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# M&A Lab

DIAGEO

UB GROUP
UNITED SPIRITS

## Diageo-USL: 'King of Good Times; Hands over Crown Jewel to Diageo

### Deal Dissected

May 2014

 

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Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).

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# Diageo – USL: “King of Good Times” Hands Over Crown Jewel to Diageo

On July 4, 2013, the Diageo Group, a British multinational alcohol beverages group completed acquisition of approx. 25.02% of shares of United Spirits Limited, a listed Indian company. The deal valued at about INR 52 Billion eventually was one of the largest transactions especially in the food and beverages industry, not just in India but across the world. The deal was also a landmark in many ways as it prompted certain changes to the M&A regulations in India.

The deal gave the Diageo Group a much anticipated entry into one of the world’s fastest growing liquor market (India). It also saw the maker of leading and marquee global brands such as Smirnoff, Johnnie Walker, Bailey and Guinness, extend its holding to brands such as Black Dog, Bagpiper and McDowell’s.

The consummation of the deal was not without its fair share of challenges. The deal was subjected to a detailed scrutiny by the Securities and Exchange Board of India as well as the Competition Commission of India. Apart from the regulatory scrutiny, the deal was also challenged before the Courts by the lenders of the Sellers (especially the Promoter Group).

The deal has been much in discussions, not only because of the legal, regulatory and commercial issues involved, but also due to the high profile promoter, Dr. Vijay Mallya, who many speculated was sanctioning the sale to ease the rising debt in both United Spirits Limited and Kingfisher Airlines.

For Diageo Group, the deal represents their first step towards consolidating their ever expanding hold in one of the fastest growing spirits market in the world. For Dr. Vijay Mallya and the UB Group, the deal represents a new partnership with an experienced global player and reduction of their (respective) debt. For United Spirits Limited, it represents the best of both worlds as an established local presence meets international governance and operational standards and also deleverages itself. Having said that, time will tell whether Diageo will do justice to the ‘King of Good Times’ going ahead.

# Contents

# 1. Glossary of Terms

| Terms | Definitions |
|---|---|
| **Acquirer** | Relay B.V. |
| **Additional Shares** | The additional shares of the Target that UBHL and KFIL had agreed under the SPA to sell if after completion of PAA, SPA and Open Offer, Diageo Group through the Acquirer was unable to acquire at least 25.1% of the Equity Shares of the Target. |
| **BSE** | Bombay Stock Exchange |
| **CCI** | Competition Commission of India |
| **Combination Regulations** | Competition Commission of India (Procedure for Transaction of Business relating to Combinations) Regulations, 2011 |
| **Competition Act** | The Competition Act, 2002 |
| **Cos Act** | The Companies Act, 1956 (Act 1 of 1956) |
| **Diageo Group** | The British headquartered multinational alcohol beverages group including the Acquirer, PAC 1, PAC 2, PAC 3 and PAC 4 |
| **Deal** | The acquisition of the Sale Shares and, if applicable, the additional shares pursuant to the SPA, the subscription to the Subscription Shares by the Acquirer pursuant to the PAA, the purchase of Equity Shares of the Target from the Public Shareholders pursuant to the Open Offer |
| **Diageo India** | Diageo India Private Limited |
| **Emerging Voting Capital** | The enlarged voting share capital of the Target pursuant to the issuance of Subscription Shares pursuant to the PAA and calculated in accordance with regulation 7 of the Takeover Code (as defined below) |
| **Equity Shares** | Fully paid up equity shares of the Target with face value of INR 10 (Rupeesten only) each. |
| **GATA** | The German Federal Cartel Office which is the German Anti-Trust Authority |
| **INR** | Indian Rupees |
| **ITA** | Income Tax Act, 1961 as amended from time to time |
| **Kar HC** | Hon'ble High Court of Karnataka |
| **KFIL** | Kingfisher Finvest India Limited |
| **Kingfisher Airlines** | Kingfisher Airlines Limited |
| **Lab** | This M&A Lab |
| **Listing Agreement** | The Listing Agreement entered into by the Target with BSE and with NSE |
| **NSE** | National Stock Exchange |
| **Offer Documents** | Includes all documents relating to the Open Offer such as the public announcement, detailed Public Announcement, letter of offer, post offer report. |
| **OFT** | Office of Fair Trading |
| **Offer Price** | INR 1,440.00 (Rupees One thousand four hundred and forty only) per share |
| **Open Offer** | Open Offer made by the Acquirer and the Diageo Group to the Public Shareholders |
| **PAA** | The preferential allotment agreement dated November 9, 2012 between the Acquirer, Diageo Group and the Target |
| **PAC** | 'Person acting in concert' as defined under regulation 2(1)(q) of the Takeover Code (defined below) |
| **PAC 1** | Diageo Plc |
| **PAC 2** | Diageo Finance Plc |
| **PAC 3** | Diageo Capital Plc |
| **PAC 4** | Tanqueray Gordan and Company Limited |

| Terms | Definitions |
|---|---|
| **PACs** | PAC 1, PAC 2, PAC 3 and PAC 4 |
| **PIGL** | Palmer Investment Group Limited |
| **Pioneer** | Pioneer Distilleries Limited |
| **Preferential Allotment** | Allotment of Subscription Shares by the Target to the Acquirer |
| **Public Announcement** | The Public announcement of the Open Offer made by the Acquirer dated November 9, 2013 |
| **Public Shareholders** | The shareholders and beneficial owners of equity shares, other than the parties to the Transactional Documents and persons acting, or deemed to be acting, in concert with such parties |
| **RBI** | Reserve Bank of India |
| **Sale Shares** | 25,226,839 Equity Shares of the Target representing 17.4% of the Emerging Voting Capital to be acquired from the Sellers under the SPA |
| **SCRA** | Securities Contract Regulation Act, 1956 |
| **SEBI** | Securities Exchange Board of India |
| **SEBI Act** | SEBI Act, 1992 |
| **Sellers** | UBHL, KFIL, SWEW (defined below), Dr. Vijay Mallaya and A.K. Ravindranath Nedungadi, in their capacities as trustees of USL Benefit Trust, PIGL (defined above) and UB Sports (defined below) |
| **SHA** | The shareholders agreement dated November 9, 2012 between the Acquirer, Diageo Group, UBHL and KFIL |
| **SPA** | The share purchase agreement dated November 9, 2012 between the Acquirer, PAC 1 and Sellers |
| **SPV** | Special purpose vehicle |
| **Subscription Shares** | 14,532,775 Equity Shares, representing 10% of the Emerging Voting Capital allotted to the Acquirer pursuant to the PAA |
| **SWCL** | Shaw Wallace & Company Limited |
| **SWEW** | SWEW Benefit Company |
| **Takeover Code** | Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011 as amended upto the date of the Public Announcement |
| **Target** | United Spirits Limited |
| **Target Group** | The Target and all its subsidiaries and entities controlled by the Target |
| **Transactional Documents** | Collectively the SPA, PAA and SHA |
| **UB Group or Promoter Group** | UBHL and each of its subsidiaries and any entity that directly or indirectly is controlled by UBHL |
| **UBHL** | United Breweries (Holdings) Limited |
| **UB Sports** | UB Sports Management Overseas Limited |
| **US$** | United States Dollars |

# 2. Prologue

The Target, the world's largest spirits company by volume[1] and largest distiller by value,[2] but bleeding as a result of heavy debt[3] and controlled by a Promoter Group whose venture into the aviation sector had gone completely awry[4] and the Diageo Group, the British multinational alcohol beverages group and the producer of some of the most premium spirits in the world were involved in a Deal which was one of the most widely discussed deals of 2012-2013. The Deal was also a landmark one in many ways as it prompted certain changes to the M&A regulation in India.

The Deal gives Diageo Group a much anticipated entry into one of the world's fastest growing liquor market (India). The Deal will see the maker of leading and marquee global brands such as Smirnoff, Johnnie Walker, Bailey and Guinness, extend its holding to brands such as Black Dog, White & Mackay (please see Section 9 Question 8 of this Lab), Bagpiper and McDowell's. The consummation of the Deal was not without its fair share of challenges as one would expect in a multi-jurisdictional, multi layered deal which resulted in the coming together of two global behemoths in the spirits industry. This meant that the Deal was also subjected to a detailed scrutiny by SEBI and CCI. Apart from the regulatory scrutiny, the Deal was also challenged before the Courts by the lenders of the Sellers (especially Promoter Group).

Diageo Group through the Acquirer only managed to acquire 25.02% of the Emerging Voting Capital of the Target which was far less than the acquisition of 53.4% of the Emerging Voting Capital of the Target that Diageo Group had envisaged on the day the Transactional Documents were executed. However immediately after completion of the Deal, the Acquirer picked up 1.3% of the shares of the Target at an average price of INR 2,400 (Rupees two thousand and four hundred only) per share through a bulk deal and some sources suggest that another open offer is also being considered.[5]

In this Lab, we seek to dissect the commercial, legal, regulatory and tax considerations of the Deal.

1. United Spirits, http://www.unitedspirits.in/aboutus.aspx (last visited on April 12, 2013).
2. Estimated to be sitting on a debt of approximately INR 8.3 billion, Business Today, November 16, 2012 available at http://www.businesstoday.intoday.in/story/10-things-to-know-about-the-united-spirits-diageo-deal/1/189891.html (last visited on December 15, 2013).
3. Business Today, *supra* note 2.
4. Currently estimated debt close to US$ 2.5 billion, Wall Street Journal, April 10, 2013 available at http://blogs.wsj.com/indiarealtime/2013/04/10/we-should-be-thankful-to-kingfisher-airlines/ (last visited on April 12, 2013).
5. VCC Circle, Diageo may launch another open offer for United Spirits, picks 1.3% for over $75M, available at http://www.vccircle.com/news/fmcg/2013/11/26/diageo-may-launch-another-open-offer-united-spirits-picks-13-over-75m (last visited on December 9, 2013).

# 3. Executive Summary

After being rebuffed several times over the last five years,[6] Diageo Group was finally able to push the Promoter Group of the Target to sell and dilute its stake in the Target and cease control over the Target. One of the sacrosanct commercial understandings between the Diageo Group and the UB Group was that post the Deal, Diageo Group should have the ability to control the Target and drive the strategy and policy of the Target. To achieve this commercial understanding, the Deal had to be structured in a multi layered manner with several fall back options incase Diageo Group failed to acquire a controlling stake in the Target even after the (A) purchase of the (i) Sale Shares under the SPA and (ii) equity shares pursuant to the Open Offer; and (B) subscription of Subscription Shares under the PAA. The fall back options were necessary as the Promoter Group, prior to the Deal, held only approximately 27.8% shares in the Target, thus, leaving the Diageo Group heavily reliant on the tender of shares by the Public Shareholders in the Open Offer and approval of the three-fourth of the shareholders for the issuance of Subscription Shares as contemplated under the PAA.

The Deal, being a complex one, was held up as a result of detailed scrutiny by SEBI and CCI. The lenders to the UB Group were also able to pose a serious challenge to the Deal as the Sale Shares were pledged with the lenders. In the end, the UB Group was able to obtain a clearance from the Kar HC to sell the Sale Shares on the condition that the Sellers would deposit INR 2.5 billion in a nationalized bank as security.[7]

Diageo Group had envisaged acquiring a total of 53.36% of the Emerging Voting Capital in the Target in the following manner:

i. Acquisition of Sale Shares under the SPA constituting 17.4% of the Emerging Voting Capital of the Target;

ii. Subscription to Subscription Shares under the PAA constituting 10% of the Emerging Voting Capital of the Target; and

iii. Acquisition from the Public Shareholders pursuant to the Open Offer constituting 26% of the Emerging Voting Capital.

However, Diageo Group was only able to acquire 25.02% of the Emerging Voting Capital in Target as only 0.04% of the shares were tendered by the Public Shareholders in the Open Offer and USL Benefit Trust, one of the Sellers under the SPA, holding 2.38% in Target was unable to sell its shares to the Acquirer as it was unable to obtain the necessary approvals from the lenders.[8]

However, immediately after completion of the Deal, the Acquirer acquired 1.3% of the shareholding in the Target at an average price of INR 2,400 (Rupees two thousand and four hundred) per share through a bulk deal and some sources suggest that another open offer is also being considered.[9] The immediate acquisition by the Acquirer after the completion of the Deal was primarily because the Acquirer had only been able to acquire 25.02% of the Emerging Voting Capital of the Target.

This was not the end of the story as, acting on a winding-up petition filed by lenders of UBHL, the Kar HC delivered its judgment on December 20, 2013, which annuls the sale of stake by UBHL to the Diageo Group. This judgment is a reversal of another verdict passed by the same court earlier in the year when it gave conditional approval to UBHL to sell its stake to the Diageo Group. The decision of the Kar HC, though may be contested in an appeal, now positions the Diageo Group with a minority status in the Target, unless the order is stayed by a higher court.

6. The Telegraph, Diageo in talks with Vijay Mallya's United Spirits, available at http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/leisure/9564293/Diageo-in-talks-with-Vijay-Mallyas-United-Spirits.html (last visited on September 14, 2013)

7. See 'Court gives conditional nod for United Spirits share sale to Diageo', available at http://www.thehindu.com/business/Industry/court-gives-conditional-nod-for-united-spirits-share-sale-to-diageo/article4746373.ece

8. See Diageo ends with 25% in United Spirits, available at http://www.telegraphindia.com/1130705/jsp/business/story_17083393.jsp#.UpMYtJKVO9E

9. See *supra* note 5.

# 4. Parties Involved in The Deal

## I. Target

The Target was incorporated as a public limited company on March 31, 1999 under the Cos Act as 'McDowell Spirits Limited'. Subsequently, its name was changed to 'McDowell & Company Limited' and eventually changed to 'United Spirits Limited' on October 17, 2006. It is the flagship company for the spirits business of the UB Group. The Target is engaged in the business of manufacturing and bottling of 'Indian made – foreign liquor' (IMFL). It is the largest spirits company in the world by volume.[10] The company has 22 'millionaire brands'[11] and also has a 59% share in the Indian market for its first line brands.[12]

The Target exports to over 37 countries and maintains a sizeable presence in India, having established manufacturing and bottling plants in every state of India.[13] With an expanding revenue base at almost INR 64.5 billion and a profit after tax of close to INR 2.65 billion,[14] the Target dominates the Indian market as an established player.[15]

## II. Sellers

### A. UBHL

UBHL is the principal (but not the only) holding company for the UB Group.[16] UBHL holds significant stakes in the following companies:

- The Target;
- United Breweries Limited[17] (upto 12.6% of the share capital);
- Kingfisher Airlines Limited(upto 60.58% of the share capital); and
- Aventis Pharma Limited. (upto 10.22% of the share capital).

UBHL also has had significant investments in three main consumer driven segments for the past decade i.e. alcoholic beverages, spirits and aviation industry, which are its main lines of business. UBHL also has presence in the engineering, fertilizers and biotechnology sectors. In aggregate, the turnover of the UB Group touched US$ 2.6 Billion in March 2008, with a market capitalization of US$ 3.2 Billion. Post the completion of the Deal and as on August 16, 2013, UBHL held 7% of the share capital of the Target.

### B. KFIL

KFIL was incorporated as a wholly owned subsidiary of UBHL. As on March 31, 2013, KFIL held 7.21% shares of the now struggling Kingfisher Airlines.[18] KFIL also acts as a holding company of the UB Group for investments in chemical and fertilizer sectors.[19] Post the completion of the Deal and as on August 16, 2013, KFIL held 4.09% stake in the Target.[20]

### C. SWEW

SWEW was incorporated as a company limited by guarantee (and therefore has no share capital). SWEW was originally incorporated as 'Shaw Wallace Executives' Welfare & Benefit Company Private Limited' which subsequently was modified to 'Shaw Wallace Executives' Welfare & Benefit Company'. Its name was subsequently changed to 'SWEW Benefit Company' on September 1, 2008. SWEW was formed primarily for the benefit / welfare of certain executives of SWCL. Prior to 2007, SWEW held some shares of SWCL. In 2007-08 SWCL was merged with the Target.[21] SWEW does not have any share capital and Dr. Vijay Mallya is the current "patron" of the

10. United Spirits, http://www.unitedspirits.in/aboutus.aspx (last visited on April 12, 2013).
11. The term 'millionaire brands' is colloquially used to refer to those brands that sell more than a million cases per annum.
12. http://www.theubgroup.com/business_beverage_spirits.aspx
13. The established presence across India constitutes one its key attractiveness for a foreign investor to enter into the Indian alcohol beverages market.
14. United Spirits Limited, Press Release, February 4, 2013 available at http://www.unitedspirits.in/Investor_PressRel/1928218071USL%20Press%20Release%20FY13%20Q-3%20February%202013.pdf (last visited on April 12, 2013).
15. Increasing from INR 1.162 billion in March, 2008 to INR 3.444 billion in March 2012.
16. Entities controlled or affiliated with UBHL or controlled by Vijay Mallya / his close family members.
17. The company that owns, manufactures and markets the Kingfisher brand of beer (as opposed to USL). UBL is also owned partially by the Heineken N.V. a member company of the Heineken Group.
18. The Financial Express, Kingfisher Fin, UB Holdings pledge stake, available at http://www.financialexpress.com/news/kingfisher-fin-ub-holdings-pledge-stake/813864 (last visited on September 15, 2013)
19. The Business Line, Kingfisher Finvest hikes stakes in MCF, McDowell Holdings, available at http://www.thehindubusinessline.com/markets/stock-markets/kingfisher-finvest-hikes-stakes-in-mcf-mcdowell-holdings/article5049376.ece (last visited on September 15, 2013).
20. USL Annual Report, 2013, available at http://www.bseindia.com/bseplus/AnnualReport/532432/5324320313.pdf (last visited on September 15, 2013)
21. Company Profile, United Spirits Limited, http://www.indiainfoline.com/Markets/Company/Background/Company-Profile/United-Spirits-Ltd/532432 (available at September 15, 2013).

company. Prior to the Deal, SWEW held 0.10% of the share capital of the Target and was not classified as part of the Promoter Group. Post the completion of the Deal, SWEW ceased to be a shareholder in the Target.

### D. United Spirits Limited Benefit Trust

USL Benefit Trust was formed as a private trust on September 20, 2006. USL Benefit Trust holds the Equity Shares of the Target as treasury stock. The trustees of USL Benefit Trust are Dr. Vijay Mallya and Mr. A.K.R. Nedungadi.

Prior to the Deal, USL Benefit Trust held 2.64% of the shares of the Target and was not classified as part of the Promoter Group. Post the completion of the Deal, USL Benefit Trust continues to hold 2.38% (note the shareholding has reduced after the Public Announcement) of shares in the Target as these shares were provided as security to the lenders and the same was released prior to the completion of the SPA.

### E. PIGL

PIGL was incorporated as a wholly owned subsidiary of the Target. Prior to the Deal, PIGL held 3.35% of the shares of the Target and was not categorized as part of the Promoter Group. Post the completion of the Deal, PIGL ceased to be a shareholder in the Target.

### F. UB Sports

UB Sports was incorporated as a wholly owned subsidiary of PIGL in Jersey, the Channel Islands. Prior to the Deal, UB Sports held 0.42% of the shares of the Target. Post the completion of the Deal, UB Sports ceased to be a shareholder in the Target.

## III. Acquirer

### A. Acquirer

The Acquirer was a wholly owned subsidiary of PAC 1 and was incorporated on July 13, 2012 in the Netherlands. It appears that the Acquirer was incorporated as a SPV for the purposes of the Deal.

### B. PAC 1

PAC 1 was incorporated as a public limited company in England & Wales by the name of 'Arthur Guinness Sir and Company' on October 21, 1886. It was renamed as 'Arthur Guinness and Sons Plc' on March 1, 1982 and subsequently to 'Guinness PLC' on May 1, 1985. The company was eventually named 'Diageo Plc' on December 17, 1997. PAC 1 is a leading premium alcoholic beverage maker with its presence spanning across 180 countries. Its most noted brands include Johnnie Walker and Smirnoff. It is listed on the London Stock Exchange and the New York Stock Exchange. In India, PAC 1 is present through its wholly owned subsidiary Diageo India. Diageo India has less than 3% of the market share in India. PAC 1 is parent company of the Acquirer, PAC 2, PAC 3 and PAC 4.

### C. PAC 2

PAC 2 was incorporated as a public limited liability company in England and Wales. It is a wholly owned subsidiary of PAC 1. PAC 2, along with certain other companies of the Diageo Group, assists in raising external debt financing for the Diageo Group. The funds available with PAC 2 are lent to companies of the Diageo Group for their operational or other requirements. It is likely that PAC 2 may have provided the necessary financial assistance for the Deal.

### D. PAC 3

PAC 3 was incorporated as wholly owned subsidiary of PAC 1 in Scotland. PAC 3 performs the same role as PAC 2 for the Diageo Group and may have likely provided the financial assistance for the Deal.

### E. PAC 4

PAC 4 was incorporated as a wholly owned subsidiary of PAC 1 in England and Wales. PAC 4's principal source of income is the dividend it receives from its subsidiaries. Thus, the cash lying on its books is likely to have been used for the Deal.

# 5. Deal Snapshot

| | |
|---|---|
| **Target** | United Spirits Limited |
| **Acquirer** | Relay BV |
| **PACs** | PAC 1, PAC 2, PAC 3 and- PAC 4 |
| **Sellers** | Sellers (as defined in the glossary of terms) |
| **Modes of acquisition proposed** | i. Secondary Purchase<br>Acquisition of Sale Shares by Acquirer from the Sellers under the SPA representing 17.36% of the Emerging Voting Capital of the Target.<br>ii. Primary Subscription<br>Allotment of Subscription Shares by the Target under the PAA representing 10% of the Emerging Voting Capital.<br>iii. Open Offer<br>Open Offer made by the Diageo Group to the Public Shareholders of the Target under the Takeover Code for the acquisition of 26% shares in the Target. |
| **Total contemplated acquisition** | 53.36% of the Emerging Voting Capital of the Target. |
| **Total action acquisition** | 36,359,192 shares representing 25.02% of the Emerging voting capital of the Target.<br>i. Secondary Purchase (under the SPA)<br>▪ **From UBHL:**<br>9,070,595 Equity Shares, representing 6.24% of the Emerging Voting Capital of the Target<br>▪ **From KFIL:**<br>7,646,392 Equity Shares, representing 5.26% of the Emerging Voting Capital of the Target.<br>▪ **From SWEW:**<br>125,531 Equity Shares, representing 0.09% of the Emerging Voting Capital of the Target.<br>▪ ***From PIGL:***<br>4,376,771 Equity Shares, representing 3.01% of the Emerging Voting Capital of the Target.<br>▪ **From UB Sports:**<br>548,460 Equity Shares, representing 0.38% of the Emerging Voting Capital of the Target.<br>The above acquisitions of Equity Shares of the Target represents 14.98% of the Emerging Voting Capital of the Target.<br>It is to be noted that the shares held by USL Benefit Trust, comprising of 3,459,090 Equity Shares, representing 2.38% of the Emerging Voting Capital of the Target, which was part of the Sale Shares under the SPA, could not be acquired as USL Benefit Trust was unable to obtain the necessary lender approvals.[22]<br>ii. Primary Subscription (under the PAA)<br>Subscription to the Subscription Shares pursuant to the PAA representing 10% of the Emerging Voting Capital of the Target.<br>iii. Open Offer<br>Acquisition of Equity Shares from the Public Shareholders representing 0.04% of the Emerging Voting Capital of the Target. |

22. See http://www.livemint.com/Companies/HaOJ7RlU4BiFsu3i5YomWJ/Diageo-set-to-complete-United-Spirits-takeover.html (last visited September 14, 2013).

| | |
|---|---|
| **Total acquisition (after completion of PAA, SPA and Open Offer)** | 25.02% of the Emerging Voting Capital in the Target. |
| **Acquisition Price** | INR 1,440 (Rupees one thousand and four hundred and forty) per each share. |
| **Total Consideration** | ▪ Sale Shares consideration<br>INR 31,430,040,480 (Rupees thirty one billion, four hundred and thirty million, forty thousand, four hundred and eighty only).<br>▪ Open Offer<br>INR 84,481,920 (Rupees eighty four million, four hundred and eight one thousand, nine hundred and twenty only).<br>▪ Preferential Allotment price<br>INR 20,927,196,000 (Rupees twenty billion nine hundred and twenty seven million, one hundred and ninety six thousand only)<br>▪ Total purchase consideration<br>Approx. INR 52,441,718,400 (Rupees fifty two billion four hundred and forty one million, seven hundred and eighteen thousand, and four hundred only). |

# 6. Chronology of Key Events

| Date | Key Event |
|---|---|
| **September 21, 2012** | Diageo Group holds advanced talks to buy a stake in Dr. Vijay Mallya's the Target.[23] |
| **November 9, 2012** | i. Execution of PAA, SHA and the SPA.<br>ii. Target Board approval accorded for allotment of Subscription Shares pursuant to the PAA.<br>iii. Public Announcement made by the Acquirer along with PACs, of an Open Offer.[24] |
| **November 20, 2012** | Publication of the detailed public statement. |
| **November 27, 2012** | Acquirer files draft letter of offer with SEBI, Target and relevant stock exchange(s) formally committing to the Open Offer. |
| **December 14, 2013** | Shareholders of the Target approve the allotment of the Subscription Shares to the Acquirer as contemplated in the PAA. |
| **January 31, 2013** | SEBI conditionally clears Diageo Group's open offer with comments.[25] |
| **February 4, 2013** | The Acquirer sends a letter through the manager of the Open Offer to SEBI to permit the commencement of the tendering period no later than 12 working days from the receipt of all statutory approvals required for the Deal. |
| **February 7, 2013** | SEBI allows the extension of the commencement of the tendering period for the Open Offer subject to the Acquirer paying a 10% interest per annum to the Public Shareholders who tender their Equity Shares in the Open Offer. |
| **February 27, 2013** | CCI clears the Deal despite expressing concern on 'ambiguous' parts of the Deal as well as seeking key information including prices and shares of the Target's products and those of its competitors.[26] |
| **April 2, 2013** | Date of publication of recommendation by the committee of independent directors of Target. |
| **April 3, 2013** | Letter of Offer dispatched to Public Shareholders by the Acquirer for the Open Offer. The share of the Target was trading at around INR 1,750 (Rupees one thousand seven hundred and fifty only). |
| **April 10, 2013** | Commencement of the tendering period for the Open Offer |
| **April 26, 2013.** | Date of expiry of the tendering period. |
| **May 13, 2013** | Open Offer is completed pursuant to which the Acquirer purchases 58,668 shares in the Target representing 0.04% of the Emerging Voting Capital of the Target. |
| **May 24, 2013** | The Kar HC allowed UBHL to sell its shares in the Target to the Acquirer Group subject to UBHL depositing INR 2,500,000,000 (Rupees two thousand and five hundred million only) as security immediately after the completion of the transaction. |
| **May 27, 2013** | PAA is consummated as the Target's board allots 14,532,775 Equity Shares to the Acquirer |

23. See http://www.bloomberg.com/news/2012-09-21/diageo-said-to-be-in-advanced-talks-for-united-spirits-stake-1-.html
24. See http://www.sebi.gov.in/cms/sebi_data/commondocs/unitedspiritspa_p.pdf.
25. See http://www.livemint.com/Companies/f4jn7f1S7U91036hubZCNJ/Sebi-clears-Diageos-open-offer-for-United-Spirits.html
26. See http://www.livemint.com/Companies/XktkfU9Glbb6qvanqTOvoN/Competition-panel-approves-DiageoUnited-Spirits-deal.html

| | |
|---|---|
| **July 4, 2013** | The Acquirer completes the acquisition of the Sale Shares as contemplated under the SPA. However, the Acquirer was unable to acquire 3,459,090 Equity Shares of the Target representing 2.38% from USL Benefit Trust as the shares were charged as security towards certain lenders and the same was not released.<br><br>The SHA becomes effective and the Acquirer, UBHL and KFIL are classified collectively as *Promoters or Promoter Group* as per the Takeover Code. |
| **November 7, 2013** | Acquirer provides an update on the post Open Offer status regarding Equity Shares of Target held by USL Benefit Trust. The Acquirer states that the 26 week deadline within which Sale Shares were required to be acquired (as stipulated under Regulation 22(3) of the Takeover Code) which is to expire on November 11, 2013 will be missed. |
| **November 11, 2013** | The twenty six week deadline is missed as Diageo Group / Acquirer / Promoter Group is unable to release the charge on the remaining 2.38% of shares of the Target held by the Target Benefit Trust. The final shareholding of Diageo Group in the Target on the completion of the Deal stood at 25.02% of the Emerging Voting Capital of the Target. |
| **December 20, 2013** | Kar HC delivered its judgment which annuls the sale of stake by UBHL to the Diageo Group. |

# 7. Deal Structure

As discussed earlier in the Lab, the deal had to be structured in a multi layered manner. In order to examine why the deal was structured in a multi layered manner with several fall back options, we need to first examine the shareholding structure of the Target prior to the Deal.

## I. Shareholding of the Target Prior to the Deal

The shareholding of the Promoter Group in the Target was around 27.78% of the share capital of the Target. Additionally, 6.5% of the share capital of the Target was held by entities/trusts which were related to the Promoter Group but were not classified as such. Thus, any acquirer which had any interest in acquiring a majority interest in the Target would have had to heavily rely on the co-operation of the public shareholders. The broad shareholding pattern of the Target prior to the Deal is reflected in **Diagram 1 below.**

In order to reduce the dependence on the Public Shareholders, Diageo Group and Promoter Group introduced several fall back options to ensure that at all points in time the Diageo Group, alteast contractually, had the majority control over the Target.

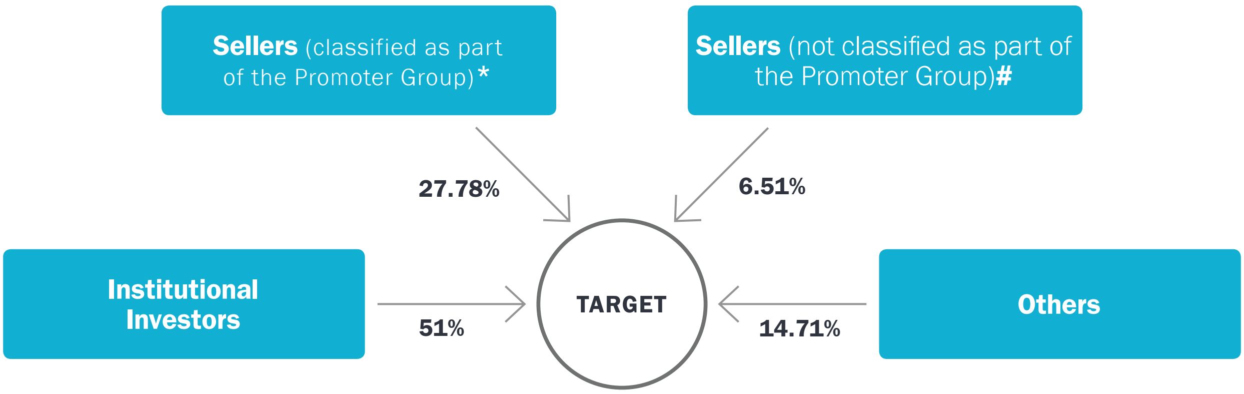


*Diagram 1*

** Promoter Group includes only UBHL and KFIL. Prior to the Deal, UBHL and KFIL collectively held approx. 27.78% of the shares of the Target. UBHL and KFIL had collectively agreed to sell 11.50% of the share capital of Target under the SPA.*

*# SWEW, USL Benefit Trust, PIGL and UB Sports who were the other Sellers under the SPA were not classified as part of the Promoter Group. Prior to the Deal, these Sellers collectively held 6.51% of the shares of the Target. These Sellers had collectively agreed to sell 5.86% of the share capital in the Target under the SPA.*

## II. Preferred Deal Structure

(i) Preferential Allotment (10%); (ii) Purchase from Sellers (17.36%); and (iii) Open Offer (26%).Since the two key objectives of the Deal were to (a) deleverage the Target and (b) provide Diageo Group with the ability to control the Target post the Deal, the Diageo Group and the Promoter Group envisaged the following structure for the Deal:

i. Issuance of Subscription Shares to the Acquirer (part of the Diageo Group) pursuant to the PAA representing 10% of the Emerging Voting Capital of the Target;

ii. Acquisition of Sale Shares from the Sellers (part of the Promoter Group) pursuant to a SPA representing 17.36% of the Emerging Voting Capital of the Target;

iii. Acquisition of Equity Shares of the Target pursuant to the Open Offer from the Public Shareholders representing 26% of the Emerging Voting Capital of the Target;

This structure would have deleveraged the Target and provided the Diageo Group a majority control. At the same time the Promoter Group would have retained some economic interest in the Target (the Promoter Group would have post Deal retained approx. 13.54% of the Emerging Voting Capital in the Target).

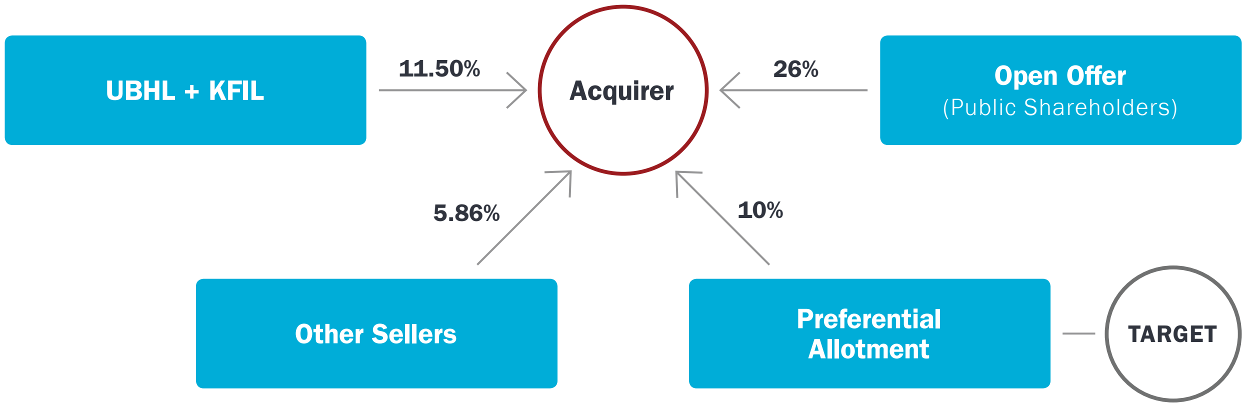


*Diagram 2*

*If the Preferred Deal Structure were successful, following would have been the shareholding pattern of the Target:-*

| Shareholders | Pre- Deal | Preferred Deal Outcome (% of Emerging Voting Capital) |
|---|---|---|
| **New Promoter** | | |
| Acquirer | Nil | 53.36% |
| **Existing and Continuing Promoters** | | |
| UBHL | 18.03% | 10% |
| KFIL | 9.69% | 3.5% |
| Other promoter companies | 0.06% | 0.04% |
| Total (UBHL + KFIL + Others) | 27.78% | 13.54% |
| **Others** | | |
| SWEW, USL Benefit Trust, PIGL and UB Sports | 6.51% | Negligible |
| Public Shareholders | 65.71% | 33.1% |

## III. Fall Back Option 1

(i) Preferential Allotment (10%); (ii) Purchase from the Sellers (17.36% + Voting Arrangement); and (ii) Open Offer (≤22.66%).

One of risks with the Preferred Deal Structure as illustrated in *Diagram 2* was that the Diageo Group was heavily reliant on the outcome of the Open Offer for attaining majority control.

Thus, in order to reduce the dependence on the outcome of the Open Offer, Diageo Group and Promoter Group agreed to incorporate a voting arrangement in the SHA wherein UBHL and KFIL (largest shareholders from the Promoter Group and signatories to the SHA) would vote (as per the their entitlements as shareholders of the Target) in accordance with the written instructions of the Diageo Group for a period of 4 (four) years or till such time as the Diageo Group acquires 50.1% of the voting share capital of the Target, whichever is earlier. The Fall Back Option 1 is illustrated in **Diagram 3** below

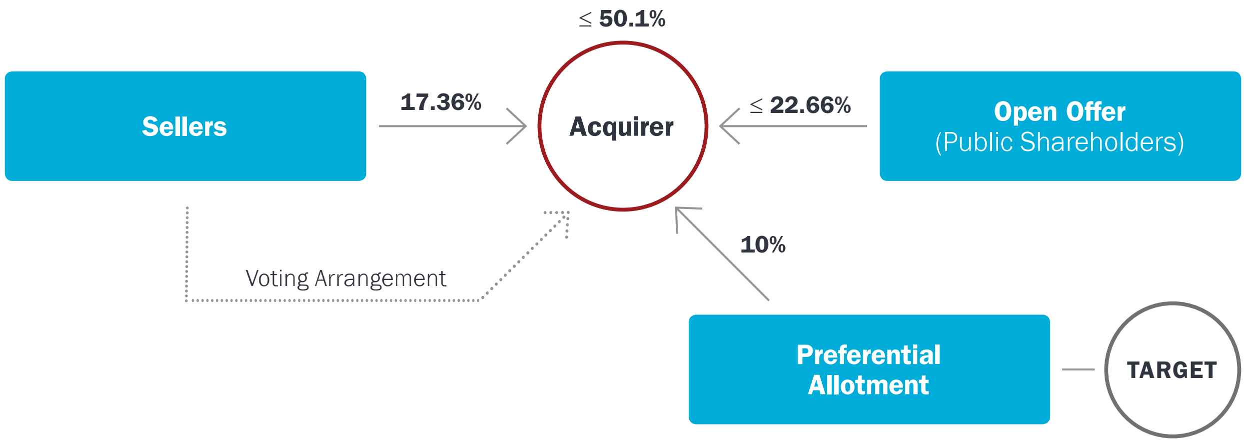


*Diagram 3*

## IV. Fall Back Option 2

(i) No Preferential Allotment; (ii) No shares are offered for sale by public shareholders in the open offer; and (iii) Purchase from the Sellers (17.36% + 7.74% + Voting Arrangement).

The Preferred Deal Structure had certain inherent risks due to the over reliance on the Public Shareholders for the Diageo Group to attain a significant stake in the Target. The way the Deal was structured (Preferred Deal Structure), Diageo Group could only attain a significant stake if (a) 3/4th of the shareholders of Target approved the issuance and allotment of Equity Shares of the Target to the Acquirer as contemplated under the PAA and; (b) tender of shares by the Public Shareholders in the Open Offer. Given, the relatively low shareholding of the Promoter Group, the shareholders resolution for the issuance of Subscription Shares was not a *fait accompli.*

Thus, the parties incorporated another fall back option which would deal with a situation where in the Open Offer and the issuance of Subscription Shares both were unsuccessful. In the event both the Open Offer and the Preferential Allotment were unsuccessful, UBHL and KFIL (part of the Promoter Group) agreed to sell Additional Shares to the Acquirer in order to ensure that the Acquirer atleast reached 25% of the Emerging Voting Capital of the Company and is atleast legally enabled to block certain items which would require a resolution by 3/4th of the shareholders of the Target. Additionally, even in this situation the Diageo Group would have the voting arrangement discussed in Fall Back Option 1. The Fall Back Option 2 is illustrated in **Diagram 4** below.

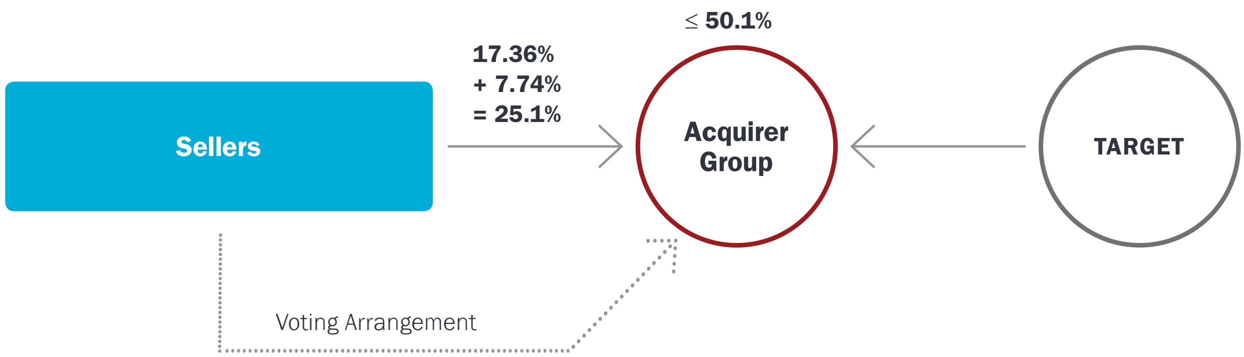


*Diagram 4*

## V. Final Deal Structure

After the completion of the (i) subscription of the Subscription Shares, (ii) purchase of the Sale Shares from the Sellers (part of the Promoter Group) and (iii) purchase of the Equity Shares tendered in the Open Offer, the Diageo Group could only acquire 25.02% of the Emerging Voting Capital of the Target as (A) 2.38% of the Emerging Voting Capital could not be acquired from USL Benefit Trust as the necessary lender approvals were not obtained and (B) only 0.04% of the shares were tendered in the Open Offer.

Thus, the final structure was in some way close to the Preferred Deal Structure wherein the requisite funds were infused into the Target and the Promoter Group continues to have some economic interest in the Company. However, Diageo Group in order to control the Company would have to rely on its rights under the SHA and Fall Back Option 1. The final structure is illustrated in **Diagram 5** below.

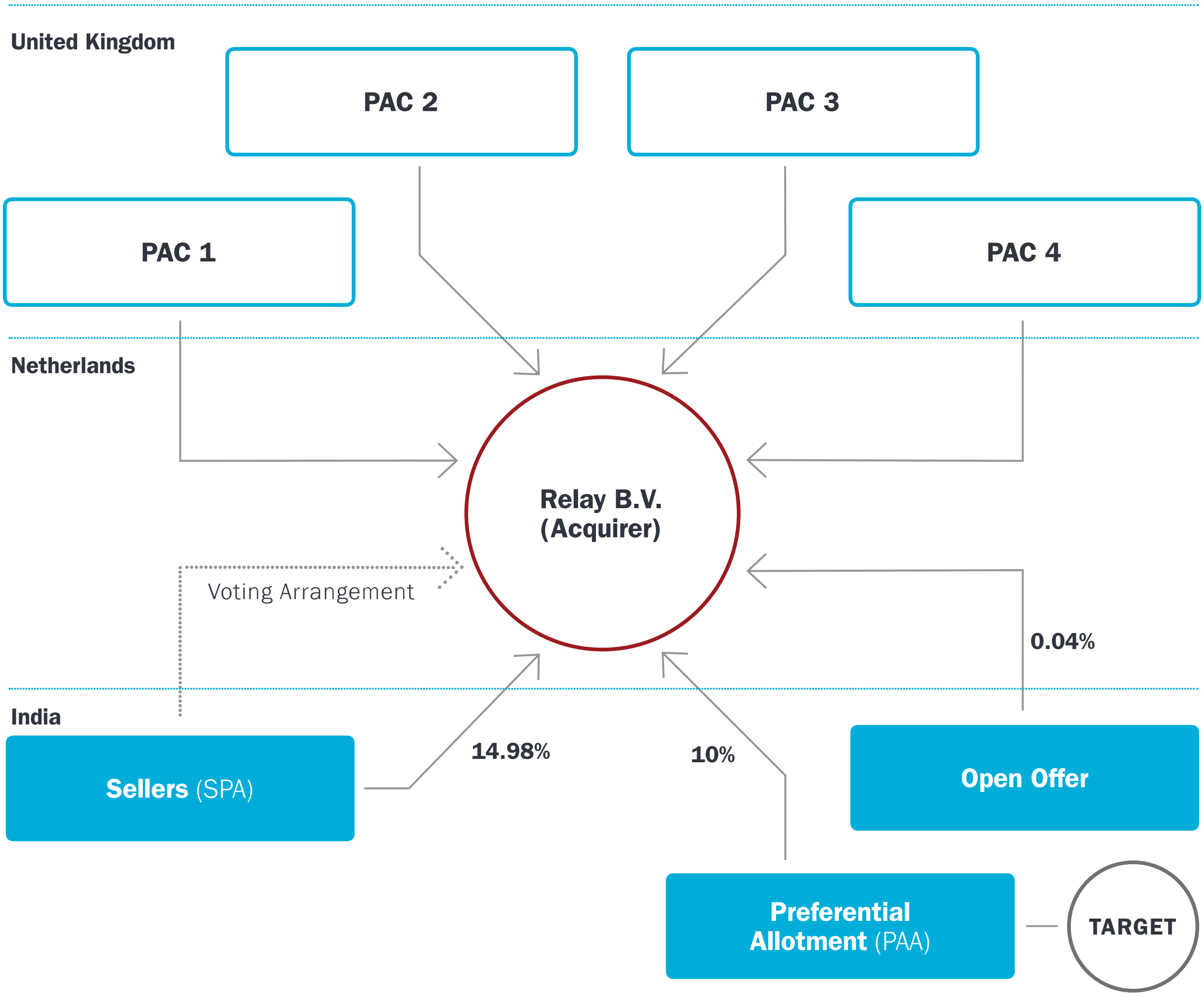


*Diagram 5*

The immediate post Deal shareholding pattern was quite different than what the parties had contemplated. But as Fall Back Option 1 and Fall Back Option 2 would suggest, Diageo Group and the Promoter Group were not completely unaware of such an outcome. The post Deal shareholding as on August 16, 2013 is detailed in the table below

| Shareholders | Pre- Deal | Preferred Deal Outcome (% of Emerging Voting Capital ) | Post Deal (% of Emerging Voting Capital) |
|---|---|---|---|
| **New Promoter** | | | |
| Acquirer | Nil | 53.36% | 25.02% |
| **Existing and Continuing Promoters** | | | |
| UBHL | 18.03% | 10% | 7% |
| KFIL | 9.69% | 3.5% | 4.14% |
| Other promoter companies | 0.06% | 0.04% | - |
| Total (UBHL + KFIL + Others) | 27.78% | 13.54% | 11.14% *(during the offer period lenders of UBHL had invoked the pledge over the shares of the Target)*[27] |
| **Others** | | | |
| SWEW, USL Benefit Trust, PIGL and UB Sports | 6.51% | Negligible | 2.38% *(held by USL Benefit Trust)* |
| Public Shareholders | 65.71% | 33.1% | 61.46% |

27. See 'Banks Invoke Pledge' available at http://www.business-standard.com/article/finance/banks-invoke-3-13-mn-pledged-shares-in-kingfisher-air-lines-113040900588_1.html (last visited November 10, 2013)

# 8. Commercial Considerations

## I. What were the key Deal Terms?

The key terms of the Deal were captured in the PAA, SPA and SHA. Some of the principal terms are discussed below:

### A. PAA

The PAA laid down the mutual terms and conditions for the Preferential Allotment by the Target and subscription of Subscription Shares by the Acquirer. Under the PAA, parties agreed that the proceeds of the Preferential Allotment will be used in the following manner:

- At least INR 16 billion to be used solely for the purpose of repaying debt of the Target and/or its subsidiaries;
- The remaining to be used solely in the ordinary course of the Target's business, including as working capital.

The subscription of Subscription Shares was subject certain customary condition precedents such as:

- Statutory approvals including from CCI and GATA.
- Approval from the stock exchanges;
- Approval from the shareholders of the Target;
- Consent from the lenders of the Target;
- No material adverse change;
- No breach of the warranties by the Target;

The Target gave customary representations and warranties in respect of the shareholding pattern, financials, litigations, business and assets of the Target, intellectual property, related party transaction, compliance with anti- bribery laws (since Diageo Group is based out of UK, an anti-bribery representation was perhaps crucial). In fact, immediately after the Deal, Diageo has taken measures to ensure better compliance with applicable anti-bribery laws (which should include the UK Bribery Act, 2010).[28]

### B. SPA

The mutual terms and conditions for the secondary purchase by the Acquirer from the Sellers were captured in the SPA. UBHL and KFIL (Promoter Group) agreed to collectively sell 11.5% of the share capital of the Target. Other Sellers i.e. SWEW, PIGL, USL Benefit Trust and UB Sports, who were not categorized as part of the Promoter Group, agreed to sell 5.86% of share capital of the Target.

Apart from the statutory approvals set out in the PAA, the SPA laid down certain additional conditions precedents, such as:

- Approval of the RBI for the acquisition of Sale Shares from PIGL, UB Sports and USL Benefit Trust.
- Execution of escrow agreement between Acquirer, Sellers and lenders and approval from RBI to enable the Acquirer to directly pay the lenders. This condition precedent was required as a significant number of Sale Shares were pledged with the lenders.
- Order of Kar HC allowing the transfer of the Sale Shares or dismissing the winding up petitions against UNHL, KFIL and SWEW

### C. SHA

As with all SHAs, the post Deal understanding and obligations of the Target, Acquirer and the Promoter Group is captured in the SHA. Some of the key rights of the parties are detailed below:

#### i. Board Rights

The Promoter Group had the right to appoint one Director (initial nominee being Dr. Vijay Mallaya) so long as it held approximately 1% of the shares of the Target. The Promoter Group also had the right to recommend independent non-executive director so long as it held approximately 4.5% of the shares of the Target. The remaining directors would all be appointed by the Diageo Group. To constitute a valid quorum for the board meeting, the presence of atleast one director appointed by the Diageo Group was required.

#### ii. Management

The Acquirer has the right to appoint the chief executive officer, the chief financial officer and head of internal audit of the Target. Further, the Acquirer also has the right through the Target to appoint a majority of the directors to the boards of each of the subsidiaries of the Target.

28. See 'USL sips on Diageo compliance lesson', available at http://timesofindia.indiatimes.com/business/india-business/USL-sips-on-Diageos-compliance-lesson/articleshow/21499216.cms

### iii. Veto Rights

The Promoter Group have retained veto rights in respect of certain matters such as (a) preferential issuance of equity shares of the Target at a discount of the volume weighted average price for 30 trading days prior to such issuance (b) change of terms of the shares held by UBHL and (c) any voluntary winding up of the Target. The items over which veto rights has been given to UBHL do not seem to indicate that UBHL would even have negative control over the Target.

### iv. Voting Arrangements

The Sellers agreed to exercise all their voting rights in respect of the shares held by them in the Target in accordance with the instructions of the Acquirer, till the earlier of the following events occurred: (a) the date on which the Acquirer acquires not less than 50.1% of the voting rights in the Target; and (b) the fourth anniversary of the first day of the first full annual accounting period of PAC 1 after the completion of the acquisition of the Sale Shares under the SPA.

### v. Right of First Offer

The Acquirer has a right of first offer against any sale of shares by the Promoter Group.

### vi. Acquisition Restrictions

The Promoter Group was provided a claw back right i.e. if the Sellers were required to sell Additional Shares (other than the originally envisaged 17.36% of the share capital of the Target under the SPA), then for one year after the completion of the acquisition of the Additional Shares by the Acquirer, the Sellers would have priority in purchasing shares of the Target to replace the sold Additional Shares.

### vii. Tag Rights

Promoter Group has the right to sell their shares (tag along right) in the event there is material disposal of shares by the Acquirer. The Promoter Group would have to sell the shares at the same price and on the same terms as the Acquirer.

### viii. Non-Compete

The Sellers are restrained from carrying a business similar to that of the Target during the term of the SHA and two years post the termination of the SHA. Interestingly, the letter of offer does not specific if the non-compete is territory specific or not.

## II. Why did the Diageo Group Consider Acquiring a Controlling Stake in the Target?

*"The acquisition of our shareholding in the number one spirits company in India is a significant milestone in Diageo's strategy to build our presence in the world's fastest-growing markets. It enhances our position as the world's number one premium drinks company as India now becomes our second-biggest market by sales revenue." - Paul Welsh, [then] CEO, Diageo*[29]

The Indian alcoholic beverages industry is valued at US$ 6 billion and is growing at a rate of 15% per year making it one of the fastest growing alcoholic beverages market in the world. The industry is fairly complex, both in terms of operation and consumer choice. The consumer's choice between the different price segments and further between the brands within such segment is highly subjective and is dependent on various complex factors. Alcoholic beverages can be broadly categorized into three main categories i.e. beer, wine and spirits. The distinction between these various types of beverages is made on the basis of ingredients, alcoholic content and the manufacturing process involved. In the last two to three years, the wine and spirits market in India has not only witnessed the entry of several new players, both domestic and foreign, but also the introduction of several new brands at various prices.

Further, the production of alcoholic beverages requires licenses from the respective state governments which determine the production capacity of each manufacturing facility and control the production and movement of both the raw materials and finished products. In order to commence manufacture of liquor, an entity requires an excise license from the respective state governments for possession of raw material and sale of liquor. Introduction of new brands also requires the permission of the state government. Additionally, new brand recognition is also fairly difficult due to prohibition on advertising of alcoholic beverages in India.

In India, prior to this Deal, the Diageo Group has been present through its wholly owned subsidiary – Diageo India, which is engaged in the manufacturing of Diageo Group products, through lease arrange-

29. Diageo announces agreements in respect of United Spirits shareholding, available at http://www.diageo.com/Lists/Resources/Attachments/1401/Unites%20Spirits%20announcement%20-%20QA%20transcript.pdf (last visited on December 15, 2013). ("Diageo Q&A")

ments with four distillers in the states of Punjab, Maharashtra, Karnataka and Madhya Pradesh. Diageo India also has three custom bonded warehouses in Delhi, Mumbai and Kolkata. Diageo Group had presence in the premium price range in the whiskey and vodka segments; however, had insignificant presence in the rum and gin segments.

As discussed above, the Indian alcoholic beverages industry poses significant challenge for a new entrant because of the following reasons: (a) procurement of multiple licenses, (b) knowledge of local choices of consumers, and (c) dealer and distributor network. Thus, it would have been difficult for the Diageo Group to organically grow in India. Thus, in order to have a significant presence in India the viable option was to look for an inorganic (acquisition) option.[30]

The acquisition of a substantial stake in the Target, which holds approximately 55% of the market positions prior to the Deal, was perhaps the most viable option for the Diageo Group to establish its presence in India. Further, both Diageo Group and the Target had good product synergies The acquisition, as it is estimated, should give Diageo Group a 70% market share in the Indian alcohol beverages industry.[31]

## III. Why did the Sellers Agree to Sell the Sale Shares in the Target? Conversely, Why did the Promoter Group wish to Dilute its Stake in the Target?

The Target has been recognized as the 'family Jewel' of Dr. Vijay Mallaya and a significant revenue generating asset for him and the UB Group. Thus, this Deal begs the question as to why the Sellers agreed to sell its stake in the Target, specifically, considering that the liquor industry in India is expected to grow significantly in the coming years which would have resulted in higher return for the Sellers.

At the outset, it is to be noted that the Sellers have not exited from the Target entirely. In fact, the Promoter Group, will continue to hold 11.4% of the Emerging Voting Capital of the Target, if not in the range of the approximately 14% (considering that 2.38% shares USL Benefit Trust which was part of the original transaction was not transferred to the Acquirer / the Diageo Group). This 11.4%-14% shareholding is significant considering that the Target continues to have dispersed shareholding pattern with majority of the shares held by financial institutions, FIIs and other public shareholders. Thus, although the Sellers may have ceased control of the 'family jewel', they still continue to hold significant stake in the Target.

The dominant reason for the Sellers to sell its stake in the Target was primarily for de-leveraging the Target and (potentially) rehabilitating Kingfisher Airlines. There was some speculation that proceeds from this Deal may likely be used by the Sellers to make the necessary capital infusion into Kingfisher Airlines and rehabilitate the carrier which has been brought to a standstill since October, 2012. However, there has been no visible development in this regard.

## IV. Why was the Deal a Win-Win for Both UB Group and the Diageo Group?

*"As Vijay said this morning, this is a winning partnership. It brings Diageo's strengths in marketing and innovation together with USL's scale, leading local spirits brands, strong routes to market, and an exceptional supply base"- Paul Welsh, CEO, Diageo*[32]

exceptional supply base"- Paul Welsh, CEO, Diageo
Whereas, the Deal gives Diageo Group an entry into the fastest growing alcohol beverages market in India, it gives the UB Group the required liquidity to invest in other group companies and also rehabilitate the tumbled Kingfisher Airlines.

Interestingly, as part of the deal, Diageo Group and UB Group have also set up a 50:50 joint venture to own and run the Sorghum beer business in South Africa. Further, Diageo Group and UB Group have also entered into MOUs to set up joint ventures in other emerging markets of Africa and Asia (excluding India). Thus, the Deal is also likely to result in global partnerships between Diageo Group and the UB Group.[33]

It is also to be noted that UB Group would continue to manufacture, sale and distribute beer in India as the same was carried outside the Target. With UB

30. We explore this in detail in the Legal, Regulatory and Tax Implications Section
31. See http://www.cci.gov.in/May2011/OrderOfCommission/CombinationOrders/C-2012-12-97.pdf
32. Diageo Q&A, *supra* not 29.
33. See Letter of Offer;

Group's 50% market share for beer, UB Group will surely continue to have presence in the alcoholic beverages market.

In so far as the '**family jewel**' is concerned, for the time being the '**king**' will continue to wear the crown as the Chairman of the Target.

## V. Why was Part of the Deal Structured Through Preferential Allotment?

The deal just doesn't go a long way in clearing the Sellers's debt incurred in other group companies but is also relevant from the perspective of deleveraging the Target. The Target's debt has been steadily growing and has been hovering over the better part of INR 80 billion[34], not being a small amount considering the Target's net profit for three to four years running has been hovering between INR 3 billion million and INR 3.2 billion.[35]

The same appears to have been a major concern for both the Target and Diageo Group while structuring the deal. Therefore, the PAA under which Diageo Group proposed to subscribe to 10% post issue paid up capital of the Target, specifically states that at least INR 16 billion will be solely utilized for the purpose of repaying the debt of the Target.[36]

## VI. What was the Outcome of the Open Offer?

Out of the Open Offer made to acquire 26% of the Emerging Voting Capital of the Target, only about 0.04% of Emerging Voting Capital of the Target was tendered and accepted.[37] For the same, out of the 1% consideration deposited in the escrow account, an amount equivalent to INR 85,362,571.51 (Rupees eighty five million three hundred sixty two thousand five hundred seventy one and fifty one paise only) was transferred in order to pay the relevant consideration

With this, Diageo Group acquired around 58,668 shares at a value of INR 1,440 (Rupees one thousand and four hundred and forty only) per share, compared to around 39,759,614 shares that were acquired by it (at the same price) under the SPA and the PAA.[38]

## VII. Why did the Open Offer **fail** and was the Open Offer Price Fair?

The term *fail* is emphasized because it is difficult to state whether Diageo Group was indeed anticipating the acquisition of 53.36% of the Emerging Voting Capital of the Target after the completion of the PAA, the SPA and the Open Offer. It was likely that Diageo Group anticipated a significant increase in the quoted price on the stock exchange post the announcement of both the purchase of shares and the preferential allotment. This was likely validated as anticipation in the market and public perception that Diageo Group's takeover would lead to a brighter future for the Target, had moved the price of the Target's shares to INR 1,815.25, which continued to climb and reached INR 2,045.25 per share at the time of expiry of the offer period resulting in an average market price during open offer period of a whooping INR 2,011.66 per share, a near 47% increase over market price at the time of public announcement.[39]

Diageo Group also possibly considered revising the Open Offer price in order to stand a better chance of looking to increase their haul from the Open Offer but considering the significant increase in the price of the Target's shares, the eventual outlay would have been significantly higher than that budgeted by Diageo Group.

By this time, commercially, it was unlikely that any shareholder would tender his / her shares for Open Offer on a stock of a company when: (i) the offer price was well below the market price at the time of tender; and (ii) the prospects from the company (in this case the Target) were only likely to improve as a new and more experienced management, especially a global liquor giant like Diageo Group, took over.

34. The Hindu, May 21, 2013 available at http://www.thehindu.com/business/Industry/united-spirits-board-clears-share-allotment-to-diageo/article4756973.ece (last visited on August 20, 2013).
35. Money Control, United Spirits Ltd., available at http://www.moneycontrol.com/financials/unitedspirits/profit-loss/US#US (last visited on September 15, 2013).
36. Draft Letter of Offer, p. 17.
37. Post Offer Report, p. 4.
38. We explore the query on why the Open Offer failed in the Commercial Considerations above.
39. Post Offer Report, p. 3.

## VIII. What and how were the Financial Obligations Proposed to be Met for the Transaction?

### A. Under the SPA and PAA

The Letter of Offer provides that that the consideration for the Deal was to be paid in cash.[40]

### B. Under the Open Offer

The maximum consideration that was payable under the Open Offer, assuming full acceptance represented 26% of the Emerging Voting Capital of the Target, was INR 54,410,708,160 (Rupees fifty four billion four hundred ten million seven hundred eight thousand one hundred sixty only) in cash.

In accordance with Regulation 17(1) of the Takeover Code, Diageo Group issued a bank guarantee in favour of JM Financial Institutional Securities Private Limited (the Open Offer Manager) for an amount of INR 6,191,070,816 (Rupees six billion one hundred ninety one million seventy thousand eight hundred sixteen only).[41] Additionally, since the escrow account was being created through a Bank Guarantee, as per Regulation 17(4) of the Takeover Code, 1% of the consideration amount also had to be deposited in the escrow account amounting to approx. INR 544,107,082 (Rupees five hundred forty four million one hundred seven thousand eighty two only). Diageo Group fulfilled the aforesaid conditions as per the Takeover Code.

40. Draft Letter of Offer.

41. The computation for this emerges from Regulation 17(1) which mandates an amount of 25% for the first INR 5 billion of an Open Offer and 10% for the remaining amount.

# 9. Legal & Regulatory Considerations

## I. Why was Court Approval Required for the Deal?

The Deal was significantly delayed because UBHL required a court approval to consummate the Deal. The creditors of UBHL had filed for a winding up petition before the Kar HC. The Kar HC had restrained UBHL from disposing off or creating any encumbrance over the shares till the disposal of the winding up petitions. Thus, to consummate the contemplated transaction under the SPA, UBHL would have had to get this order vacated or modified. The modification / vacation of the Order was also set out as a condition precedent to the consummation of the transaction under the SPA.[42]

UBHL had filed an application before the Kar HC for the vacation / modification of the above order. The Kar HC gave an approval to UBHL to sell the shares as contemplated under the SPA, subject to UBHL depositing INR 2.5 billion as security (term deposit with a nationalized bank).

This litigation has already and may further dent the hopes of the UB Group to revive Kingfisher Airlines, if at all such was the intention.[43]

## II. Why was the Acquirer Required to make an Open Offer to the Public Shareholders for 26% of the Emerging Voting Capital of the Target?

As per Regulation 3(1) of the Takeover Code, an acquirer together with persons acting in concert cannot acquire shares or voting rights in a target company which would entitle them to exercise 25% or more of voting rights in such target company without making a public announcement of an open offer. Further, Regulation 4 of the Takeover Code states that irrespective of any acquisition of shares or voting rights, if the acquirer directly or indirectly acquires control over a target company, then it must make a public announcement of an open offer for the acquisition of shares from the public shareholders. As per the Takeover Code, such open offer must be atleast for 26% of the total share capital of the target company calculated as of the tenth date from the closure of the tendering period and after factoring all potential increases contemplated during the offer period.

The SPA and PAA wherein the Acquirer contemplated an acquisition of 27.36% of the Emerging Voting Capital of the Target and the SHA under which the Acquirer had the right to control the Target triggered the open offer obligation under Regulations 3(1) and 4 of the Takeover Code.

## III. Why was the Acquirer Required to pay an Interest to the Public Shareholders?

The Acquirer requested SEBI to extend the date of commencement of the tendering period to not later than 12 working days from the receipt of statutory approvals required to consummate the Deal. SEBI granted the extension through a letter dated February 7, 2013 subject to the Acquirer paying an interest of 10% p.a. to the Public Shareholders who tender their shares in the Open Offer.

The levy of interest by SEBI is in accordance with proviso to sub-regulation 11 of Regulation 18 of the Takeover Code which gives SEBI the power to extend the date of payment of open offer consideration to the public shareholders subject to the acquirer paying an interest to the public shareholders who tender their shares in the open offer.

## IV. Why was the Acquirer Required to make an Open Offer for Pioneer?

Regulation 5(1) of the Takeover Code states that for the purposes of Regulation 3 and 4 acquisition of shares or voting rights in, or control over, any company or other entity, that would enable any person and persons acting in concert with him to exercise or direct the exercise of such percentage of voting rights in, or control over, a target company, the acquisition of which would otherwise attract the obligation to make a public announcement of an open offer for acquiring shares under these regulations, shall be considered as an indirect acquisition of shares or voting rights in, or control

42. Draft Letter of Offer, p. 19.

43. The Mint, SEBI clear Diageo Open Offer with riders, available at http://www.livemint.com/Companies/f4jn7f1S7U91036hubZCNJ/Sebi-clears-Diageos-open-offer-for-United-Spirits.html?ref=dd (last visited on September 15, 2013)

over the target company. Thus if an acquisition of the shares of a parent company which also results in the acquirer exercising 25% of the voting rights of its listed subsidiary or control over its listed subsidiary, then the acquirer would have to make a public announcement of an open offer to acquire atleast 26% of the shares of the listed subsidiary from the Public Shareholders.

Since, in the present instance the Target was the promoter of Pioneer and held approximately 82% of the paid up share capital of Pioneer, the Deal qualified as an indirect acquisition under Regulation 5(1) of the Takeover Code and hence, the Acquirer along with the Diageo Group and the Target were required to make an open offer for the acquisition of the remaining shares (approximately 18%) of Pioneert.

## V. What were SEBI's Comments / Concerns on the Deal?

The SPA contemplated that UBHL will have the right, but not the obligation, to sell its remaining shares in the Target to Diageo Group over a period of seven years at INR 1,440 per share (put option right). SEBI, while providing its comments to the Draft Letter of Offer objected to the put option right under the SPA, principally on the ground that same is a forward contract and thus in violation of the Takeover Code.

This issue is not novel. SEBI has time and again objected to put and call options. Most famously, SEBI had objected to the put and call arrangement in the Cairn – Vedanta deal. In 2011, SEBI had issued a directive to Vedanta Resources and Cairn UK Parent to drop the arrangements in respect to the put and call option and pre-emption right from their agreements. SEBI had taken the view that the put and call options are in violation of Notification No. SO 184(E) dated March 1, 2000 issued by SEBI since these do not conform to the requirements of a spot delivery contract nor with a contract of derivatives under Section 18A of the SCRA. SEBI has stated that since these options would be exercised on a future date, such deal would not qualify as spot delivery contract as defined in section 2(i) of SCRA. The put / call option would not qualify as valid derivative contract as per section 18A of the SCRA as these are exclusively entered into between two parties and not traded on stock exchanges and settled on the clearing house of the recognized stock exchanges.

To solve this regulatory conundrum, Diageo Group and UBHL agreed to remove the put option right from the SHA.

## VI. Were there Legal Hurdles for Diageo Group to Enter into India Directly (Organic Expansion)?

As we have covered in our "Commercial Considerations" section, Diageo Group's aim of investing in India through the purchase of Target has largely been on account of the purported 'license raj' that continues to dominate the Indian liquor industry. Regulations are levied on a state-level basis (alcohol being a State list subject[44]) resulting in inconsistent and often cumbersome regulations across states which involve complex procedures not easily accessible to foreign investors. Following are the considerations:

It is the State Government which, principally, regulates and taxes the potable alcohol. The Central Government regulates the potable alcohol to the extent of the alcohol that is imported into India and imposes a customs duty on such import. The framework surrounding potable alcohol can be classified as follows:

### A. Regulatory

The States that permit manufacture, sale, etc. of potable alcohol have imposed strict regulatory conditions for manufacture, sale and consumption of alcohol. Potable alcohol is also exposed to stringent quality controls, labeling and packaging requirements, and restrictions on advertisements

### B. Prohibitory

Out of the twenty-eight States in India, there are four States which have prohibited manufacture and sale of alcohol in totality.

### C. Revenue and Taxation

Potable alcohol is one of the most heavily taxed commodities in India. The principal taxes which are applied to potable alcohol are excise duty, countervailing duty on excise (on potable alcohol manufactured in other states), Value Added Tax (VAT) on sale of potable alcohol, and customs duty (on imported alcohol). In addition to these taxes, different types of fees are also levied, the most significant of which is the license fee (dealt with in detail later).

44. Entry 8 and Entry 51 of List II to Schedule VII of the Constitution of India.

In conclusion, challenges on account of regulatory hurdles faced in navigating the potable spirits industry in India could prove to be tough and may even be inefficient for a foreign investor to consider entering into. It may therefore be much more beneficial to utilize the services of an industry veteran, such as the Target, gain experience and then expand into the Indian industry accordingly as Diageo Group has sought to do.

## VII. Was the Deal Considered by CCI to have an Appreciable Adverse Effect on Competition in the Relevant Markets / Sectors?

CCI also held up the completion of the Deal as it sough further information from both Diageo Group and Target.[45] CCI's concern was largely based on fall back conditions which stated that if Open Offer was unsuccessful, then UBHL would sell Additional Shares held or that UBHL would vote as per the instructions of the Diageo Group on all matters for a period of four (4) years or till such time as Diageo Group acquires 50.1% of the shares of the Target, whichever is earlier.[46] Although CCI raised concerns and sought additional information, it cleared the Deal with no major observations on February 26, 2013.[47]

CCI examined the Deal in context of Section 5 and 6 of the Competition Act. CCI observed that Diageo Group by virtue of the Deal would be able to effectively participate in India's large and rapidly growing spirits market, in which the Target is a key player with local knowledge and strong brands. CCI also concluded that the Deal would provide an opportunity to the Diageo Group to add value to the existing brands which should result in a huge change in Diageo Group's emerging market global footprint. However, having made these observations, CCI approved the Deal based on the following analysis:

### A. Presence of other Competitors in Market

CCI was of the view that the narrow price sub-segments in the overall whisky segment, in which even if the brands of the Target and the Diageo Group were considered to be close competitors, there were multiple other players and brands that should be able to compete with the Target and Diageo Group.

### B. No Overlap Between Products

CCI further found that the Target and Diageo Group were mostly present in different price spectrums in the branded spirits market with negligible overlap between their products in each of the branded spirits segment.

### C. New Products & Benefit of Consumer

CCI was of the view that the Deal would bring new products and more variants of the existing brands at different price points which would ultimately enable the consumer to expand their choice set. Further, CCI was of the considered view that the proposed combination may allow for increasing product differentiation as a consequence of both brand proliferation and brand extension.

The following observation of CCI is apposite:

*"In the present case, Diageo Group's acquisition of USL may give a boost to the premiumisation strategy. Thus, new premium brands of the established brands (brand proliferation) and new premium brands (brand extension), are likely to be introduced in the market for spirits. The degree of product differentiation across price segments is likely to increase in the post combination scenario. The combination may increase and improve consumer choice and since the combining parties produce distant substitutes, the synergy of the firms will not detract competition."*

### D. Continued Governance by State Regulation

CCI further found that the manufacture, production, distribution and sale of alcoholic beverages in India is controlled and regulated by state governments. On this basis, CCI found that the prevailing regulatory control of the state governments on the introduction of new brands in the market as well the pricing of existing or newly introduced brands of the alcoholic beverages in India should prevent any anti-competitive practice.

45. Financial Express, CCI wants USL Diageo to rework ambiguous parts of the deal, available at http://www.financialexpress.com/news/cci-wants-diageo-usl-to-rework-ambiguous-parts-of-deal/1060558 (last visited on September 15, 2013).

46. *Ibid.*

47. The Economic Times, Competition Commission clears United Spirits – Diageo deal, available at http://articles.economictimes.indiatimes.com/2013-02-28/news/37352233_1_combination-of-share-purchase-spirits-market-brand-extension (last visited on September 15, 2013)

## VIII. Why did the OFT Examine the Deal and what were the Issues and the Outcome?

The Diageo Group has significant presence in the spirits market in UK and the UB Group is also active in the supply of spirits in the UK through its subsidiary Whyte and Mackay. Hence, the OFT was required to consider whether the Deal would result in the creation of a relevant merger situation under the merger provisions of the Enterprise Act, 2002. If yes, then the OFT would had to inquire into whether the creation of that situation resulted in, or may be expected to result, in a substantial lessening of competition within any market or markets in the UK for goods or services.[48]

The OFT has expressed its concerns principally relating to substantial competition in the retail market between the Diageo label spirit – Bell's Whiskey and Whyte & Mackay's own-label and branded blended whisky. The OFT after considering evidence on the matter found that the merger of the Diageo Group with Whyte & Mackay would lead to a "substantial lessening of competition in the supply of blended whisky to retailers."[49]

The Diageo Group has since offered to sell most of its Whyte & Mackay business to address OFT's concerns with the exception of two malt distilleries. Further, under extant anti-trust laws in the UK, sale of Whyte & Mackay business should be agreed up-front to a suitable buyer approved by the OFT. This would mean that the OFT would consult publicly on the suitability of the proposed buyer (of the Whyte & Mackay undertakings), as well as all other aspects, during the public consultation period.[50]

It is likely that the Diageo Group will not be too concerned by this development, with (at that time) CEO Paul Walsh going on record to state that the "Deal is not hinging on Whyte & Mackay" and that it would not affect the outcome of the Deal if they were required to dispose of Whyte & Mackay on account of anti-trust implications.[51]

As of date, the OFT is yet to publish the detailed report of its investigation into Deal.

## IX. What Impact did the Deal have on M&A Regulation in India?

Whilst it is difficult to argue that any regulatory change is as a result of a particular deal, there have been some changes in the Indian M&A regulatory landscape in and around this Deal. Following are some of the key changes:

### A. Validity of Options

As discussed above, SEBI has allowed sale and purchase of securities pursuant to an option subject to certain conditions. Though this may not be attributable only to the Deal, it is likely that it had a significant impact in hastening the decision making of the regulator.

### B. Purchase on the Market

SEBI vide a circular dated September 6, 2013 has allowed non-residents to purchase shares on the stock exchange under the FDI route if the shares are of a company which is controlled by the non-resident. This regulatory change directly benefits the Diageo Group as it will be able to make the much needed creeping acquisition (considering the outcome of the Deal) fairly easily. In fact as stated above the Diageo Group has purchased shares of the Target after the Deal through a bulk trade.

### C. Takeover Code

SEBI in March, 2013 made amendments to the Takeover Code which now requires any acquirer acquiring control or 25% of the shares or voting rights in a listed company pursuant to a preferential allotment, to make a public announcement of an open offer on the date of execution of such preferential allotment agreement. Further, SEBI has also amended the regulation relating to withdrawal of open offer. As per the revised regulation, an acquirer acquiring control or 25% of the shares or voting rights in a listed company pursuant to a preferential allotment can only withdraw the open offer if requisite statutory approvals are not obtained (which may not include the required shareholders resolution for a preferential allotment). It is believed

48. Office of Fair Trade, Diageo plc / United Spirits Limited, available at http://oft.gov.uk/OFTwork/mergers/Mergers_Cases/2013/DiageoUnitedSpirits#.UjTN6z9oLMg (last visited on September 15, 2013).

49. Press Release, OFT considers Diageo divestment remedy in whisky merger 79/13, available at http://www.oft.gov.uk/news-and-updates/press/2013/79-13#.UpQ2rcSnrvw (last visited on November 26, 2013).

50. *Ibid.*

51. Diageo plc, Diageo announces agreements in respect of United Spirits shareholding – QA Transcript, available at www.diageo.com/Lists/Resources/Attachments/1401/Unites Spirits announcement - QA transcript.pdf (last visited on November 26, 2013).

that some of these changes have been made as a knee jerk reaction to this Deal as under the PAA and SPA; the Acquirer had the right to walk away from the Deal upon the non-fulfillment of certain condition precedents. These walk away rights were too extensive and hence it has prompted a reaction from the regulator. However, the jury is still out on the merits of these amendments.

# 10. Tax Considerations

## I. What are the Tax Implications of the Deal on the Sellers?

Section 4 and 5 of the ITA outlines the taxing scope of residents and non-residents. It states that residents will be taxed on their worldwide income and non-residents will be taxed on their India sourced income (income arising or accruing, or deemed to accrue or arise in India). Sale of Equity Shares would be subject to tax as per Section 45 (read with Section 48) of the ITA. Whilst the Sellers who are Indian residents will be taxed on their global income, they would have been taxed without any implication in India. For the non-resident sellers (specifically for PIGL and UB Sports), however, irrespective of their status as non-residents, on account of Section 9(1)(i) of the ITA the gains arising from the sale of shares would be taxable in India.[52]

Therefore, since the transfer of shares by the non-resident sellers was an off the market transaction (that is not carried out on the floor of the exchange[53]), tax would be levied at the rate of 10% (exclusive of surcharge and cess). For resident sellers, the tax would be levied at 10% (exclusive of surcharge and cess and without indexation benefits) or 20% (exclusive of surcharge and cess but with indexation benefits). It should be noted, however, that no STT would have been paid.

## II. Why did Diageo Group use an Intermediary Entity (Relay B.V.) as the Acquirer Situated in Netherlands for the Deal?

Netherlands as a holding jurisdiction is quite popular not just for making economic investments into India but also for making strategic investments. This is attributable to several key advantages associated with Netherlands.

Primary advantage (especially from a commercial standpoint) is that Netherlands is a developed and stable economy with no significant exchange controls regulations, thus, making movement of funds into and out of Netherlands easy. Netherlands is ranked 29th on the "Ease of Doing Business" parameter (compared to India's 132nd rank).[54] Netherlands also has a wide range of bilateral investment treaties (around 105)as well as a good network of tax treaties that allow it to operate harmoniously with various jurisdictions.[55]

However, what sets Netherlands apart additionally is its inclusion in the EU Interest and Royalties Directive[56] and the EU Parent Subsidiary Directive[57] coupled with the near full-fledged Participation Exemption regime for dividends and capital gains. This makes Netherlands a very attractive holding and operating jurisdiction for EU based companies looking to make investments into India. This is primarily because Netherlands enjoys a favorable tax treaty with India as well allowing for a sale by a Netherlands parent company of shares of an Indian company to any non-resident to be taxed only in Netherlands (and not India).[58]

52. Section 9(1)(i) of the ITA is a "deeming" provision which deems all income accruing or arising directly or indirectly through the transfer of a capital asset situated in India to be taxable in India. The Indian tax regime deems the situs of a share of an Indian company to be placed in India.
53. See http://www.bseindia.com/stock-share-price/stockreach_sast.aspx?scripcode=532432
54. Economy Rankings, IFC and the World Bank, available at http://www.doingbusiness.org/rankings (last visited on September 15, 2013).
55. ICSID Database of Bilateral Investment Treaties, available at https://icsid.worldbank.org/ICSID/FrontServlet (last visited on September 15, 2013).
56. Council Directive 2003/49/EC of 3 June 2003 available at http://www.hmrc.gov.uk/manuals/intmanual/intm400010.htm (last visited on August 21, 2013)
57. Council Directive 2011/96/EU of 30 November 2011 available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:345:0008:0016:EN:PDF (last visited on August 21, 2013).
58. Article 13(5) of the India Netherlands Double Tax Avoidance Agreement.

# 11. Epilogue

For Diageo Group, the Deal represents their first step towards consolidating their ever expanding hold in one of the fastest growing spirits market in the world i.e. India. For Dr. Mallya and the UB Group, the Deal represents a new partnership with an experienced global player and reduction of their (respective) debt. For the Target, it represents the best of both worlds as an established local presence meets international governance and operational standards and also deleverages itself.

In light of all this, the much recent order of the Kar HC annulling the sale of stake by UBHL to the Diageo Group has created another faltering roadblock for the Deal. Time will tell whether Diageo will get hold of the 'family jewel' and, if so, whether Diageo will be able to do justice to the 'King of Good Times' going ahead

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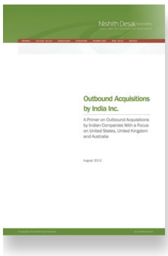

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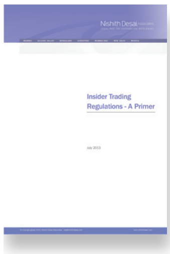

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# NDA Insights

| TITLE | TYPE | DATE |
|---|---|---|
| File Foreign Application Prosecution History With Indian Patent Office | IP Lab | 02 April 2013 |
| Warburg - Future Capital - Deal Dissected | M&A Lab | 01 January 2013 |
| Public M&A's in India: Takeover Code Dissected | M&A Lab | August 2013 |
| Copyright Amendment Bill 2012 receives Indian Parliament's assent | IP Lab | September 2013 |
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