control along with the UB group post the First Open Offer?
- II. Whether the UB Group exercised control post the Second Offer?
- III. Whether disclosures made post the First and Second Offers clarified the status of 'control' by the Noticees?
- IV. Whether the Diageo Group i.e. the Noticees could be said to have acquired sole control in November 2015 as alleged in the SCN?
- V. Whether the Noticees are required to make an open offer?

10. Relevant provisions of law are reproduced hereunder for ease of reference:

### Regulation 2(1)(e) of the SAST Regulations- Definition of 'control'

*(e) "control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner:*

*Provided that a director or officer of a target company shall not be considered to be in control over such target company, merely by virtue of holding such position;*

### Regulation 2(1)(q) of the SAST Regulations - Definition of 'persons acting in concert'

*"(q) –persons acting in concert means,—*

*(1) persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co operate for acquisition of shares or voting rights in, or exercise of control over the target company.*

*..."*

### Regulation 4 - Acquisition of control

*"Acquisition of control.*

*4. Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations."*

## **I. CONTROL POST THE FIRST OPEN OFFER**

11. I note that the First Open offer was made by the noticees pursuant to execution of three agreements, namely Preferential Allotment Agreement

("PAA"), Share Purchase Agreement ("SPA") and Share Holding Agreement ("SHA") all of them dated November 09, 2012. The Letter of Offer filed in pursuance of the First Open Offer (hereinafter referred to as "**First Letter of Offer**") noted that Noticee No. 1 was the Acquirer and Noticee No. 2 along with its related entities were persons acting in concert with Noticee No. 1. The First Letter of Offer included extracts and summary of relevant aspects of each of the aforesaid Agreements. The SPA pertained to sale of shares by UBHL, KFIL and other related entities to the Noticees. The SPA also provided for sale of additional shares to the Noticees in the event the preferential allotment was not complete and the Acquirer held less than 25.1% in USL. The SHA was also entered into between the Noticees on the one hand and UBHL and KFIL on the other. In addition to other aspects, the Letter of Offer recorded that the Competition Commission of India (CCI) had vide its order dated February 26, 2013 granted its approval for acquisition of control of the Target Company by the Acquirer and the acquisition of shares within a period of 5 years upto 53.4% in the Target Company's share capital (Refer page 21 of the First Letter of Offer). Summary of some of the key provisions of the SHA recorded in the First Letter of Offer, are as follows:

(i) Appointment of Directors - UBHL obtained the right to nominate one person to be a director on the board of USL and one person to act as independent non-executive director. The right to appoint the aforesaid directors could stand rescinded if certain specified obligations under the SHA were not adhered to by UBHL. The Acquirer and Diageo (noticees to this Order) held the right to nominate or recommend all the remaining directors on the board of USL.

(ii) Management- The Acquirer was to have the right to nominate the CEO, CFO and Head of Internal Audit of USL and the right through USL to appoint a majority of the directors to the boards of each of the subsidiaries of USL.

(iii) Right of First Offer - The Acquirer obtained the right to be offered any shares if UBHL or its related entities were to sell shares. Shares held by UBHL and its related entities were also restrained from being transferred to a competitor or affiliate of a competitor.

(iv) Acquisition restrictions - UBHL and related entities were given the priority to acquire equity shares to replace any additional shares that may have been sold to the Noticees.

(v) Tag Rights- UBHL, KFIL and related parties were given the right to 'tag along' in connection with significant disposals of equity shares by the Acquirer

and related entities to third parties, at the same price and on the same terms and conditions.

(vi) Non-Compete- UBHL, its related entities and promoters were restrained from carrying on any competitive business or disclose any confidential information in relation to USL's business.

**12.** The First Open Offer, which was completed on May 13, 2013 (*being the date when the payment to shareholders/return of rejected shares took place*), was stated to have been made in accordance with regulation 3(1) and regulation 4 of the SEBI(SAST) Regulations i.e. on account of the Acquirers having acquired shares entitling them to exercise 25 % or more of the voting rights as well as on account of the Acquirer having acquired control.

**13.** According to the SCN, the allegation regarding UB group holding joint control in USL along with the Noticees is based on the following facts:

- (i) Continued disclosure of UB Group entities as being part of the promoter group
- (ii) The UB Group's power to nominate directors in terms of the SHA
- (iii) Coordinated voting arrangements under the SHA
- (iv) Veto Rights under the SHA granted to UBHL

**14.** For ease of discussion, the aforesaid matters are categorized separately. I now proceed to address each of the said categorized matters.

**(i) UB Group disclosed as 'Promoter'**

The first pertains to the relevance of person(s) being disclosed as 'promoter(s)' of a listed company. The SCN has alleged that UB group companies had continued to be disclosed as a part of the promoter group even after the First open offer and therefore Diageo group and UBHL exercised joint control over USL. Also, according to the SCN, no disclosures indicating change in control had been disclosed. The relevant extract of the SCN is reproduced below for ease in reference :

"It is stated in Diageo letter dated March 18, 2016 that *"The SHA became effective upon completion of transaction on July 4, 2013. The SHA recorded that the UB group had ceased to be in control of USL upon completion of the transaction on July 04, 2013 and UBHL, KFinvest and Dr. Mallya would continue to be identified as promoters of USL only on account of their historical connection*

*with and contribution to USL and their having been identified as promoters in the offer documents”.*

However, it is observed that no such disclosures were made in the letter of offer/ to the stock exchanges.

Further, it is observed that UBHL and other UB group companies have also continued to be disclosed as part of promoter group even after the open offer. Therefore, it is alleged that Diageo group and UBHL exercised joint control over USL."

I cannot agree with this allegation of the SCN. The mere fact that UBHL, KFIL and related entities were disclosed as 'promoter' of USL does not render them in control of the company. The SAST regulations cross-refers to the SEBI(ICDR) Regulations, 2009 in order to define 'promoter'. Regulation 2(1)(za) of the ICDR Regulations defines promoter as follows-

"  
(za) "promoter" includes:  
(i) the person or persons who are in control of the issuer;  
(ii) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public;  
(iii) the person or persons named in the offer document as promoters:  
Provided that a director or officer of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter:  
...."

From the aforesaid definition of 'promoter', it is clear that a person who was named in the prospectus of the company as 'promoter', could be called as such without being in actual control of the company. It transpires from the aforesaid definition that while a person who is in control would necessarily have to be qualified as a promoter, the converse is not automatically implied. In fact, the shareholding pattern as of March 2018, as available on the BSE website, continues to disclose UBHL and KFIL, among others as promoters. If one were to assume that the inference drawn in the SCN was correct, UBHL and KFIL should continue to be treated as being in control given their disclosure as 'promoters', which, as per the SCN, is not the case. It is also noted that a formal systematic process for reclassification of promoters into public was introduced through Regulation 31A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR Regulations**"). Further, the Settlement Agreements dated February 25, 2016 between USL and Dr. Vijay Mallya as well as between Diageo Group and Dr. Vijay Mallya *inter alia* provided that that the UB Group would make an application to USL seeking

reclassification of the UB Group's promoter status in terms of Regulation 31A of the LODR Regulations.

**(ii) Presence of Two UB Directors on the Board**

I have examined the SHA's provisions with respect to appointment/removal of directors and management of USL, as provided in Clause 3 of the said SHA. Clause 3.6 of the SHA reads as follows:

*"The Parties agree that Diageo BidCo will (i) have the right to nominate persons to carry out the roles of Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Head of Internal Audit of the Company and (ii) have the right to appoint, through the Company, a majority of the directors to the boards of each Subsidiary of the Company. The UB Parties shall exercise, and UB shall procure that the other members of the UB Controlled Group shall exercise, their respective voting rights in relation to the Company and shall, so far as they are able, take such other steps as are necessary to enable the appointment of such persons to such positions."*

The aforesaid clause makes it clear that the UB Group was required to vote in favour of Diageo Group's nomination of key management personnel of USL and the appointment of majority of directors of USL's subsidiaries. Clause 3.2 and 3.4 deal with appointment and removal of directors. Clause 3.2 (i) reads as follows:

*(i) From the Completion Date and for so long as a Qualifying Holder continues to be beneficially entitled to not less than 6,539,750 Shares, UB shall be entitled to:*

*(a) nominate one person to be a Director (the Parties agreeing that the Individual shall be the initial UB Director nominated hereunder);*

*(1) recommend one person (who is eligible under Applicable Law to act as an independent non-executive director) to act as an independent non-executive director and which person shall neither be, nor deemed to be a nominee director of any member of the UB Group or any member of the Diageo Group. If a person validly recommended for appointment as an independent non-executive Director pursuant to this Clause 3.2(i)(b) is deemed to be ineligible to act as an independent non-executive Director by reason of the provisions of this Agreement (whether by reason of a change in Applicable Law, interpretation or otherwise): UB shall, instead of being entitled to recommend a person to act as an independent non-executive Director pursuant to this Clause 3.2(i)(b), be entitled to nominate second person to be a non-executive Director and the Diageo Group, the UB Parties shall, and shall procure that the UB Controlled*

*Group shall, exercise their respective voting rights in relation to the Company and, to the extent permissible in Applicable Law, their right to instruct or request their nominee Directors to vote, subject to their fiduciary duties, in favour of the appointment of such person as a Director and in favour of the taking of such steps, including seeking to increase the number of Directors and independent directors on the Board as may be necessary to permit the appointment of such person as a second Director nominated by UB."*

The aforesaid clause makes it clear that the UB Group was entitled to nominate a maximum of 2 directors on the Board for which the Diageo group would provide its support specifically to Dr. Vijay Mallya who was entitled under the SHA to be appointed as Chairman of USL. However in terms of Clause 3.2 (iii), the UB Group's right to nominate or recommend a person to be a director would cease *inter alia* if a UB Group member failed to comply with certain obligations under the SHA and the SPA. Under regulation 2(1)(e) of the SAST Regulations, the first criteria for determining whether a person has acquired control is whether he can appoint majority of the directors on the board of the listed company. I note from the Annual Reports filed by USL on the Stock Exchange website that in the Financial Years 2012-13 and 2013-14, the number of directors were 8 and 12 respectively. Clearly, going by the clauses of the SHA, the UB Group did not exercise the right to appoint a majority of directors on USL's board. Therefore on this criteria also, UB Group could not have been said to have exercised control over USL.

### **(iii) Veto Rights**

I have perused the 'veto rights' clause both as represented in the SHA as well as summarized in the Letter of Offer. The 'veto rights' clause in the SHA reads as follows:

#### **5. VETO MATTERS**

**5.1** *For so long as a Qualified Holder is beneficially entitled to at least 1,307,950 Shares, the provisions of Clause 5.2 and 5.3 shall apply. This is subject to Clause 5.5.*

**5.2** *Diageo BidCo shall not (and shall, to the extent permissible in Applicable Law, request that their nominee Directors, subject to their fiduciary duties, not to) submit to any meeting of the Board, or any committee of the Board, or to shareholders by way of postal ballot, electronic voting, in General Meetings or otherwise any proposal in relation to any of the matters set forth in SCHEDULE II (the "**Veto Matters**") unless UB has first been notified in writing by Diageo BidCo of any proposal with respect to any such Veto Matter and a period of 15 days has elapsed since the giving of such notice. If UB has conveyed to Diageo BidCo its*

*rejection/dissent in writing to such Veto Matter at any time during this period, then Diageo BidCo shall not submit to any meeting of the Board, or any committee of the Board, or to shareholders by way of postal ballot, electronic voting, in General Meetings or otherwise any proposal in relation to any such Voting Matter.*

*5.3 Subject to Clause 5.5, if any matter, decision, action or resolution relating to a Veto Matter shall be considered or taken up for voting at any Board meeting, General Meeting, by way of a postal ballot or electronic voting or otherwise, in circumstances where UB has conveyed to Diageo BidCo its rejection/dissent in writing to such Veto Matter at any time prior to the commencement of the Board meeting, General Meeting, issuance of notice for the postal ballot or electronic voting or any other notice in relation to the consideration of such matter, Diageo BidCo shall exercise, and Diageo plc shall procure that each other member of the Diageo Group shall exercise, its voting rights in relation to the Company against such matter, decision, action or resolution.*

*5.4 The UB Parties and the Diageo Parties agree to exercise their respective voting rights in relation to the Company, and otherwise to use reasonable endeavours, to cause the adoption by the Board, within 6 months of Completion, of a delegated authorities matrix identifying the matters which require the prior approval of the Board. Such delegated authorities matrix may be revised by the Board from time to time.*

*5.5 Clauses 5.2 and 5.3 shall cease to apply if:*

- (i) a UB Party or any member of the UB Group fails to perform or comply with its obligations under the Share Purchase Agreement to sell Additional Shares;*
- (ii) a UB Party or any member of the UB Group breaches Clauses 3.2(vi) , 3.4, 3.6, 6, 8 or 14.4 of this Agreement;*
- (iii) UB is or comes to be (directly or indirectly) either Controlled by, or under common Control with, a Competitor or Competitor Affiliate; or*
- (iv) Individual ceases to Control UB,*

*provided in the case of (i) and (ii) that if such failure or breach is capable of being remedied so that the status quo ante is restored, and is so remedied at no cost to the Company's Group and the Diageo Group within a period of 24 days, clauses 5.2 and 5.3 shall revive and once again apply.*

The veto matters are specified in Schedule II of the SHA which read as follows:

- 1. Any pre-emptive issue of Shares at a discount of over 25 per cent to the volume-weighted average price for the 30 trading days ending the day before the date on which the issue is announced. For the avoidance of doubt, nothing in this Agreement grants any right of veto with respect to, or imposes any restriction on, any other issue of shares or change to the capital of any member of the Company's Group.*
- 2. A change to the terms of the Shares held by any member of the UB Group, other than changes which apply to all Shares of the same class. For the avoidance of doubt, nothing in this Agreement grants any right of veto with respect to, or imposes any restriction on, any issue of Shares.*
- 3. A voluntary solvent winding-up or dissolution of the Company (save in the context of a merger transaction).*
- 4. A voluntary delisting of the Company from a Stock Exchange.*
- 5. Entering into any agreement or arrangement in relation to any of the foregoing.*

6. *An amendment to the Articles which prejudices in any material respect any right of UB under this Agreement.*

None of the items listed under the head 'Veto rights' indicate that they form part of management or policy division having a bearing on the running of the Target Company. I note that the aforesaid veto rights which are limited in number and ambit only appear to be protective in nature. From the aforesaid, serial numbers 5 and 6 are only consequential in nature in as much as it deals with entering into agreements or amendment to articles in pursuance of the veto matters mentioned at serial numbers 1 to 4. Merely because certain veto rights accrue to a shareholder, it does not tantamount to concluding that such person held control in the target company. While serial numbers 1 and 2 prevent active discrimination against the shares held by the UB Group, veto matter at serial number 3 seeks to prevent voluntary closure of the company and serial number 4 supports the tradeability of the UB Group's shares. Veto rights restricted to protect the rights of a shareholder are not sufficient to prove control. The veto rights that accrued to the UB group under the said SHA, primarily sought to protect the value of their shareholding in USL. Control is defined in regulation 2(1)(e) of the SAST Regulations, 2011 to include "*the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.*" If the test of 'control' was to be satisfied, the veto rights must have been sufficient enough to govern the decision making process of a company's management whether by being in a capacity to directly or indirectly influence management or policy decisions or stall management or shareholder decisions, being directly or indirectly instrumental in modifying policy etc. The veto rights in question do not further the management interests of the UB group. If limited protective shareholder rights were to be treated as synonymous with 'control', listed companies may undergo repeated corporate restructuring processes on frivolous grounds, leading to constant instability in management of such companies which, infact may be counterproductive to investor interest. If, on the other hand, veto rights were to traverse beyond the boundaries of being merely protective to demonstrate control over a company's management or be

seen as an influence on its policy decisions, the provisions of regulation 4 of the SAST Regulations, 2011 would certainly be triggered. I am convinced that the veto matters listed in Schedule II of the said SHA are not reasonably sufficient to constitute 'control' and therefore UB Group could not have been said to be in control over the Target company i.e USL.

**(iv) Voting Arrangements**

The Voting Arrangements clause read as follows:

*"6. VOTING ARRANGEMENTS*

*6.1 For so long as the Diageo Group continues to hold all the Shares acquired by Diageo BidCo pursuant to the Share Purchase Agreement, the Allotment and the Open Offer (disregarding any disposals that may be required under Applicable Law), the UB Parties hereby agree that, until the earlier of:*

*(i) the date on which Diageo Group first acquires 50.1% of the Shares carrying voting rights, and*

*(ii) the date which is the fourth anniversary of the first day of the first full Annual Accounting Period which begins after the Completion Date, the UB Parties shall, and shall procure that each of their respective Controlled Affiliates shall, exercise their respective voting rights in relation to the Company in accordance with the written instructions of Diageo BidCo, provided by Diageo BidCo to each UB Party at least 4 days prior to the date on which the UB Parties and their Controlled Affiliates are required to vote such Shares.*

*6.2 If, in respect of any matter, decision, action or resolution, a UB Party does not receive written voting instructions from Diageo BidCo at least 4 days prior to the date on which it is required to vote its Shares (and to procure that its Controlled Affiliates vote their Shares), neither that UB Party nor any of its Controlled Affiliates shall be required to vote its Shares based on Diageo BidCo's instructions in relation to such matter, decision, action or resolution.*

*6.3 For so long as Clause 5.2 applies, the voting obligation in Clause 6.1 does not apply with respect to any Veto Matter (as defined in Clause 5.2)."*

A bare perusal of the aforesaid clause conveys the impression that the UB Group was bound to comply with any of the written instructions of the Diageo Group. However a closer analysis of the said clause reveals a potentially different picture. While the UB Group was obliged to adhere to Diageo's instructions, it is also true that Diageo was dependant on the UB Group's support in order for Diageo to exercise control over USL. As per the quarterly shareholding pattern filed as of September 2013, Diageo had acquired 25.02% of USL's voting capital. However the same shareholding pattern reveals that public shareholders holding more than 1% amounted to 21% and total public shareholding amounted to more than 60%. It appears that the significance of the voting arrangement stems from this dispersed shareholding. Effectively

therefore, the Diageo group was reliant on the UB Group in order to control the management and affairs of USL. Consequently even though the SHA appears to present a one-way relationship or a domination of Diageo group over the UB group's voting rights, in reality the voting arrangement ensured that the UB Group continued to be instrumental in Diageo's exercise of control over USL. Without the support of UB Group through the voting arrangement, it seems doubtful whether the Diageo group could have exercised control over the USL. The relationship which arose from the voting arrangement was central to the ability of the UB and Diageo groups to jointly exercise control over USL. This voting arrangement was also specifically important for appointment of Diageo's nominee director and USL's key management personnel ("**KMP**"). Therefore I am of the view that Clause 6 of the SHA read along with the fact that provisions of Clause 3 of the SHA required the UB Group to vote in favour of the Diageo nominee directors and KMP nominated by the Diageo group, conferred 'control' on the UB Group even post the First Open Offer.

## **II. CONTROL POST THE SECOND OPEN OFFER**

**15.** The Second Open Offer which was stated to have been made under regulation 3(2) of the SAST Regulations was completed on July 02, 2014. At the time of the Letter of Offer (hereinafter referred to as "**Second Letter of Offer**") having been sent to the shareholders, Relay BV i.e. Noticee No. 1 was said to hold 28.78% of USL's voting capital. Pursuant to the Open Offer made by Noticee No. 1 and Noticee No.2 (who was a person acting in concert with Noticee No. 1), the Acquirer and the PAC held 54.78% of USL's voting capital. The following statements made in the Second Letter of Offer are significant disclosures regarding the Noticees' control over USL:

*"Pursuant to the terms of SHA, subject to certain shareholding thresholds being met and for a specified period of time, UBHL, KFIL and entities controlled by them are required to exercise all their respective voting rights in respect of equity shares that they hold in the Target Company in accordance with the written instructions of Relay. "*

**(refer para 7, page 20 of the Second Letter of Offer)**

*"Relay and Diageo took control of the Target Company and open offer was made to the public shareholders of PDL(\*) in accordance with Regulation 3(1), Regulation 4 and Regulation 5 of the SEBI (SAST) Regulations."*

**(refer para 5 on page 44 and 45 of the Second Letter of Offer)**

**( \* - PDL or Pioneer Distilleries Ltd. is a subsidiary of USL)**

- 16.** It is not in doubt that both the Letters of Offer were sent to the shareholders in terms of the procedure laid down in the SAST Regulations.
- 17.** The First Letter of Offer had made it explicitly clear that the Noticees were taking control of USL since the disclosure had stated that the open offer was in pursuance of regulation 4 of the SAST Regulations as well. The clauses of the First Letter of Offer also support the said disclosure. While in share percentage terms post the open offer, the Noticees had acquired shares amounting to 25.02% of USL's voting capital, the Share Holding Agreement gave substantial rights of management to the Noticees. However the Second Letter of Offer did not clarify whether the Noticees had acquired sole control or that the UB Group had ceased to hold control in USL, even though it was disclosed as 'promoter group' of USL. At the same time, the fact that the voting arrangement would be in place only until the Noticees acquire 50.01% was disclosed in the First Letter of Offer.
- 18.** The Second Open Offer resulted in the Noticees holding 54.78% of USL's voting capital. Having more than half the voting capital, the Noticees were not only in a position to appoint majority of the directors and nominate key managerial personnel, they were also in a position to approve ordinary shareholder resolutions on the strength of their own shareholding. Infact on page 28 of the First Letter of Offer, while dealing with the Voting Arrangement clause in the SHA, it has been explicitly stated that the said clauses would cease with effect from the noticees acquiring not less than 50.1%. Therefore significantly, as of July 02, 2014 (i.e. date of Completion of Second Open Offer), the voting arrangement between the UB and Diageo Groups ceased to exist and therefore even on this basis, the former could not have been said to have continued to exercise control.

### **III. DISCLOSURES POST THE FIRST AND SECOND OPEN OFFERS**

19. I have perused the Annual Reports of USL for the Financial Years 2012-13, 2013-14 and 2014-15 to understand how the company has sought to disclose the status of its shareholders and who among them were in control of the company. The tone and tenor of the Annual Report of 2012-13 makes it quite obvious that during the financial year under consideration USL was a UB Group company. The said Annual report disclosed the acquisition of 25.02% by Diageo in USL, but the saddle and reins of the company appeared clearly to be with Dr. Vijay Mallya and the UB Group. The UB Group logo also was found throughout the Annual Report. The report also mentioned that review of USL's systems was carried out by *"the UB Group's Internal Audit Department, the Company's own Operations Review personnel, and by independent auditors."* A bare perusal of the Annual Report of 2014-15 made it apparent that control of USL had changed to the Diageo Group. The covering page of the Annual Report itself recorded that USL was a Diageo Group company. The changed director composition and key management of the company also make it rather obvious that the Diageo was in control of USL. This reinforces the argument made in the preceding paragraphs of this Order that Diageo Group had certainly acquired complete control over USL post the Second Open Offer.
20. The Annual Report of 2013-14 was also examined to ascertain the stance of "control" between the parties and as disclosed to the public. While the UB logo reproduced on most of the Annual reports' pages present a picture of the UB group continuing to remain in control over USL post the First Open Offer, some of the statements made in the Annual report of 2013-14 appear to lack clarity on the issue of 'control'. Extracts of such statements made in pages 10, 43 and 148 of the said Annual Report are reproduced for ease in reference:

#### Page 10

*Directors' Response: Management informed the Board that: (i) pursuant to a previous resolution passed by the board of directors of the Company on 11 October 2012, certain dues (together with interest) aggregating to Rs.13,374 Million were consolidated into, and recorded as, an unsecured loan by way of an agreement entered into between the Company and UBHL on 3 July 2013; (ii) the interest rate of 9.5% p.a. was in accordance with Section 372A of the Companies Act, 1956, read with the circular issued by the Reserve Bank of India publishing the bank rate in terms section 49 of the Reserve Bank of India Act, 1934.*

***The management and the nominee directors of the controlling shareholder have informed the Board that they will take all the necessary steps within their power and***

authority as management and directors of the Company to fully protect the interest of the shareholders in this regard.

(emphasis supplied)

Page 43 (Independent Auditor's Report)

We draw attention to:

1. Note 25(c) to the financial statements, which states that subsequent to the balance sheet date, **a bank has declared one of the directors of the Company as a willful defaulter in respect of another company where he is a promoter director.** The Reserve Bank of India's Master Circular on Willful Defaulters along with certain covenants in the loan agreements sanctioned by the Company's bankers raise an uncertainty on the impact of this development on the availability of credit facilities to the Company. **The said director has assured the Board that he will take appropriate steps to ensure that the operations of the Company are not impacted. Having received such assurance from the said director and appropriate comfort from the controlling shareholder of the Company, the financial statements have been prepared on a going concern basis;**

(emphasis supplied)

Page 148 (Notes to the consolidated financial statements)

**The Group** on or prior to 3 July 2013, entered into certain agreements with entities which can be considered as directly or indirectly owned/ controlled/ significantly influenced by the **erstwhile promoter group**, for provision of services, use of trademarks/ logos and sponsorship rights on normal commercial terms which were at arms length and in the ordinary course of business. Such agreements are expected to yield benefits to the Company through improved brand visibility and also will continually support the business of the Company.

(emphasis supplied)

From the above extracts, the expressions "controlling shareholder", "erstwhile promoter group" etc. appear vague and do not clearly indicate cent per cent 'control' with Diageo. Both the First and Second Letters of Offer also do not clarify whether Diageo group was in 'sole control' of USL or not. In view of the above, I am inclined to agree with the allegation made in the SCN that there were no disclosures to the effect that UB Group was identified as promoters only because of their historical connection with USL.

#### **IV. CHANGE IN CONTROL POST NOVEMBER 25, 2015?**

21. The SCN had alleged that post the First Letter of Offer, on account of the Veto Rights and the Voting Arrangement as a result of the SHA executed between the Diageo and UB Groups, the latter continued to exercise joint control along with the former. The SCN also notes that post the Second Open Offer, since the Diageo Group had acquired more than 50.1%, the Voting Arrangement had ceased to continue (*in accordance with Clause 6 of the SHA*). Nonetheless, according to the SCN, since the UB Group continued to possess

Veto Rights, it continued to exercise control over USL. The veto rights themselves allegedly ceased to exist with effect from November 25, 2015 since the UB Group failed to vote in accordance with the Diageo Group's instructions. Consequently, the SCN has placed reliance on this date to allege that control changed from being jointly exercised by the UB Group and Diageo Group to being solely exercised by the Diageo Group i.e. the Noticees.

**22.** However as concluded in the preceding paragraphs while the voting arrangement had ceased to exist post the Second Open Offer (where after the Noticees had acquired more than 54% of USL's voting capital), the veto rights that admittedly continued thereafter were limited and protective in nature and could not by themselves or as standalone rights sufficiently constitute 'control' in terms of regulation 2(1)(e) of the SAST Regulations. Since such limited veto rights did not constitute 'control', it could not be said that the UB Group had continued to exercise joint control over USL. Consequently the cessation of such rights cannot constitute a *change in* control in favour of the Diageo Group. Further, post the Second open offer in 2014 whereby Diageo acquired a majority of the voting capital on its own, the rights given to the UB Group could not have been sufficient enough to constitute control in terms of regulation 2(1)(e) of the SAST Regulations. Also, based on the disclosures made in the Annual Reports of USL, as discussed in the foregoing paragraphs of this Order, it is but obvious that control had conclusively changed hands after the Second Open Offer in 2014. In view of all of the above, I am not inclined to agree with the allegation in the SCN that Diageo had acquired sole control of USL with effect from November 25, 2015, based on the incident of breach of voting arrangement by the UB Group. Infact Diageo had acquired absolute control post the Second open offer itself and the voting arrangement clause had ceased to be in operation from then on.

**23.** Now, while not an issue specifically contested in the SCN, I must address the aspect of change in control from joint to sole, since it is central to the allegation in the matter before me. On this issue the report of the First Bhagwati Committee, which led to the drafting of the SAST Regulations of 1997 read as follows:

"

*The Committee, therefore, agreed to define control. The Committee also felt that concept of joint control which is often seen in practice should also be recognised. The Regulations should make it explicit that cessor of any one person from joint control, thus giving the remaining person or persons sole control or taking of any person or persons in joint control by a person having sole control shall not be construed as 'change in control over the company' attracting the Regulations."*

The aforesaid view reflected in the text of the SAST Regulations, 1997 which read as follows:

"

*12. Acquisition of control over a company.—Irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company, unless such person makes a public announcement to acquire shares and acquires such shares in accordance with the Regulations.*

*Provided that nothing contained herein shall apply to any change in control which takes place in pursuance to a resolution passed by the shareholders in a general meeting.*

*Explanation:—(i) For the purposes of this Regulation where there are two or more persons in control over the target company, the cessor of any one such person from such control shall not be deemed to be a change in control of management nor shall any change in the nature and quantum of control amongst them constitute change in control of management*

*Provided however that if the transfer of joint control is through sale at less than the market value of the shares, a shareholders meeting of the target company shall be convened to determine mode of disposal of the shares of the outgoing shareholder, by a letter of offer or by block-transfer to the existing shareholders in control in accordance with the decision passed by a special resolution, Market value in such cases shall be determined in accordance with Regulation 20*

*(ii) where any person or persons are given joint control, such control shall not be deemed to be a change in control so long as the control given is equal to or less than the control exercised by person(s) presently having control over the company.*

**24.** The Achuthan Committee Report which led to the drafting of the SAST Regulations 2011 did not discuss this issue nor did this issue find a specific mention in the text of the SAST Regulations 2011. But considering that the essential jurisprudence of the two Regulations relating to acquisition of control has not changed, one would assume that the Bhagwati Committee Report's

rationale on cessation of joint control to sole control not constituting acquisition of control must continue even in the context of the 2011 Regulations. In my view, in a case where one of the two promoters renounces his control over the Target Company such that the entire control of the company vests in the hand of the lone promoter who continues, it cannot be said that there is a 'change in control' as the public shareholders are familiar with both the promoters being in control of the company and have accepted the same. In this case, the acquisition of control under Regulation 4 of the SAST Regulations by the Noticees has been notified in the First Open Offer itself. Likewise the details of the voting arrangements and veto rights which were part of the SHA were also disclosed. Hence I do not find that the alleged trigger of open offer arising out of cessation of joint control is substantiated.

**V. WHETHER THE NOTICEES ARE REQUIRED TO MAKE AN OPEN OFFER?**

**25.** In view of the conclusions arrived at in the preceding paragraphs of this Order, I do not find it appropriate to direct an open offer against the Noticees as proposed in the SCN.

**DIRECTIONS**

**26.** In view of the conclusions drawn with respect to each of the listed issues, I find it appropriate to dispose of the allegations laid out in the Show Cause Notice dated May 12, 2017 without any further directions against the noticees thereof.

**DATE: September 06, 2018**

**PLACE: Mumbai**

**G. MAHALINGAM  
WHOLE TIME MEMBER  
SECURITIES AND EXCHANGE BOARD OF INDIA**