

M&A

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THE CURIOUS CASE OF SPICE JET: WHY IS SEBI QUIET?

On February 23, 2015, Ajay Singh (“AS”) acquired a controlling stake of 58.46% in the ailing budget airline, Spice Jet, from Mr. Kalanithi Maran and Kal Airways (“Existing Promoters”). While the deal is a temporary savior for both the aviation industry in general and Spice Jet in particular, it has triggered an interesting debate on some intricate aspects of the Indian takeover code specifically general exemption from an open offer in the case of a scheme of reconstruction.

THE DEALS

On January 15, 2015, Spice Jet informed the Bombay Stock Exchange (“BSE”) that the Spice Jet board had recorded the transfer of a controlling stake by the Existing Promoters to AS pursuant to a Scheme of Reconstruction and Revival for the takeover of ownership, management and control of Spice Jet (“Scheme”) to be filed before the Competent Authority, the Ministry of Civil Aviation, Government of India (“MCA”). Thereafter on January 22, 2015, Spice Jet informed the BSE that Spice Jet had received the approval of the MCA for the Scheme. On January 29, 2015 AS executed a share purchase agreement with the Existing Promoters of Spice Jet for the acquisition of 58.46% stake in Spice Jet. However, interestingly public announcement of an open offer was not made by AS.

While the details of the Scheme have not been made public, it appears from the board resolutions made available in the public domain and the media reports that the Scheme is (a) to transfer the management, ownership and control from the Existing Promoters to AS, (b) recapitalize the company and (c) improve operational efficiency by reorganizing the routes in which the airline operates.

THE CONTROVERSY

Unless exempted under the takeover code or by the Indian securities regulator (“SEBI”), (i) an acquisition of 25% stake or more or (ii) the acquisition of control requires the acquirer to make a mandatory offer to the public shareholders for atleast another 26% stake of the target company. Therefore, *prima facie* AS’s acquisition should have triggered the mandatory open offer under the takeover code. The takeover code envisages two broad categories of exemption, one which is expressly provided for under the takeover code and others where SEBI specifically exempts the acquirer(s) from making an open offer. In this case, it appears that AS has not approached SEBI for a specific exemption. On the contrary, AS has contended that the acquisition is pursuant to the Scheme approved by a competent authority (in this case the MCA) under law and therefore is expressly exempt under the Indian takeover code.

Regulation 10(1)(d)(ii) of the Indian takeover code exempts an acquisition pursuant to a *scheme of arrangement involving the target company as a transferor or a transferee company or a reconstruction of the target company including amalgamation, merger, demerger pursuant to an order of the court or a competent authority under any Indian or foreign law (emphasis supplied)* (“Exemption”). Therefore, to qualify for an exemption under this Exemption two tests must have to be met-(i) the acquisition of shares or control is pursuant to a scheme of reconstruction and (ii) it is approved by a court or a competent authority under any law.

The controversy in this case is (a) whether the Scheme qualifies as a scheme of reconstruction and (b) whether the MCA is a competent authority under law to approve the Scheme.

THE ANALYSIS

Is the Scheme a scheme of reconstruction? It has been argued that the scheme of reconstruction that is exempt under the Exemption code is limited to schemes undertaken under s. 391-394 of the Companies Act, 1956 (“Cos Act”) and since the Scheme in the case of Spice Jet is not a scheme undertaken under s. 391-394 of Cos Act it does not squarely fall within the Exemption. This argument may have some merit based on the following propositions:-

(a) General principle of exemptions:- The Indian takeover code envisages limited instances wherein a general exemption from an open offer is provided and such instances can be conceptually categorized to acquisition(s) (a) wherein no real change of control takes place (for e.g. inter-se transfer between promoters) (b) undertaken in the ordinary course of business (for e.g. acquisition by underwriters and stock brokers) or (c) which requires the prior approval of the shareholders and a special mechanism is provided under law for the same (for e.g. acquisition pursuant to SICA, CDR, delisting offer). Therefore, the scheme of arrangements or reconstruction also must necessarily fall under one of these buckets and since it does not fall under (a) or (b), it must conceptually fall under (c) in line with the spirit of the Indian takeover code and broader principles of governing general exemption from an open offer.

(b) Historical construction:- Similar exemption was available under the old takeover code (“1997 Takeover Code”) and based on the discussions of 2002 Bhagwati Committee Report (“2002 Report”) it is abundantly clear that the Exemption is limited to schemes of reconstruction undertaken under s. 391-394 of the Cos Act as such schemes are

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statutorily contemplated and require the approval of the shareholders and courts thus conferring adequate protection to the shareholders (this is perhaps the reason why originally preferential issue of shares was exempt under the 1997 Takeover Code).

While the argument seems attractive, legally sustain it may not be entirely straightforward. Firstly on a plain reading of the exemption there is nothing to suggest that the scheme of reconstruction contemplated under the Exemption is limited to schemes undertaken under s. 391-394 of the Cos Act. In fact the phrase "including" and "any law" in language of the Exemption envisages schemes of reconstruction which may not be in the form of mergers, amalgamations or demergers under s. 391-394 of the Cos Act. Secondly, the historical construction of the Exemption in (b) above can be controverted on the ground that neither 1997 Bhagwati Committee Report nor the 2002 Report expressly states that acquisition pursuant to scheme of arrangement or reconstruction for which an exemption from an open offer is granted is limited to schemes undertaken under s. 391-394 of the Cos Act. In fact it can be potentially argued that the 2010 Report of the Takeover Regulation and Advisory Committee contemplates an exemption for any scheme of reconstruction which transforms the target company and does not allude to only schemes of reconstructions undertaken under s. 391-394 of the Cos Act.

Therefor AS and Spice Jet may very well argue that the Scheme involves a change in control of the company, recapitalization and operational changes and therefore may by itself qualify as a reconstruction and should be exempt under the Exemption so long as it is approved by a competent authority under any law.

Is MCA a competent authority under law?

In order to satisfy the Exemption it is not sufficient to demonstrate that the acquisition is made pursuant to a scheme of reconstruction of the target company, the acquirer will also have to demonstrate that such reconstruction is contemplated under some law or regulation and is approved by a competent authority. The exemption is not available in cases where the parties undertake a voluntary reconstruction of the target company and approach the regulatory authorities for necessary approvals. It may well be argued that no law or regulation expressly mandates or empowers MCA to initiate or approve the reconstruction of a scheduled air transport company such as Spice Jet and therefore MCA is not a competent authority for the purposes of the Exemption.

It is correct that the Aircrafts Act, 1934 ("AA") or the Aircraft Rules, 1937 ("AR") does not expressly contemplate a scheme of reconstruction or revival. However, on a closer analysis of the scheme of the AA and AR, the argument that MCA is a competent authority to approve a reconstruction for the purposes of the Exemption may have some force. Under the AA, the MCA has the power to monitor and regulate the operation of all air transport services and specifically regulate tariffs. Further, introduction of new routes or alteration in existing routes or change in ownership or control of a scheduled air transport passenger airline also requires an approval of the MCA (through Directorate General of Civil Aviation). The MCA has the power to temporarily suspend an airline carrier's licence/permit if the MCA is of the view that the airline does have the financial resources to undertake regular operations and this power has been recently exercised in the case of Kingfisher Airlines. The suspension may be lifted if the airline carrier is able to submit a revival plan to the MCA.

On the basis of the above, AS and Spice Jet may well argue that Spice Jet was financially distressed and could have lost its license and therefore had to undertake the Scheme which was mandatorily required to be approved by the MCA and therefore such the Scheme is undertaken under a specific law (AA read with AR) and approved by a competent authority (MCA) for the purposes of the Exemption.

Is the Controversy Puerile?

It may well be argued that the entire discussion is puerile as none of the shareholders of Spice Jet seem to be agitated. However, such an argument may not be accurate as the takeover code does not contemplate a whitewash provision (shareholders agreeing to waive an open offer in certain circumstances) and therefore the duty is upon the SEBI to enforce the provisions of the takeover code in case there is a violation. In this case, tacitly SEBI seems to have taken the view that AS is exempt from making an open offer. However, given the controversy and possible a potential misuse of the Exemption given its wide ambit, some guideline/clarification from the regulator should certainly help.

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