# Foreign Airlines Permitted to Hold Equity Stakes in Indian Carriers

By Stephen B. Huttler, Kenneth P. Quinn, Jennifer E. Trock and Sonakshi Jha*

*On September 20, 2012, the Government of India notified the public that it has undertaken a series of reforms relating to foreign investments in the country, including allowing foreign airlines to hold up to 49 percent foreign direct investment ("FDI") in Indian airlines. This decision, coupled with significant cuts on the taxes on overseas corporate borrowers, may lure foreign investors toward India, although Indian airlines face formidable financial pressures. The move comes at a time of renewed focus on liberalizing airline ownership laws in the U.S. and Europe.*

According to the Ministry of Industry and Commerce, Department of Industrial Policy and Promotion, per Press Note 6 of 2012 ("Press Note 6"), permitted foreign airlines will be able to hold up to 49% equity in Indian carriers except for Air India. This much-awaited reform by the Government of India forms a part of the broader FDI reform package that has been introduced in various other sectors, including retail and power.

## FDI in Aviation Prior to, and Under Press Note 6

Prior to this important change in policy, FDI in airlines was automatically permitted for investments of up to 49% and with government approval for investments between 49% and 74%. However, foreign airlines were prohibited from participating in such equity investments, and their investments were limited to equity of companies operating cargo airlines, helicopter and seaplane services.

The new policy allows foreign airlines to hold equity stakes of up to between 49% and 100% in Indian carriers other than Air India, depending on the type of company. Specifically, foreign airlines may automatically invest up to 100% in cargo airlines, helicopter and seaplane services and, with government approval, up to 49% in passenger airlines. Additional limitations exist for investments in passenger airlines similar to other governmental policies restricting foreign ownership and control of national air carriers. The limitations imposed on such investments are as follows:

* Ms. Jha is a member of the Bar Council of Delhi, India.

(i) Such investments require government approval and are subject to the upper limit of 49%, in contrast to the otherwise applicable FDI limit of 74% in the category.

(ii) The 49% limit incorporates both FDI and investments by the foreign institutional investors (FII).

(iii) To be eligible for a scheduled operator status, the company has to be one registered and having its principal place of business within India, with its chairman and at least two-thirds of its directors being citizens of India. The "substantial ownership and effective control" of such company must be vested in Indian nationals.

(iv) In addition to the above, if any technical equipment is imported into India as a result of such investment, then such import would require the approval from the Ministry of Civil Aviation in India.

(v) Investments and individuals will be subject to security reviews.

## Future Prospects for FDI in Aviation in India

This reform is good news not only for the foreign airlines looking to expand in India, but also comes as a relief for the Indian aviation industry, which has been going through severe financial difficulties. Some prominent Indian carriers such as Kingfisher Airlines, which has been debt-ridden, had been advocating for this change for the past few months. Indian business tycoon Vijay Mallya has already indicated that he is hoping the new policy will encourage foreign airlines to take equity stakes in his cash-strapped Kingfisher Airlines.  He recently was quoted at his shareholders' meeting saying: "We are in talks with foreign airlines and other potential investors for equity stake in the holding company (UB Holdings Ltd.) of our airline. They are showing interest to invest, as there is growth opportunity."

The requirement of government approval and the limitations placed on the structure of the ownership of the carrier entities does limit the extent of this reform, but is customary around the world. The United States, for example, permits only up to 25% voting equity held by non-U.S. citizens, with up to 49% total equity held by non-US citizens where the equity comes from countries with "open skies" regimes. The President and two-thirds of the board and management of all U.S. carriers must also be U.S. citizens, and the air carrier must be under the "actual control" of U.S. citizens. The U.S. does not have separate rules for airline versus non-airline investment as in India, nor does it distinguish between passenger and cargo/helicopter/seaplane services.

To his credit, the European Commission Vice President responsible for transport, Siim Kallas, has renewed his call for broad negotiations with the U.S. to review and liberalize foreign ownership restrictions to permit cross-border equity deals in the aviation industry, if not outright mergers. The premise behind his push, that U.S. airline ownership laws are a "relic" and anachronistic, preventing both the free flow of capital and needed global consolidation, are sound and worthy of serious consideration. Both U.S. and European carriers are facing increasing competition from Middle Eastern and Asian carriers; they already have well-formed alliances.

In India, even though the new policy does not allow a foreign airline to hold a majority stake in the Indian entity, under the Indian corporate laws, any foreign airline that will hold a stake greater than 25% in the Indian entity will have the right to block special resolutions. These rights likely will be subject to government scrutiny, as they would be in the U.S., to ensure they represent standard minority investor protections and not attempts to exert actual or effective control over the day-to-day running of the airline.

Relaxation of the FDI policy in the aviation sector has been coupled with certain other measures that could boost foreign investment toward India. One such significant measure is the reduction in withholding taxes for overseas borrowing by Indian companies from 20% to 5%. Given the high interest rates prevailing in India, this reduces the borrowing cost for the Indian companies significantly. This indicates that the government of India is leaning in favor of encouraging foreign investment in the economy and creating a foreign-investment-friendly climate in the days ahead.

The aviation sector in India is currently in dire need of funds. Given the existing demand for foreign investment and relaxation of the FDI norms in the sector, this can be seen as a great opportunity for the foreign airlines looking to expand their global presence to explore the viability of investing in Indian air carriers.

---

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors of this alert.

Kenneth P. Quinn (bio)
Washington, DC
+1.202.663.8898
kenneth.quinn@pillsburylaw.com

Stephen B. Huttler (bio)
Washington, DC
+1.202.663.8121
stephen.huttler@pillsburylaw.com

Jennifer E. Trock (bio)
Washington, DC
+1.202.663.9179
jennifer.trock@pillsburylaw.com