Intra Legem

April 27, 2018

MAHARAJA WOES: "FIGHT OR FLIGHT"

No more wind beneath the wings for Air India?

Introduction

In the recent past, a lot has been debated over the ongoing privatization process of the national carrier "Air India". The Government of India (GOI) in collaboration with the Ministry of Civil Aviation (MCA) and the management of the airline have been working on different ways to draw out a strategy towards the privatization process.

The GOI has now given its in-principal approval to divest 76% of its stake in Air India to private players and retain balance 24%, including Air India's shareholding interest in Air India Express Limited (AIXL) and Air India SATS Airport Services (AISATS). The MCA has released a preliminary Information Memorandum (IM) dated March 28, 2018 which contains information about the strategic disinvestment of Air India, AIXL and AISATS. Further, MCA has sought Expression of Interest (EoI) for the sale of 76% stake from interested bidders through an open competitive bidding process.

Benefit of 76% disinvestment over 24% or 49%

The IM released by the GOI allows 76% disinvestment of not only Air India but also its key subsidiaries AIXL and AISATS. AIXL is a wholly-owned subsidiary of Air India Limited and provides air transportation services between India and certain destinations in Middle East and South East Asia. AISATS is a 50:50 joint venture between Air India Limited and SATS Limited, a Singapore based company and is a provider of food solutions, ground handling and catering services.

With the GOI now divesting its stake from Air India and subsidiaries, it is an opportunity for foreign airlines to invest in Air India. The IM opens up avenues for individual bidders as well as a consortium of individuals/airlines to invest in Air India. With 76% disinvestment, the control and management of Air India will solely vest with the private player, thereby allowing them to operate without much hurdle. However, since GOI has retained 24% stake, the winning bidder will not be able to exercise 100% control and also merge the airline with any of their existing businesses as long as GOI holds a stake.

The acquisition of Air India would provide the investor with best international slots and immediate access to the domestic network. Since the disinvestment has also been extended to AIXL, the investor will also have the right to control and manage AIXL along with a ready base of air transportation services. In relation to AISATS, the investor shall also have the opportunity to tie up with a Singapore based entity having an expertise in food solutions, ground handling and catering services of upto 60 years.

Significant highlights of the IM

The IM inter alia includes the procedure for the entire disinvestment bidding process, guidelines and eligibility criteria for investment, the debt and liabilities of Air India, AIXL and AISATS, etc. As per the IM the deadline for submission of the EoI is May 14, 2018.

Regulation governing Foreign Direct Investment (FDI) in aviation and investment in Air India

According to the Foreign Direct Investment Policy, 2017 (the "Policy");

- FDI limit for Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline and regional Air Transport Service has been raised from 49% to 100%, with FDI up to 49% permitted under automatic route and FDI beyond 49% through Government approval, while 100% for NRI; and
- Foreign airlines are allowed to invest in the capital of Indian companies i.e. operating scheduled and non-scheduled air transport services to the limit of 49% of their paid-up capital, subject to government approval.

Even though FDI was permitted in Indian aviation companies, it expressly restricted foreign airlines to invest in Air India. However, Press Note 1 of 2018 removed the aforesaid restriction on Air India and permitted foreign airlines to invest in Air India, subject to certain conditions such as: (a) foreign investment in Air India, including that of foreign airlines to not exceed 49%, either directly or indirectly (b) substantial ownership and effective control of Air India to continue to be vested in Indian nationals.

It is clear from the above that the FDI policy restricts the ownership and control of Air India to Indian nationals. However, with the onset of the disinvestment process and issuance of the IM, the aforesaid condition of ownership and control in favour of Indian nationals is debatable. Therefore, pursuant to the completion of the bidding process and award of the bid, the FDI policy will be required to be suitably amended.

Understanding investor liabilities and debt under the 76% disinvestment model

Air India is currently jostling with an insurmountable debt of about Rs.52,000 crores and salary arrears of approximately Rs.1,200 crores accrued from the year 2012. Any prospective bidder will be required to absorb this liability. However, interested bidders have been expressing interest in acquiring only

the cash-rich divisions of the national carrier and not absorbing the entire debt. The IM clearly mentions that the interested bidder will be responsible for the existing debts of Air India post disinvestment.

More so, post the release of the IM, many airlines who were earlier expressing their interest in acquiring Air India have backed out since it appears that the terms of the IM are not favorable to such airlines. Only a handful of international airlines (albeit no formal EoI has been submitted by them) have expressed their interest to acquire the debt-ridden airline.

The GOI can consider disinvesting in a phased manner by currently retaining 24% and gradually privatizing Air India 100%, by disinvesting the balance 24%.

Opportunities presented by including AISATS

AISATS, being one of the companies partaking in the disinvestment process, is the only continuous profit-making entity since the past 5 years. AISATS currently provides customer airline services to a wide territorial range based in Bengaluru, Delhi, Hyderabad, Mangalore and Trivandrum in India. According to the IM, in the near future, India is expected to be the fastest growing market with the expected growth in the passenger traffic and fleet size of Indian carriers on a rise. This would give rise to opportunities to the investors investing in AISATS as the said entity already has a favourable air traffic base as well as an prospects of a tie-up with an entity having expertise in food solutions, ground handling and catering services.

Investor responsibilities towards government employees

The employees of Air India (including pilots) have been demanding clearance of salary dues amounting to Rs.1,200 crores. Air India recently has 11 (eleven) unions opposing its privatization due to fear of retrenchment. The GOI needs to negotiate the terms of employment for such employees beforehand, i.e. prior to the bidding process by incorporating details pertaining to the same in the IM in order to ensure that the privatization process does not get stalled. Further, upon transfer of control and management pursuant to the disinvestment, the investor will be required to absorb the salary arrears and

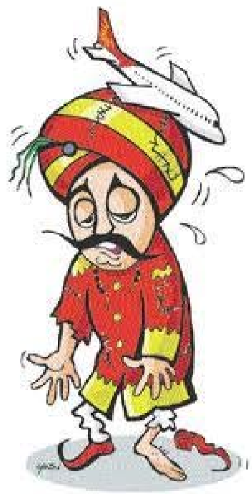
provide employee benefit to such employees on terms which are no less favourable than the current employment terms.

Conclusion

Thus, it appears that the GOI needs to pay more heed towards the current sensitive debt situation as the same has an effect on the proposed disinvestment process. Further, the GOI can agree to disinvest in a phased manner by currently retaining 24% in order to take care of core issues like debt, employees and overheads and gradually privatizing the national carrier entirely by disinvesting the balance 24%.

We suggest that in order to attract interested investors, the GOI can amend the IM by absorbing maximum debt and lessening the liability on the investor, removing the 3 (three) year lock-in period condition for consortium of bidders and removing the condition stating that the investor shall not merge their existing business with that of the business of Air India acquired by such investor post disinvestment.

However, the increasing political interference in the privatization process is leading to a delay in the sale of Air India and there could be a time period where Air India will gradually slide into oblivion. Therefore, it'shigh time that the GOI and MCA cooperate with each other on behalf of Air India to make an informed "flight or fight" choice, in order to save the Maharaja.



Contributed by:

Tejasvini Shirodkar, Partner: tejasvini@rajaniassociates.net

Pearl Boga, Senior Associate: pboga@rajaniassociates.net

Karen Issac, Associate : kissac@rajaniassociates.net

Contact Us

Rajani Associates
Advocates & Solicitors

Krishna Chambers
59 New Marine Lines
Mumbai 400020, India
t: +91 22 4096 1000
e: intralegem@rajaniassociates.net
w: www.rajaniassociates.net

AREAS OF PRACTICE

| Capital Markets | Private Equity | Mergers and Acquisitions | Corporate Litigation & Arbitration | Projects & Project Finance |
| Real Estate & Trust | Corporate & Commercial | Banking & Finance | Structuring | TMT | IPR | Employment |