



Diageo plc UK-United Spirits Limited & Dr. Mallya–Governance be Damned

Corporate Governance Research
Proxy Advisory Services
Corporate Governance Scores
Stakeholders' Education



Private and confidential
For limited circulation only
© Stakeholders Empowerment Services 2012 –
2013 | All Rights Reserved

BACKGROUND

Pursuant to an Agreement between Diageo Plc with Dr. Mallya (UB Group) for buying shares of UNITED SPIRITS LTD. (USL), an announcement was made on 9th November, 2012 regarding the transaction between Diageo plc (along with PAC) and UB group (UBH).

SES had released in past following reports in relation to the transaction and post transaction dispute between Diageo and Dr. Mallya.

Proxy Advisory Report – [Extra-ordinary General Meeting \(22nd January, 2016\)](#)

Proxy Advisory Report – [Postal Ballot \(7th January, 2016\)](#)

Research Report 2015 - [United Spirits Ltd-AGM Voting Pattern](#)

Proxy Advisory Report – [Annual General Meeting \(24th November, 2015\)](#)

Research Report 2015 - [United Spirits Limited –Diageo vs. Dr. Mallya: No More United in Spirits](#)

Proxy Advisory Report – [Extraordinary General Meeting \(9th January, 2015\)](#)

Proxy Advisory Report – [Extraordinary General Meeting \(28th November, 2014\)](#)

Proxy Advisory Report – [Postal Ballot \(26th November, 2014\)](#)

Proxy Advisory Report – [Annual General Meeting \(30th September, 2014\)](#)

Proxy Advisory Report – [Postal Ballot \(2nd July, 2014\)](#)

Proxy Advisory Report – [Court Convened Meeting \(16th June, 2014\)](#)

Research Report 2012 – [USL Diageo Transaction](#)

Central to the dispute were findings of inquiry ordered at the behest of Diageo by USL Board and other related issues. The Inquiry Report had indicted Mr. Mallya and others for carrying out transactions which were prima-facie not proper. The matter came to a stage where the Board Chairman-Dr. Mallya was asked to resign and he refused to resign. It was a clear cut indication that both Dr. Mallya and Diageo were at loggerheads and were not seeing eye to eye. Proof of the same was available in the voting results of AGM relating to adoption of accounts. The resolution was voted FOR by Diageo but voted AGAINST by Dr. Mallya and his group.

Resolution for adoption of accounts					
Category of Shareholder	votes polled-Total	vote in favour		vote Against	
		Number	%	Number	%
Promoter	8,55,61,679	7,96,12,346	93.05%	59,49,333	6.95%
Public Institutional	2,10,66,564	99,05,509	47.02%	1,11,61,055	52.98%
Public-others	38,20,848	38,20,650	99.99%	198	0.01%
Total Votes	11,04,49,091	9,33,38,505		1,71,10,586	

This was probably the first such case where a section of promoter has voted against the proposal for adoption of accounts. The reason for such a behaviour by a section of promoter to behave was not far to seek nor it was hidden. The Directors Report was full of replies by the Company on Auditors Qualification. In no uncertain terms the Board in its response had put blame on erstwhile promoters (Dr. Mallya and UB Group) and had sought for ouster of the erstwhile promoter from the Board and chairman's position. Erstwhile Promoter and his group was not left with any other option but to vote against. As vote in favour of the account would tantamount to accepting what the Auditors had written and what the Board had responded to.



The other significant observation is behaviour of Institutional Investors, who have voted against the proposal more than in favour. This is significant and reflects a positive change towards investors participation and expressing their displeasure. Or was it a case that these Institutional shareholders voted because they were in favour of erstwhile promoters? SES is of the opinion it can only be imagined and there is absolutely no chance that any Institutional investor would extend support to erstwhile promoter after reading audit qualifications.

This voting pattern and pressure from investors (which is not in public domain) must have rang alarm bells for USL Board and Diageo.

INACTION ON PART OF DIAGEO:

SES has been raising questions both in its reports and various media interactions that Diageo must act and rescind its agreement with Dr. Mallya relating to Dr. Mallya for being chairman of USL under certain circumstances. The logic of SES argument was that findings of inquiry committee gave sufficient reasons to Diageo to rescind its agreement as agreements are made in good faith with no side guilty of any impropriety.

SES in its reports maintained that Diageo has to take a stand one way or other. Whether Diageo was aware of the mis-governance at USL or not prior to its takeover of USL. If Diageo was not aware then it had a very good legal case against Dr. Mallya and could very well rescind the agreement, remove Dr. Mallya by moving a resolution and move on and in the case and if Diageo was aware of all the issues then it must come out clean and admit its mistake and admit that it had hidden the same from shareholders.

While SES had believed that it was never a case that Diageo was not aware of mis-governance, it took its chances, took calculated risks and was caught and had no option but to bring the same to attention of shareholders due to change in related party law in 2014. If Diageo was not aware of issues then it would have certainly instituted a case against Merchant Bankers involved in the deal, the due diligence team, the Auditors concerned and others associated with the transaction and rescinded its agreement with Dr. Mallya and UB Group. It did nothing and now has signed an agreement with Dr. Mallya, shaking hands, exonerating him of any wrongdoing and rewarding him through monetary and non-monetary benefits. It appears as if Diageo was wrong all this time and Dr. Mallya was wrongly hounded.

AGREEMENT WITH DR. MALLYA

USL has released a statement to Indian Stock Exchanges late night on 25th February 2016 and the same was disseminated on website of BSE on 26th February 2016 at 8.14 AM, however, there was no information on USL website. On the other hand, Diageo Website in UK has following Press Release titles "Diageo announces agreement with Dr Vijay Mallya for his resignation as Chairman and nonexecutive director of USL "on 25th February 2016 (<http://www.diageo.com/en-row/newsmedia/pages/resource.aspx?resourceid=2900>)

The Press Release states terms of agreement and the same are summarised hereunder. SES has added its view after each of the terms of agreement

- **Resignation of Dr. Mallya-** *Diageo and Dr Mallya have ended the prior agreement between them regarding Dr Mallya's position at USL. Disputes that had arisen under that agreement are concluded by today's agreement and, accordingly, Dr Mallya has resigned from his position as Chairman and non-executive director of USL, as well as from the boards of other USL group companies.*

SES Comment: Were the disputes personal between Diageo and Dr. Mallya or related to USL affairs making other shareholders of Diageo and USL an interested party. Is it the view of Diageo that other shareholders do not matter or they speak for all of them or it is their belief that what is good for Diageo is also good for all other shareholders? Can the disputes be concluded in this manner?



- **Termination payment-Diageo has agreed to pay \$75 million to Dr Mallya in consideration** for (i) his resignation and the termination of his appointment and governance rights and his relinquishing of the rights and benefits attached to his position as Chairman and non-executive director, (ii) his agreement to five-year global non-compete (excluding the United Kingdom), non-interference, non-solicitation and standstill undertakings, and (iii) his agreement that he and his affiliates will not pursue any claims against Diageo, USL and their affiliates.

SES Comment: Diageo in no uncertain terms had accused Dr. Mallya and UB Group for wrong doing. It is a strange case that accuser is paying the accused compensation? Is this admittance on part of Diageo that all their accusations were absolutely wrong? Or is it a case that Dr. Mallya levelled counter allegations against Diageo, which are not in public domain and Diageo yielded after getting caught on wrong foot? In normal circumstances accuser does not pay unless proved wrong. Shareholders need to know what is the truth. What were his claims against USL? Were they genuine? If those were genuine claims all through Diageo and USL were misguiding shareholders?

- **No Personal liability of Dr. Mallya-Separately, Diageo has agreed that Dr Mallya will have no personal liability to Diageo in relation to (i) the findings of the inquiry by USL (announced on 25 April 2015) into certain matters referred to in its financial statements and the qualified auditor's report for the financial year ended 31 March 2014 (the "USL Inquiry"),**

SES Comment: this is as strange as it could be. Diageo/ USL had referred the matter to Regulators (SEBI, MCA and Stock Exchanges) and now they are exonerating Dr. Mallya by becoming super regulator and deciding that there will be no personal liability. As if these regulators have seconded the adjudication job to Diageo. In case the Regulators do impose any penalty on Dr. Mallya, will Diageo volunteer to pay the penalty? What if there is any criminal liability. Has Diageo estimated the same and disclosed to shareholders? How come Diageo give a certificate of no liability? Is Diageo the law maker and law enforcer.

- **Release From Personal Obligation-In addition, Diageo has agreed, subject to Dr Mallya's ongoing compliance with today's agreement, to release Dr Mallya from his personal obligation to indemnify:**

- *Diageo Holdings Netherlands B.V. ("DHN"), a Diageo group company, against its liability under its previous guarantee to Standard Chartered in respect of a \$135 million loan facility of Watson Limited*
- *Diageo Finance plc ("Diageo Finance"), a Diageo group company, against its liability under its previous guarantee to Standard Chartered of £30 million of borrowings made by United Breweries Overseas Limited*

SES Comment: This release amounts to **an indirect future payment** of the sum involved and as argued in SES report earlier all such payments are part of initial transaction not disclosed to Regulators.

- **Service by Family of Dr. Mallya-Whilst Dr Mallya will have no ongoing role at USL following today's agreement, Diageo and USL have agreed the following limited arrangements in recognition of his family's historic connection with USL and his 30 years of service:**

- *Dr Mallya will have the honorary title of "Founder Emeritus - USL".*
- *Mr Sidhartha Mallya, Dr Mallya's son, will remain on the board of the USL group company which holds the Royal Challengers Bangalore IPL franchise. Diageo may not seek to remove him from that board for a period of two years, subject to agreed exceptions. Dr Mallya will have the honorary title of Chief Mentor while Sidhartha Mallya remains on that Board. It is also agreed that the members of that board will be able, if they wish, to consult with Dr Mallya.*

SES Comment: This amounts to rewarding Dr. Mallya and his family. All this could have been understandable if Diageo would have stated that all their inquiry, audit reports and reference to Regulators was farce and indeed they found nothing against Dr. Mallya. Unfortunately, such is not the case.

- **Shareholders Agreement with UBHL**

- *UBHL has indicated that it may be prevented from agreeing to terminate the Shareholders Agreement Diageo agreed with UBHL and KFinvest immediately by reason of certain legal and*



court restrictions which may apply as a result of winding-up proceedings to which it is subject in India.

- *Regardless of whether UBHL obtains court leave for termination of the Shareholders Agreement, **Diageo believes that UBHL and KFinvest's board appointment and other governance rights under the Shareholders Agreement have already ceased on account of prior breaches of the agreement.** Whilst UBHL and KFinvest have previously disputed this, Diageo would contest strongly any attempt by UBHL and KFinvest to assert rights to appoint a replacement nominee director to the USL board. Further, Dr Mallya has undertaken to Diageo that he will not seek or accept any nomination to the USL board.*

SES Comment: It sounds quite strange that while Diageo maintains that UBHL and KFinvest had breached the agreement and lost their rights, it goes ahead and gives compensation under the same agreement which was breached.

- **Arrangements between USL and Dr Mallya**

- *Under this agreement, Dr Mallya confirms his agreed resignation and provides non-compete, non-interference, non-solicitation and standstill undertakings directly to USL. **Dr Mallya and USL have also agreed a mutual release in relation to matters arising out of the USL inquiry.***
- *As consideration for USL's obligations under this agreement, Dr Mallya has procured or agreed to procure the termination by the relevant counterparties of certain agreements to which USL is party which were entered into prior to Diageo's acquisition of **USL shares from UBHL in July 2013 but which USL is currently prohibited from performing as a result of Indian related party rules and a prior negative shareholder vote.***
- *As part of its arrangements with Dr Mallya, USL has entered into an agreement with him which allows him or a party nominated by **him to acquire up to 13 domestic properties from USL.** The properties have historically been used or occupied by Dr Mallya and were previously the subject of the domestic real estate option agreement that has now been terminated as described above.*

SES Comment: this agreement raises lots of queries. If a fraud was committed or certain improper transactions were committed and the matter is with regulators, how can there be a mutual release specially by USL? It is nothing but a related party transaction and the same cannot be given effect to without shareholders' approval. It cannot be a case of USL that this agreement is in normal course of business. It is also an indirect method of compensating or performing all related party agreements which were defeated in 2014. As regards properties it raises and exposes malaise in many companies which buys property in name of company for exclusive use of promoters. Here there are at least 13 such properties which were for exclusive use of Dr. Mallya. Whether these perquisites were calculated and counted in his remuneration is a question to ask?

SUMMARY:

- SES is of the opinion that both at USL and at Diageo corporate governance does not matter otherwise how can Diageo settle the matter in private using the public (shareholders) Funds?
- Whether the two boards met and approved this? Whether audit committee approved this?
- In its Q3 results statement the Company had clearly written that it is still investigating if there are any further transactions which are improper? It also wrote that it is pursuing all its claims. The results were declared on 27th January 2016. What transpired in between 27th January 2016 and 25th February 2016, that company being an aggressor pursuing its rights surrendered all rights and dropped claims.
- There is certainly more than what shareholders have been told.
- SES would like shareholders and Regulators having the duty to protect shareholders as well as ensure good governance demand that all the relevant details of original agreement and current agreement be made public
- Entire financial benefits direct, indirect including write offs and waiver of liability, amounting to US\$ 315 Million, be included as compensation to Dr. Mallya, the original selling shareholder and open offer price be calculated accordingly taking these payments as part of consideration.



- Shareholders must insist that all cases of diversion of funds etc. shall be taken to their logical conclusion.
- Regulators must call for statement from Diageo and Board members and Auditors Past and present whether Diageo had prior knowledge of agreements, diversion of funds etc. prior to open offer? Records of due diligence, advisory from investment bankers must be called for to find the facts.
- Dr. Mallya had earlier accused Diageo and stated that Diageo had done a detailed due diligence prior to takeover and were aware. It appears that Dr. Mallya had spoken the truth which rattled Diageo and feared that if a case is filed against Dr. Mallya it will open a can of worms for Diageo making their position untenable and Diageo will be liable for non-disclosure, misrepresentation and wilful concealment of facts from Regulators and shareholders. They could not take the risk of exposing themselves and this costly settlement. This give credence to SES claim that all throughout Diageo was aware of the mess at USL, they took calculated risk and budgeted the same in its price to Dr. Mallya. The apple cart was disturbed with new regulations coming in force. Regulators must act to bring truth to surface
- Wrongdoings of any one cannot be pardoned by cloaking them “in the best interests of all”

Research Analyst: J N Gupta

DISCLAIMER

While SES has made every effort and has exercised due skill, care and diligence in compiling this report based on publicly available information, it neither guarantees its accuracy, completeness or usefulness, nor assumes any liability whatsoever for any consequence from its use. This report does not have any approval, express or implied, from any authority, nor is it required to have such approval. The users are strongly advised to exercise due diligence while using this report.

This report in no manner constitutes an offer, solicitation or advice to buy or sell securities, nor solicits votes or proxies on behalf of any party. SES, which is a not-for-profit Initiative or its staff, has no financial interest in the companies covered in this report except what is disclosed on its website.

The report is released in India and SES has ensured that it is in accordance with Indian laws. Person resident outside India shall ensure that laws in their country are not violated while using this report; SES shall not be responsible for any such violation.

This report may not be reproduced in any manner without the written permission of Stakeholders Empowerment Services.

All disputes subject to jurisdiction of High Court of Bombay, Mumbai

All rights reserved.

