GOVERNMENT OF INDIA

Ministry of Natural Resources & Scientific Research

REPORT OF THE AD HOC COMMITTEE ON THE COMPENSATION TO BE PAID ON THE NATIONALISATION OF THE KOLAR GOLD MINES

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New Delhi.
June 25, 1956.

REPORT.

The Government of India constituted on May 11, 1956 a Committee to consider the proposal of the Mysore Government in regard to compensation for the Kolar Gold Field Mines and to recommend what, in the Committee's view, would constitute fair and reasonable compensation, as follows:-

Shri K.N. Kaul, Joint Secretary, Ministry of N.R.& S.R.	Chairman.
Shri B.K. Nehru, Jt. Secretary, Ministry of Finance (DEA)	Member.
Shri C... Menon, Jt. Secretary, Ministry of Finance (PEN Dn.)	Member.

The Committee met on May 15 and decided to study the method of determining compensation employed by the Central Government in recent cases of nationalisation, namely, the Reserve Bank of India, Imperial Bank of India, Indian Airlines, Air India International and Life Insurance. It also considered it necessary to obtain a detailed statement of the claim put forward by the Company and a precise indication of the views of the Mysore Government on such claim.

2. It accordingly met the representatives of the Mysore Government (Shri Bharath and Shri Jagannatha Rao) on May, 25 and 26 to hear the Mysore Government's views first. The Committee understood that there were three Companies operating in the State:

1. Champion Reef
2. Mysore Gold
3. Nandidroog

The assets and liabilities in the Mysore State of the three Companies, namely, (1) Champion Reef (KGF), (2) Mysore Gold (KGF) and (3) Nandidroog (KGF) belong to three Rupee Companies registered in 1951 in the Mysore State. These Rupee Companies are 100% subsidiaries of three Sterling Companies, namely, Champion Reef, Mysore Gold and Nandidroog without the appellation K.G.F. The assets of the Sterling Companies comprise investments in the U.K., certain other investments and shares in the three Rupee Companies. The Mysore Government based their compensation on the price of the British Companies shares of the face value of 10 shillings each as quoted on the Madras Stock Exchange. The price of the Rupee Companies shares - with the exception of the Mysore Gold (KGF) - could not be taken as these shares were not quoted on the Stock Exchange. A copy of the quotations adopted for this purpose expressed in Indian currency was furnished to the Committee. The date taken into account in the case of Champion Reef and Nandidroog was 6.1.55, which was more than three months before there was any talk of nationalisation. In the case of Mysore Gold (KGF) it was possible for the Mysore Government to go by the market quotations of the Indian Company's shares, since the Indian Company's shares held by the British Company were distributed to the shareholders when the British Company went into liquidation in June, 1955 and were offered by the shareholders for sale on the Madras Stock Exchange. In order to be on the safe side and to give the maximum benefit to the shareholders, the Mysore Government had adopted the highest market quotations of these shares since they began to be quoted in Madras. On this basis the Mysore Government had calculated the compensation payable as follows:-

Rs.(lakhs)	
40.16	Mysore Gold Company.
21.73	Champion Reef.
25.91	Nandidroog.
87.80	

It was explained to the Committee that this sum of Rs.87.80 lakhs was exclusive of the other assets in the U.K. of Champion Reef and Nandidroog which, according to their book values as on 31.12.54, were worth Rs.31.48 lakhs net. In other words, the shareholders of the British Companies stood to receive as compensation under the Mysore Government formula Rs.87.80 lakhs plus Rs.31.48 lakhs, or a total of Rs.119.28 lakhs; 31.48 lakhs representing compensation for assets in the U.K. not nationalised.

3. The Committee was further informed that when the Rupee Companies were formed on 1.4.51, certain fixed assets like buildings, machinery, and plant and other capital assets like

mining rights, were transferred to them by the British Companies at enhanced values in excess of the book values. The extent of the enhancement, representing a capital gain, was credited in the books of the British Companies to a capital reserve account as follows:

	Rs(lakhs)	£
Champion Reef	2.13	15,960
Nandidroog	5.88	44,084
Mysore Gold	10.43	78,241
	18.44	138,285
Ooregam	16.70	125,235
	35.14	263,520

It was explained to the Committee that, in the case of the Ooregam mines (sterling) which went into liquidation in 1954, the benefit of the enhanced values of the assets had already accrued to the shareholders. In the case of Nandidroog and Champion Reef the enhanced values had no significance for the shareholders in view of the fact that the Mysore Government had calculated compensation on the basis of the entire assets of the British Companies, including those of their Indian subsidiaries. In the case of Mysore Mining the inflated values must be presumed to have depressed the Rupee Company's shares somewhat. The extent of the fall in the share values was difficult to determine, but its effect could not have been very significant. By and large, it could be said that, under the Mysore Government's formula, the full benefit of the capital appreciation was allowed to accrue to the shareholders of the British Companies concerned and that it did not affect the compensation payable.

4. The Committee further understood that, in arriving at the figure of Rs.87.80 lakhs the Mysore Government had made no reduction in respect of certain contingent liabilities of substantial amounts brought to its notice by the Company. These liabilities were as follows:-

	Lakhs
Termination gratuity	68.0
Bonus 53-54	5.4
Service gratuity and silicosis compensation	12.30
Leave settlement	13.30
Passage	1.60
Pension Fund	18.00
Liabilities of management	2.4
Contingencies	15.2
	136.2

Substantial as these liabilities were, they had no influence on the market quotations adopted for the purpose of evaluating the shares because this information was not made known to the public at the time. If these liabilities, based on the Company's own calculations, are added to Rs.87.80 lakhs, and Rs.31.48 lakhs for the U.K. assets also taken into account, the total compensation offered by the Mysore Government, it was explained to the Committee, would amount in reality to Rs.255.48 lakhs.

5. It was further explained to the Committee that the alternative method of evaluating the assets and liabilities of these Companies had also been considered by the Mysore Government. According to the book values the assets of Mysore Gold, Champion Reef and Nandidroog, less liabilities, amounted to Rs.211.9 lakhs. Deducting the contingent liability of Rs.136.2 lakhs, the compensation payable on this basis, without making any adjustments to the Company's figures, would work out to Rs.75.7 lakhs. The Mysore Government had not been furnished with detailed particulars showing how the book values had been calculated; but on the basis of certain minimum ad hoc adjustments that it had found it necessary on very broad considerations to make the effect was to reduce the value of these assets by about one crore. If this adjustment is made, it was pointed out, the compensation payable would be converted into a minus figure. The Mysore Government had, therefore, decided to adopt the method of share valuation which was more favourable to the Company.

6. The Committee next heard the Company's case, as put forward by its own representatives. These could not meet the Committee earlier than June 11, 1956 and the matter was somewhat delayed. In the meanwhile Shri B.K. Nehru had to leave on deputation abroad and was replaced by Shri H.A. Sujan. The Committee was told by Mr. Taylor that the Company's claim to compensation was based on the replacement value of the assets, less depreciation for the number of years for which they were used. The original cost of the Company's assets had been written down year by year at varying rates of depreciation so that many of them

were now valued in the books at only a few rupees. Nevertheless, these assets, or at least a majority of them were capable of being used for a number of years to come and, if sold, could still fetch substantial prices. The Company considered its shareholders were entitled in equity to the full benefit of these prices, whatever the valuation indicated in the Company's balance-sheet. On the basis of replacement costs, the Companies had valued their assets at about Rs.8.5 crores. For loss of future profits, based on the anticipated life of the mines, the Companies had added a figure of 2 crores, making a total of Rs.10.5 crores. For insurance purposes the Companies assets had been valued at about Rs.6.39 crores. Mr. Taylor conceded that neither of these estimates could be said to bear a proper relation to the earning power of the business and that the Companies could not, therefore, rightly expect to recover their full value. He, however, criticised the basis of share valuation adopted by the Mysore Government as being altogether unrealistic. In his opinion market quotations of the shares were no proper index to the real value of the assets of the Companies. Actually these assets were worth several times the value of the Companies shares at current market rates.

7. In a further memorandum submitted by the Company, the assets were revalued on the replacement costs basis, at Rs.875 crores, and on the basis of their original costs less depreciation at incometax rates, at Rs. 343 crores. The "break-up" value of these assets, which the Company urged could be raised by the sale of dismantled plant and machinery and stores was put at Rs. 300 lakhs while the capitalised value of the Company's profits was estimated at Rs. 349 lakhs. On the basis of these figures the Company's representatives submitted that a negotiated settlement approximating 400 lakhs net would be fair and reasonable both to the Government and to the shareholders.

8. Having heard the views of both parties the Committee felt it necessary to settle the principles that should govern the grant of compensation in this case in order to arrive at an appropriate method for computing a fair and reasonable compensation. There are a number of recognised methods employed for evaluating a business based on replacement costs, actual cost less depreciation at statutory incometax rates, capitalised value of anticipated profits, and so on. The Committee considered that none of these methods would be appropriate to the circumstances of this case, as they were open to one serious objection or another. For example, the replacement cost method, which the Company had urged, would not, in the case of a heavily capitalised industry such as this one, reflect in any measure the true income earning capacity of the business. The Committee was of the view that these various methods would give results which could only serve as rough guides to what the correct valuation should be. The matter had, therefore, to be examined on the basis of first principles.

9. The Committee has done so and is of the opinion that the nationalisation of an industry must be regarded as a political decision, taken by a Government in exercise of its sovereign powers to give effect to a social policy for which, in a democratic setup, it has a popular mandate. The compensation to be paid must, therefore, be related to the social objective in view. Whatever that objective, it is now widely recognised that compensation must be such that there is no discrimination against those compulsorily dispossessed of their property in the interest of the community as a whole. In other words, the dispossessed must be given compensation as nearly equal as possible to the value of the property of which they are deprived. In the case of a joint stock company such as the present one, the property of which the owners i.e. shareholders are deprived is their share scrip. If compensation is so arranged that the financial position of shareholders after nationalisation remains much the same as before, the claims of equity, justice, reason and fairplay in a social sense can be said to have been fully satisfied.

10. The Committee felt that this result could best be achieved by basing compensation on the income yielding capacity of the shares. This capacity can be measured with fair accuracy by reference to past dividend yields. Compensation should, therefore, be paid in an amount which would ensure to the shareholders roughly the same yield in future. The capitalised value of past yields is best reflected in the market quotations of the shares. The Committee recognises that there is force in the contention that market quotations do not necessarily reflect the true value of shares. Values on the stock exchange were subject to a variety of influences, some of which were wholly extraneous to the industry in question. Frequently market sentiment affected share prices most. Subject to this reservation,however, market price~~s~~ of shares, if carefully selected, could reflect, within reasonable limits, the true value of the shares. In compensating the shareholder, therefore, for the shares of which he is deprived, the Committee thought a good basis ~~is~~ would be the stock exchange valuation. Such valuation must be of a date as near to the date of transfer of ownership as possible; but in all fairness it must not be of a date when it could be said to have been influenced by threats of nationalisation. The Committee further recognised that share values could be depressed by action of Government in levying an onerous duty or a discriminatory impost. These factors could be considered and taken into account. But if it was recognised that the party to be compensated was the shareholder and not the Company and that the compensation was to be so adjusted as to leave the financial position of the shareholder unaffected, the Committee was of the view that the share valuation basis was the one calculated to give fairest results of allthe alternative methods mentioned in the discussions.

11. The Company's representatives gave careful thought to the Committee's views but said that, as practical businessmen

they were not so much interested in abstract principles as in their financial effect on the interest of the Company and its shareholders. They were, therefore, reluctant to give their assent to the principles formulated by the Committee, unless they knew how they would affect the shareholders financially. The Committee pointed out that, while it was only reasonable that the Company should know the financial effects of the principles they were asked to agree to, from the Committee's point of view the principles were more important then their financial consequences. If the principles were fair and sound the results that flowed from them would also be reasonable.

12. In adopting the share valuation basis the Committee felt it necessary first to decide the criteria that must govern the selection of the market quotations of the shares. In its opinion the first of these criteria must be that the stock prices are taken as of a date as near as possible to the vesting date, subject of course to other considerations. Secondly, since the prices of shares on a particular date would not normally be as representative of their true value as the average of a selected period, it would be advisable to follow the U.K. practice and adopt this alternative basis for the determination of the stock prices. Thirdly, in selecting the period regard must be had to such factors as threats of nationalisation, which could be said to have vitiated market quotations. These criteria were by no means exhaustive; and the Committee invited the Company's representatives, as ~~of~~ the Govt. of Mysore representative, to suggest any other criteria they might think fit for the Committee's consideration. As no other criteria were suggested, the Committee has adopted the ones it has formulated for the selection of the period.

13. The Committee felt it advisable to request the Company's representatives themselves to suggest a period or

periods in the light of the agreed criteria. The basis they recommended for the Committee's consideration was the 5 year period 1945 to 1949. This period, they urged, was one immediately preceding any talk of nationalisation, since the idea was first mooted in connection with the repeal of the gold duty in 1949. This period is also to be preferred over others because it was in 1945 that the Mysore Govt. had granted certain ad hoc relief from the gold duty. The incidence of the gold duty had proved more onerous than was expected when it was levied in 1940, and was considered by the Mysore Govt. to have prejudicially affected the development of the mines. On the basis of this period the Company estimated the value of the shares at Rs. 225 lakhs.

14. The Committee has given careful consideration to this period but feels it is open to the serious objection that it is too far removed from the vesting date. The longer this interval the greater the inaccuracies that are likely to creep in. It would not be possible wholly to ignore all that happened since 1949 to affect the business of the Company. To take account of these happendings and to appraise their financial significance would be an impossible task. The Committee, therefore, thought it advisable to consider the period of 5 years immediately preceding the decision to nationalise the mines, namely 1950-54. The year 1955 had to be excluded, as it was in that year that nationalisation was the subject of considerable public debate, eventuating in the decision to take the mines into public ownership. Share prices could not but have reacted to these developments. The Govt. of Mysore itself had recognised this and had taken the market quotations of 6.1.55 for the purpose of stock valuation. Based on the average of the period 1950-54 the Company's representatives estimated the value of the shares at Rs. 101 lakhs approximately.

15. The large disparity between these two figures was

explained by the Company's representatives in various ways. Principally, it was due to the fact that during the period 1950-54 share prices had slumped owing to the agreement of 1949. Under this agreement a provision was first to be made for depreciation and development, after payment of income-tax and super-tax, up to 15% of the working expenses. Thereafter dividends not exceeding 6% of the share capital could be declared, the remaining profits, if any, being shared in the ratio of 1 : 1 or 3 : 1 depending upon their amount. The Company's representatives urged that this was a highly discriminatory levy, for which there was no parallel to be found anywhere in the world. The effect of the levy was a serious depression of the shares on the London Stock exchange as the investor had little prospect of ever obtaining more than 6% on his share whatever the actual future prospects of the Companies. Moreover, throughout the period 1950-54 the trend was for the cost of production to rise and that of theprice of gold to fall. A graph indicating these trends was furnished and is attached. These trends, particularly in regard to the price of gold, had been reversed in 1955. The Company's representatives, therefore, thought it would be unfair to select this period for stock valuation when trading conditions were at their worst. The Committee, however, ~~takes~~ look the view that gold, like that any other commodity, has its business cycle and that there is nothing unusual in the behaviour of gold prices during this period. The fact that the cost of production rose during this period, though it declined, as the graph shows, in 1954, is also of no material significance, since such possibilities cannot be excluded in assessing the future prospects of the Companies.

16. The Committee has given very careful consideration to the suitability of the average of the periods 1945-49 and 1950-54 for the purpose of evaluating thestocks. The

former period goes too far back to be regarded as capable of reflecting the true value of the shares for the year 1956. On the other hand, the period 1950-54 is open to the objection that share prices during this period must have been depressed as a result of the agreement of 1949. In the case of Nandydroog they dropped steadily from 8s 8.5d in 1950 to 6s and .5d in 1954; Champion Reef from 10s 4.5d in 1950 to 4s 7.4d in 1954 and Mysore Gold from 7s 3d in 1950 to 4s 11.25d in 1954. These are significant drops and cannot, in the Committee's views, be wholly explained by the deterioration in the price of gold or in trading conditions generally.

17. The Committee's attention was drawn in this connection to the discovery in 1950 of a new reef in the Nandydroog area, which had radically altered the future prospects of these mines. Up to the time of this discovery the general feeling was that the mines were nearing their end and could last for another four or five years only. The discovery of 1950 set the life of the Nandydroog mine at about 50 years. Even so fundamental a development, the Company's representatives urged, had not improved the share quotations, because of the agreement of 1949, and their prices had continued to slump. The Committee feels there is some force in this contention, though it is impossible to appraise its exact significance.

18. Neither of the two periods, it is clear, is capable by itself of reflecting the true value of the shares. Nevertheless, the Committee feels the truth must lie somewhere in between. In the very special circumstances of this case, and in the absence of a better alternative, the Committee feels it would be fair and reasonable to take the arithmetic mean of the figures of these two periods (Rs. 225.51 and Rs. 102.55) as the valuation of the stocks viz. Rs.164 lakhs. This figure can by no means claim accuracy other than that

it is better or more truly representative of the actual value of the shares than any other figure.

19. The Mysore representatives drew the Committee's attention at this stage to the contingent liabilities of Rs. 136 lakhs already mentioned in para 4 and claimed that a deduction of this amount should be made from whatever figure may be arrived at on the basis of share valuation. The Committee considers this contention is not tenable in that all these liabilities are incidental to the normal working of a business of this kind and there is nothing unusual about them. Such liabilities are invariably met from year to year as they arise and constitute a charge against the revenues of the Company.

20. In basing compensation on this figure of Rs. 164 lakhs the Committee's attention has been drawn to the fact:

(i) that minerals being a wasting asset the life of a mine diminishes as more and more ore is extracted; and

(ii) that there was a serious rock burst in February, 1956, the financial effect of which cannot be disregarded.

The Committee considers that while (i) is correct, allowance must also be made for the new deposits discovered as a result of development work going on continuously. With regard to (ii) it appreciates that while rock bursts are a common enough feature of these mines, that of February 1956 was one of unusual intensity, involving the Company in substantial loss. On the other hand, the Committee feels it must also make allowance for the following factors:

(i) The present day value of the bulk of the capital assets owned by the Companies is undoubtedly substantially higher than that indicated in the balance sheet, on which alone market sentiments must be presumed to have been based.

(ii) The Agreement of 1949 prevented share values from reflecting to any reasonable degree of accurary the discovery of the new reef in the Nundidroog area; and

(iii) Some consideration is also due to shareholders, particularly where they are non-Indians, for the disturbance caused to their investment and the expenditure they will be put to in reinvesting what they receive by way of compensation.

These factors are difficult to evaluate; but the Committee feels the claims of justice and fairplay will have been adequately met if a net addition of Rs.5. lakhs is made to the sum of Rs.164 lakhs, making a total of Rs.169 lakhs. From this sum must be deducted Rs.50 lakhs, which the Committee understands represents the value at current market rates of the investments, mostly in Government securities, held by the Companies in the U.K. Subject to this figure being verified, there will be left a balance of Rs.119 lakhs net payable as compensation to the Companies. This amount may be paid in full provided dividends are declared at a rate not exceeding 6% of the share capital from the profits of 1955, after making adequate provision for incometax and super-tax liability; and that no other disbursements of any kind ~~are to~~ be made to the shareholders.

21. The compensation payable to each of the three Rupee Companies can be readily deduced from the figure of Rs.164 lakhs after ascertaining the market value of the sterling investments held by them and distributing the sum of Rs.5 lakhs pro rata.

22. The Committee has felt unable, on the data before it, to make any specific recommendation with regard to the form in which compensation should be paid. It suggests, however, that every effort should be made to pay off at least the smaller shareholders (say up to Rs.10,000) in cash. It has requested the Company to furnish information on the number of small shareholders deserving of this treatment. This question will need to be examined with reference to the proportion of the liquid assets owned by the Company to its fixed assets.

23. The Committee wishes to place on record its sense of deep gratitude to the officers of the Mysore Government who assisted the Committee in every way in the conduct of these proceedings and gave so ungrudgingly of their time and attention at considerable personal inconvenience and discomfort in the blistering heat of June. The Committee is equally grat~~ified~~ful to Mr. Taylor and his colleagues for their fullest co-operation with the Committee in its deliberations. But for their tireless energy, patience and forbearance the Committee would not have concluded its labours as soon as it actually did.

(K.N. Kaul)
Joint Secretary,
Ministry of N.R. & S.R.

(C.S. Menon)
Joint Secretary,
Ministry of Finance.

(H.A. Sujan)
Deputy Secretary,
Ministry of Finance.

New Delhi,
June 25, 1956.