
CASE ANALYSIS ON WIKI KIDS LTD. AND ORS. V. REGIONAL DIRECTOR, SOUTHEAST REGION AND ORS

Riyan Karbhari, BBA LLB (Hons)., O.P. Jindal Global Law School

ABSTRACT

This case focused on a proposed amalgamation between Wiki Kids Limited and Avantel Limited. Initially approved by shareholders, the merger was later contested and ultimately rejected by the National Company Law Tribunal (NCLT).

The NCLT's decision was grounded on several factors, including Wiki Kids' lack of commercial operations, its financial instability, and the perception that the merger primarily benefited the promoters. Despite support from regulatory bodies, the NCLT and subsequently the National Company Law Appellate Tribunal (NCLAT) upheld the rejection of the proposed amalgamation.

Facts

The petitioner company, Wiki Kids Limited, sought to merge with Avantel Limited and presented a scheme of amalgamation to the Andhra Pradesh High Court. The court approved the convening of meetings for shareholders, secured and unsecured creditors, for their approval for the scheme. The High Court issued certain directions to the companies. The scheme proposed by the management of both these companies was approved by 99.99% of their shareholders¹. However, the case was later transferred to the National Company Law Tribunal (NCLT) of Hyderabad in accordance with the Ministry of Corporate Affairs' notification dated 7th December 2016. The NCLT, after having sought certain clarifications, rejected the scheme stating that it primarily benefited the common promoters without public interest. This decision was taken in spite of no objection from the regulatory bodies such as Bombay Stock Exchange Limited, Securities and Exchange Board of India, Registrar of Companies, Regional Director, and Official Liquidator. This decision of the NCLT was then appealed against in National Company Law Appellate Tribunal (NCLAT) Hyderabad wherein the decision of NCLT was upheld and the scheme of amalgamation of the two companies was rejected.

Decision of lower court

In leu of the notification issued by MCA, this scheme of amalgamation came under the purview of NCLT. Section 3 of this notification held that "All proceedings under the Act, including proceedings relating to arbitration, compromise, arrangements and reconstruction, other than proceedings relating to winding up on the date of coming into force of these rules shall stand transferred to the Benches of the Tribunal exercising respective territorial jurisdiction."² The NCLT sought clarifications from the company regarding the rationale of the Scheme, valuation report submitted to the regulatory authorities and their comments. The NCLT observed that Wiki Kids did not begin its commercial operations following its incorporation in 2004. Furthermore, there was no actual revenue or profit for this company. The transferors income was mainly dependent on a single source viz., Fixed Deposit. Moreover, it noted that even after going on a spending binge, Wiki Kids was only worth 22 lakh rupees, having already

¹ Wiki Kids Ltd. and Ors. v. Regional Director, South East Region and Ors., (NCLAT, December 21, 2017) MANU/NL/0228/2017.

² "Companies (Transfer of Pending Proceedings) Rules, 2016" [2016] Official Gazette No. 3663, 8 December 2016 https://www.mca.gov.in/Ministry/pdf/CompaniesTransferofPending_08122016.pdf accessed 16 March 2024

spent 95 lakh rupees of its 117 lakh rupees of paid-up share capital³. As on the date of the case, the company had still not started its commercial production/operation, even though 13 years had already passed since its incorporation. The reasoning of the company was that through the merger, Avantel would be able to diversify into rapidly expanding and lucrative markets without having to wait for any capital. Through this merger, Avantel would be able to optimise and expand its current resources and infrastructure, which would improve cash flows, increase net worth, improve credit rating, and strengthen the value of the company for all of its stakeholders. They also believed that this scheme of amalgamation would also allow Avantel to participate more actively and profitably in a market that is becoming more liberalised and competitive.

As per the proposed share exchange ratio, the transferor company's promoters/shareholders are set to receive 100 equity shares in the transferee company for every 289 equity shares they hold in the transferor company. Both the Audit Committee and Amalgamation Committee of the transferee company deliberated on recommendations regarding the Share Exchange Ratio provided by independent entities. After assessing the entire scheme, including the Share Exchange Ratio, these committees endorsed it to the Board of Directors of the Transferee Company. The computed eligible share count for exchange stood at 4,04,845, with a valuation of Rs. 5.05 crores based on the market price as of March 31, 2016⁴. However, the market value of the transferee company's shares witnessed a significant surge by June 30, 2017, potentially leading to a higher valuation ranging from approximately Rs. 11.99 crores to Rs. 12.40 crores. Regulatory authorities had not considered this effect of the scheme of amalgamation. Financial benefit was flowing only to the few common promoters⁵. Essential information which is to be provided by both the companies was also not provided. As a result, a well informed decision could not be formed by all the stakeholders. Since the objective, rationale and purpose of the scheme was skewed i.e. it was only benefiting a select group and was not in accordance with public interest, the scheme of amalgamation was not upheld⁶.

³ Wiki Kids Ltd. and Ors. v. Regional Director, South East Region and Ors., (NCLAT, December 21, 2017) MANU/NL/0228/2017.

⁴ IndiaCorpLaw, 'NCLAT on Public Interest in Amalgamation Scheme' (2018) <<https://indiacorplaw.in/2018/01/nclat-public-interest-amalgamation-scheme.html>> accessed 16 March 2024.

⁵ Cyril Amarchand Mangaldas Blog, 'NCLT can reject scheme arrangement not in public interest' (21 January 2018) <https://tax.cyrilamarchandblogs.com/2018/01/nclt-can-reject-scheme-arrangement-not-public-interest/> accessed 16 March 2024.

⁶ IndiaCorpLaw, 'NCLAT on Public Interest in Amalgamation Scheme' (2018) <<https://indiacorplaw.in/2018/01/nclat-public-interest-amalgamation-scheme.html>> accessed 16 March 2024.

Appellants arguments

The appellants contended that they have adhered to all the essentials while proposing an implementing a scheme of amalgamation wherein there was no objection to the scheme from any concerned authority, including the registrar of companies. The appellants also contended that the management and the board of directors “examined the relative business strengths and a Scheme of Amalgamation” and agreed to it in accordance with the provisions of the Companies Act. According to the appellants, the subordinate court has looked at the decision purely from the standpoint of financials as a result they are overlooking the potential business model that could be formed post the success of amalgamation. The appellants further contend that the share exchange ratio was calculated by a qualified, independent chartered accountant in compliance with established legal and valuation principles, and that the tribunal disregarded well-established precedent holding that courts should not add the stakeholders' business acumen to their own. The appellants argued that the NCLT could not act as an appeal court and sit in judgement over the informed view of the concerned parties to the Scheme because that would fall within the purview of the concerned parties' commercial wisdom. They cited the rulings of *M/s Miheer H. Mafatlal*⁷ and *M/s Hindustan Lever Employees' Union*⁸. It was further argued that by refusing to accept the Scheme, the NCLT went beyond its authority because its sole responsibility was to guarantee that all parties had been properly consulted⁹.

Respondents Arguments

The first respondent's attorney emphasised that affidavits from all creditors and owners of the transferor and transferee entities had given their approval to the proposed scheme¹⁰. They emphasised that at a meeting where information about the merger was given, the shareholders of the transferee firm approved the plan. Without a doubt, the valuation report served as the foundation for the share exchange ratio. Legal cases were referenced to bolster the legitimacy of the appraisal procedure. The sixth respondent's attorney stated that SEBI does not perform valuations; instead, it depends on merchant bankers and independent valuers. Once released,

⁷ *M/s Miheer H. Mafatlal v Mafatlal Industries Ltd* [1997] 1 SCR 6.

⁸ *Hindustan Lever Employees' Union v Hindustan Lever Ltd and Others*, [1995] 1 SCR 551.

⁹ Cyril Amarchand Mangaldas Blog, 'NCLT can reject scheme arrangement not in public interest' (21 January 2018) <https://tax.cyrilamarchandblogs.com/2018/01/nclt-can-reject-scheme-arrangement-not-public-interest/> accessed 16 March 2024.

¹⁰ *Wiki Kids Ltd. and Ors. v. Regional Director, South East Region and Ors.*, (NCLAT, December 21, 2017) MANU/NL/0228/2017.

SEBI's observations have no effect on market movements unless complaints are filed. The Official Liquidator backed the merger, claiming it would boost finances and benefit stakeholders, and disclosed no wrongdoing in the transferor company's operations¹¹. In order to justify the Tribunal's approval of the scheme, the arguments generally highlight the consent acquired, the valuation procedure, SEBI's restricted role, and the favourable impact on stakeholders.

Majority decision

NCLAT, on the basis of the valuation report, stated that the company has not generated any revenue in spite of creating assets. They merely assume that the company would be successful in its attempt to create a new business model, but these assumptions would be valid and on a sound basis only if they were based on past performances. NCLAT agrees with the NCLT on the fact that the benefit was not in public interest and was flowing only to a select few people. While other shareholders' interests are dependent on future performance, promoters' interests have been carefully considered and safeguarded during the merger process.

The NCLAT went on to clarify that judicial and technical members make up the NCLT's constitution. As such, it possesses sufficient knowledge to scrutinise a plan and guarantee that it is equitable and reasonable for every stakeholder. The NCLAT concurred that it might not be ideal for the NCLT to examine specific mathematical aspects. Nonetheless, it should use the knowledge at its disposal and decline to adopt a plan if, in its judgement, it does not serve the public interest if a thorough examination of the plan reveals that it unfairly benefits a specific class of people.

Consequently, the NCLAT maintained the NCLT's ruling and concluded that the Scheme did not benefit all shareholders. Notably, the NCLAT rejected the Appellants' reliance on the Supreme Court's decisions in *Hindustan Lever Employees' Union*¹² and *Miheer H. Mafatlal*¹³,

¹¹ Cyril Amarchand Mangaldas Blog, 'NCLT can reject scheme arrangement not in public interest' (21 January 2018), <https://tax.cyrilamarchandblogs.com/2018/01/nclt-can-reject-scheme-arrangement-not-public-interest/> accessed 16 March 2024.

¹² *Hindustan Lever Employees' Union v Hindustan Lever Ltd and Others*, [1995] 1 SCR 551.

¹³ *M/s Miheer H. Mafatlal v Mafatlal Industries Ltd* [1997] 1 SCR 6.

distinguishing them based on the facts¹⁴.

Analysis

In this ruling, the NCLAT made it clear that it has a duty to safeguard the public interest in its entirety and that, as such, it has the authority to reject an amalgamation plan. This was especially true in this instance, where the public interest was not being served because the amalgamation plan benefited only a specific class of people. The NCLAT additionally noted that an amalgamation plan must be thoroughly reviewed and the public interest must be one of the criteria used to test the plan, rather than being narrowly analysed solely based on the fulfilment of legal requirements¹⁵.

Further clarification has been provided by the NCLAT, which states that a scheme's compliance with all regulations (including shareholder and creditor approval) and the lack of any negative regulatory authority observations does not imply that the scheme is in the public interest at large. This decision is significant because it means that, when deciding whether to restructure a business, the parties involved must make sure that any arrangement plan put forth under the Companies Act of 2013¹⁶ has a justification that explains how the plan will benefit all shareholders and is in the public interest.

It is important to remember that courts have held—based on the Supreme Court's decision in *Miheer H. Mafatlal*¹⁷—that the reach of judicial scrutiny in these kinds of cases is extremely constrained and is not appealable. Courts have decided that they are not in a position to interfere with schemes of such arrangements so long as there are no legitimate objections to the scheme, no irregularity has been identified, and the parties have fulfilled all applicable statutory obligations at the appropriate time. This is thus because, following examination of the companies' financial statements and operations, these schemes are founded on the expectations of worried creditors, shareholders, and experts and professionals, in addition to competent authorities.

¹⁴ Cyril Amarchand Mangaldas Blog, 'NCLT can reject scheme arrangement not in public interest' (21 January 2018) <https://tax.cyrilamarchandblogs.com/2018/01/nclt-can-reject-scheme-arrangement-not-public-interest/> accessed 16 March 2024.

¹⁵ IndiaCorpLaw, 'NCLAT on Public Interest in Amalgamation Scheme' (2018) <<https://indiacorplaw.in/2018/01/nclat-public-interest-amalgamation-scheme.html>> accessed 16 March 2024.

¹⁶ The Companies Act 2013 (India).

¹⁷ *M/s Miheer H. Mafatlal v Mafatlal Industries Ltd* [1997] 1 SCR 6.

Consequently, courts shouldn't examine the scheme's wisdom if there are no relevant objections that will harm anyone. To be more precise, as noted in the *J.K. Agri Genetics Ltd. v. Union of India*¹⁸ case, a plan that has the support of the majority of shareholders cannot be denied clearance only because it favours the promoter group exclusively. In this sense, the NCLAT opinion expands the NCLT's jurisdiction of review and seems to go against the current judicial position¹⁹.

¹⁸ *J.K. Agri Genetics Ltd. v. Union of India* [2012] 175 Com Cases 306 (Calcutta HC).

¹⁹ IndiaCorpLaw, 'NCLAT on Public Interest in Amalgamation Scheme' (2018) <<https://indiacorplaw.in/2018/01/nclat-public-interest-amalgamation-scheme.html>> accessed 16 March 2024.