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Vodafone deal has a precedent

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The government's ongoing scrutiny of a multi-billion- dollar stake in Hutchison Essar Ltd by Vodafone Group in the booming Indian cellular market comes exactly a year after New Delhi approved an almost similarly structured telecom acquisition.

A $1 billion (Rs4,400 crore) deal—which saw Malaysia's Maxis Communications and the Reddy family of Apollo Hospitals Ltd taking over regional mobile-phone firm Aircel Cellular Ltd—had support extended by the Kuala Lumpur company to promoters of the Indian health-care firm to finance their equity purchase. The transaction was approved by the Foreign Investment Promotion Board (FIPB), a government body that clears overseas ownership in certain sectors, in March 2006.

This was how the deal to buy Aircel, India's seventh-ranked mobile phone services firm by customers, was structured: Maxis directly owns 65% in Aircel. In addition, it funded, through preference shares, a flexible quasi-debt instrument—almost the whole of the Reddy family's $284 million investment, equivalent to 26% in the cellular company, according to people familiar with the structure as well as regulatory filings made by the Malaysian company.

In return, Maxis has an option to buy out the Reddys from a joint venture, Deccan Digital Networks, which owns 35% of Aircel and through which the Hyderabad investor group's ownership of the cellular company is routed.

Of the $378 million required by Deccan Digital to buy the 35% stake in Aircel, just $10 million was raised as equity and the remaining via preference shares. Accordingly, the Reddys had to put in only around $7.5 million as capital investment with the rest raised as quasi-debt, almost wholly from Maxis.

"It is only debt. We have taken a loan. It does not make them the owners of the company," said Suneeta Reddy, executive director of finance of the Apollo group of companies, in a phone interview. "Besides, the entire deal was approved by FIPB."

With the proposed Vodafone deal, FIPB has sought clarifications from the Reserve Bank of India (RBI) and the law ministry on whether the 12.26% stake, held jointly by Max India chairman Analjit Singh and Asim Ghosh, chief executive of Hutchison Essar—the firm Vodafone wants to take over by buying out the two-thirds stake of Hutchison Telecommunication International Ltd (HTIL)—is considered a foreign stake or not, since their investments in the Mumbai-based cellular firm are financed by loans backed by HTIL, the Hong Kong owner.

If their 12.26% stake is counted as foreign, then the foreign holding of Hutchison Essar will cross 74%, including 52% owned by HTIL and 22% held by domestic firm Essar Group's foreign entities. That would be a violation of India's foreign investment in tele-com sector rules and may complicate Vodafone's proposed acquisition, the largest-single purchase of an

Indian business.

In its proxy-funding aspect and the call option given to the foreign partner, the Maxis- Reddys deal is similar to the arrangement between HTIL, and Singh and Ghosh, lawyers said.

"If FIPB can allow such proxy funding, hedged by call options, in one case, it's interesting that they are conducting an inquiry into this one," said a legal expert, who isn't involved in the Vodafone situation and didn't want to be quoted.

Other lawyers and regulatory specialists interviewed by *Mint* were of the opinion that though call options, as future purchase choices on equity are referred to, are accepted by regulators, options that give the buyer—in this case, the foreign firm—a discounted price on the equity, are likely to flout RBI guidelines. They point out that companies have to be valued on the same principles when the call option is being exercised, and not at a discount, as when the original purchase of shares was made, according to rules laid out by the banking regulator.

"Under the law, whenever call options are allowed under foreign direct investment guidelines, the foreign firm can purchase additional equity only after following the pricing rules of the RBI, which stipulate that all issuance of shares after the initial deal have to follow the same pricing guidelines," said Vyapak Desai, asenior associate with Nishith Desai & Associates, a Mumbai law firm specializing in corporate law that isn't involv-ed in the Vodafone or Maxis transactions.

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