



Telecom Regulatory Authority of India

Recommendations

on

Lock-in period for Promoter's Equity and other related
issues for Unified Access Service Licensees (UASL)

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PREFACE

The Telecom Sector in India today is highly competitive with 281 Access service licensees (Basic-2; CMTs-39 and UASL-240). Of the 240 UASL licenses, 121 were awarded between December, 2007 and January, 2008 alone. The total number of telephone connections stood at 400.05 million at the end of January'09, bringing the overall tele-density to 34.50 per 100 persons. The exponential growth in the sector has been facilitated by the reforms process, policy initiatives, and technological developments fostering a healthy competitive environment. The entry barriers in terms of eligibility criterion and entry fee have been lowered and the policy for Foreign Direct Investment (FDI) has been further liberalized. The FDI limit was enhanced from 49% to 74% in telecom services subject to certain conditions in 2005.

The Revenues from the telecom services for the year 2008-09 is expected to touch Rs 1500 billion and the investment in the Telecom services is likely to be approximately Rs 2500 billion at the end of FY 2008-09. A highly capital intensive sector, the gestation period is also significantly high. Despite the phenomenal growth, the overall tele-density is 34.50% (January, 2009) and the rural tele-density is only 13.13% (December, 2008). Evidently, there is tremendous scope for further expansion of network requiring further infusion of capital. With the growth being contributed mainly by mobile telephones, availability and proper utilization of spectrum, which is a scarce national resource, assumes importance.

Telecom Regulatory Authority of India (TRAI) received a reference from the Department of Telecommunications (DoT) seeking recommendations on the considered views of the Telecom Commission on the restrictions that should be there in the license agreements "...in order to prevent fly-by-night operators making a windfall gain." These restrictions relate to the issue of lock-in period for promoter's equity for Unified Access Service Licenses (UASL), restriction on declaration of special dividend in case of additional equity etc. While similar conditions had existed in the initial licenses when

the sector was opened up for private participation, these underwent changes over time, and were removed from the licenses issued from 2007 onwards. With spectrum coming bundled with the license, and its limited availability, regulation of transactions in equity of UAS Licensee Company has assumed significance. In this context, a proper balance between the capital requirement of the Licensee Company and having a competitive telecom market in India needs to be ensured in order to have a steady and uniform growth of the sector.

The Authority initiated a consultation process on January 9, 2009. Based on the comments of the stakeholders, and examination of the various other factors like growing market, current policy & regulations, competitive scenario etc., the Authority has framed its recommendations on the issues raised by the DoT. The Authority would also like to acknowledge the valuable inputs provided by the Securities and Exchange Board of India (SEBI).

In these recommendations, the attempt has been to maintain a level playing field, ensure efficient utilization of spectrum, transparency in the system and to uphold the interest of the consumer as supreme while fostering growth in telecom sector. It is hoped that these recommendations would meet not only the concerns raised by the DoT, but would also promote a healthy growth through sustained infusion of capital in the sector. It is the understanding of the Authority that the recommendations would be considered holistically taking into account the recent developments in the Telecom sector.

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CHAPTER 1

INTRODUCTION

Background

- 1.1 The Telecom Industry in India has witnessed exponential growth with the advent of liberalization and de-monopolization under the National Telecom Policy, 1994 and New Telecom Policy, 1999. The consequent association of private sector aided by positive regulatory and policy environment has been instrumental in making the impressive growth of telecom sector possible. The overall tele-density has reached 34.50% at the end of January, 2009. Total telephone connections are 400.05 million (362.30 million wireless subscribers and 37.75 million wireline subscribers). The Gross Revenue (GR) of the Indian telecom service sector for the previous financial year (2007-08) was Rs. 1300 billion, contributing nearly 3% to the national GDP. In current financial year (2008-09), GR has already aggregated to nearly Rs. 1120 billion in the first three quarters and is anticipated to touch Rs 1500 billion by the end of the financial year.
- 1.2 This growth in Indian Telecom Sector has attracted a large number of operators to tap its potential. As on 31.10.08, 281 Access Service Licenses have been issued in the country. Out of this, 121 were new UAS Licenses, issued¹ between December, 2007 and January, 2008. Presently, the market is highly competitive with 12 to 14 Access Service Licensees in each service area. With the increase in the competition and size of the market, the prospects of transactions in equity of UAS Licensee Company and merger & acquisition activities have also increased. Though, provisions relating to substantial equity, transfer/assignment of license under certain conditions and intra service area merger of licenses are stipulated under the current

¹ Source: www.dot.gov.in

licensing regime, there are no provisions relating to lock-in or addition of equity shareholding and their related aspects.

Reference received from Department of Telecommunications (DoT)

1.3 A reference dated November 24, 2008 (Annexure A) was received from the Department of Telecommunications (DoT) seeking recommendations of Telecom Regulatory Authority of India (TRAI) on the considered view of the Full Telecom Commission that there should be following restrictions in the license agreements in order to prevent fly-by-night operators making a windfall gain:

- i) The promoters who have 10% or more stakes in the company and whose networth has been taken into consideration for determining the eligibility for grant of UAS license should not sell their equity in the UAS Licensee Company for a period of 3 years from the effective date of license (s). However, issue of additional equity share capital by the licensee companies/their holding companies by way of private placement/public issues shall be permitted. Further, the lock-in provisions shall not be applicable in case the shares are transferred pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers with the condition that such shares should have been pledged for investment only in the particular licensed project.
- ii) In cases, where money is brought into the company by issue of fresh equity, there shall be a restriction on declaration of special dividend by the company for a period of 3 years.
- iii) The above conditions (i) and (ii) would not be applicable to the licensees holding UAS/CMTS licenses for a period of 3 years if they acquire any new UAS licenses in some service areas in order to enlarge their area of operations.

1.4 The DoT sought recommendations of TRAI in terms of clause 11 (1)(a) (iv) of the TRAI Act, 1997, as amended by TRAI (Amendment) Act, 2000 which deals with measures to facilitate competition, creating a level playing field and promote efficiency in the operation of telecommunication services so as to facilitate growth in such services. Since the issues raised in the reference have a direct bearing on the terms and conditions of license of service providers and would call for appropriate changes in the license agreement to address the various concerns raised, TRAI has examined and recommended under clause 11(1)(a)(ii), “terms and conditions of license to a service provider” in addition to clause 11(1)(a)(iv) as suggested by DoT in its reference.

Consultation Process

1.5 In keeping with the TRAI’s approach of a transparent consultative process, the Authority issued a Consultation Paper on January 9, 2009. The comments of the Stakeholders were posted on TRAI’s website. An Open House Discussion (OHD) was held in Delhi, on February 4, 2009. These recommendations are formulated after taking into account the comments received in the consultation process, changing market scenario in India and current policy & regulations. The Authority after carefully examining all the responses received from the stakeholders, deliberations on the various issues emanating from the submissions from stakeholders and the developments that have prompted the reference, has arrived at the recommendations; summary of which is available in Chapter – 4.

CHAPTER 2

EXTANT POLICIES AND REGULATIONS

- 2.1 The Telecom Sector was opened to private participation in services with the introduction of the National Telecom Policy 1994. Since then liberalized Government policies and positive regulatory framework have ensured a very healthy growth of telecom sector and provision of affordable, competitive and a wide choice of services to the consumers.
- 2.2 The changes effected in the license terms and conditions relating to lock-in, merger and acquisition (M&A), substantial equity and transfer/assignment in Cellular Mobile Telephone Service (CMTS)/ Unified Access Service (UAS) license agreements from time to time are tabulated in Table 1 (pages No. 72 - 77).

2.3 Existing clauses in UASL Agreement

- 2.3.1 The relevant clauses in the existing UAS License Agreement related to ownership of the Licensee company, net-worth, restrictions on transfer of license etc. are reproduced below:

Ownership of the LICENSEE Company

“1.1 The LICENSEE shall ensure that the total foreign equity in the paid up capital of the LICENSEE Company does not, at any time during the entire Licence period, exceed 74% of the total equity subject to the following FDI norms :

- (i) Both direct and indirect foreign investment in the licensee company shall be counted for the purpose of FDI ceiling. Foreign Investment shall include investment by Foreign Institutional Investors (FIIs), Non-resident Indians (NRIs), Foreign Currency Convertible Bonds (FCCBs), American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and convertible preference shares held by foreign entity. Indirect foreign investment shall

mean foreign investment in the company/ companies holding shares of the licensee company and their holding company/companies or legal entity (such as mutual funds, trusts) on proportionate basis. Shares of the licensee company held by Indian public sector banks and Indian public sector financial institutions will be treated as 'Indian holding'. In any case, the 'Indian' shareholding will not be less than 26 percent.

- (ii) FDI up to 49 percent will continue to be on the automatic route. FDI in the licensee company/Indian promoters/investment companies including their holding companies shall require approval of the Foreign Investment Promotion Board (FIPB) if it has a bearing on the overall ceiling of 74 percent. While approving the investment proposals, FIPB shall take note that investment is not coming from countries of concern and/or unfriendly entities.
- (iii) FDI shall be subject to laws of India and not the laws of the foreign country/countries.

1.2 The LICENSEE shall declare the Indian & Foreign equity holdings (both direct and in-direct) in the LICENSEE company and submit a compliance report regarding compliance of FDI norms and security conditions on 1st day of January and 1st day of July on six monthly basis to the LICENSOR. This is to be certified by the LICENSEE Company's Company Secretary or Statutory Auditor.

1.3 The merger of Indian companies may be permitted as long as competition is not compromised as defined in condition 1.4 (ii).

1.4 The LICENSEE shall also ensure that:

- (i) Any changes in share holding shall be subject to all applicable statutory permissions.
- (ii) No single company/ legal person, either directly or through its associates, shall have substantial equity holding in more than

one LICENSEE Company in the same service area for the Access Services namely; Basic, Cellular and Unified Access Service. 'Substantial equity' herein will mean 'an equity of 10% or more'. A promoter company/ Legal person cannot have stakes in more than one LICENSEE Company for the same service area.

Note: Clause 1.4(ii) shall not be applicable to Basic and Cellular Licensees existing as on 11.11.2003, and in case one of them migrates to UASL it shall not be necessary to surrender the other License. Further, Basic and Cellular Licensees existing as on 11.11.2003, shall not be eligible for a new UASL in the same service area either directly or through its associates. Further, any legal entity having substantial equity in existing Basic / Cellular licensees shall not be eligible for new UASL.

(iii) Management control of the LICENSEE Company shall remain in Indian Hands.”

Networth

“1.7 The promoters of LICENSEE shall have a combined net-worth² of Rs _____ crores (Rupees _____ crores only) and the net-worth of only those promoters shall be counted who have directly in their name at least 10% equity stake in the total equity of the company. In case of acquiring any other UASL licence, the licensee shall maintain additional net-worth as prescribed for new UASL for that service area also.”

Restrictions on 'Transfer of Licence'

“6.1 The LICENSEE shall not, without the prior written consent as described below, of the LICENSOR, either directly or indirectly, assign or transfer this LICENCE in any manner whatsoever to a third party or enter into any agreement for sub Licence and/or partnership relating to any subject matter of the LICENCE to any third party either in whole or in part i.e. no sub

² Rs. 100 crore for Category A & Metro; Rs. 50 crore for Category B and Rs. 30 crore for Category C service areas

leasing/partnership/third party interest shall be created. Provided that the LICENSEE can always employ or appoint agents and employees for provision of the service.

6.2 Intra service area mergers and acquisitions as well as transfer of licences may be allowed subject to there being not less than three operators providing Access Services in a Service Area to ensure healthy competition as per the guidelines issued on the subject from time to time.

6.3 Further, the Licensee may transfer or assign the License Agreement with prior written approval of the Licensor to be granted on fulfillment of the following conditions and if otherwise, no compromise in competition occurs in the provisions of Telecom Services :-

- (i) When transfer or assignment is requested in accordance with the terms and conditions on fulfillment of procedures of Tripartite Agreement if already executed amongst the Licensor, Licensee and Lenders; or
- (ii) Whenever amalgamation or restructuring i.e. merger or demerger is sanctioned and approved by the High Court or Tribunal as per the law in force; in accordance with the provisions; more particularly Sections 391 to 394 of Companies Act, 1956; and
- (iii) The transferee/assignee is fully eligible in accordance with eligibility criteria contained in tender conditions or in any other document for grant of fresh license in that area and show its willingness in writing to comply with the terms and conditions of the license agreement including past and future roll out obligations; and
- (iv) All the past dues are fully paid till the date of transfer/assignment by the transferor company and its associate(s) / sister concern(s) / promoter(s) and thereafter the

transferee company undertakes to pay all future dues inclusive of anything remained unpaid of the past period by the outgoing company.”

2.4 TRAI’s recommendations on M&A, substantial equity, transfer of license and roll out obligations as part of its Recommendations on “Review of license terms and conditions and capping of number of access providers” (28.08.2007)

2.4.1 Merger & Acquisition

- “6.9 The relevant service market be defined as wire line and wireless services. Wireless service market shall include fixed wireless as well.
- 6.10 The relevant geographic market shall be licensing service area as it exists today.
- 6.11 For determination of market power, market share of both subscriber base and adjusted gross revenue of licensee in the relevant market shall be considered to decide the level of dominance for regulating the M&A activity.
- 6.12 M&A guidelines should use Exchange Data Records (EDR) in the calculation of wireline subscribers and specifically VLR data, in the calculation of wireless subscribers for the purpose of computing market share based on subscriber base.
- 6.13 The duly audited Adjusted Gross Revenue shall be the basis of computing revenue based market share for operators in the relevant market.
- 6.14 The market share of merged entity in the relevant market shall not be greater than 40% either in terms of subscriber base or in terms of Adjusted Gross Revenue.
- 6.15 No M&A activity shall be allowed if the number of wireless access service providers reduces below four in the relevant

market consequent upon such an M&A activity under consideration.

6.16 The existing cap of 2x15 MHz per operator per service area for metros and category A circle and 2x12.4 MHz per operator per service area in category B and C circle applicable for a post merger entity be removed for purposes of regulating M&A activity.

6.17 The annual license fee and the spectrum charge are paid as a certain specified percentage of the AGR of the licensee. On the merger of the two licenses, the AGR of the two entities will also be merged and the license fee will be therefore levied at the specified rate for that service area on the resultant total AGR. Similarly, for the purpose of payment of the spectrum charge, the spectrum held by the two licensees will be added/merged and the annual spectrum charge will be at the prescribed rate applicable on this total spectrum.”

6.18 A mix of ex-ante and ex-post approach for regulating acquisitions of equity stake of one licensee Company/ legal person/promoter company in the enterprise of another licensee in the same license area. Acquisition of equity capital up to 10% of the target licensee’s enterprise shall be permitted by an automatic route and anything beyond that and up to 20% of the equity holdings of the target licensee company, shall be approved on a case by case basis and the process of such approvals will be based on the M&A guidelines contained in these recommendations.”

2.4.2 **Transfer/Assignment of License**

“6.19 The Authority while examining the issue of M&A had also deliberated on these terms for the transfer of licenses and has come to the conclusion that the present terms and conditions

are adequate and therefore the Authority recommends that it does not require any change in the existing terms.”

2.4.3 **Roll out obligations**

“6.31 Without any change in the provision of LD, in case the roll out obligation is not met even after 52 weeks of the period prescribed for completing roll out obligations, the Authority recommends that the reference to termination of license in clause no. 35.2 of UASL may be replaced by the following:

- i. The performance bank guarantee be forfeited and the service provider may be asked to resubmit PBG of the same amount.
- ii. No additional spectrum may be allocated to licensees till he does not fulfill the roll out obligations.
- iii. Such a licensee should not be eligible to participate in any spectrum auction till the roll out obligation is met.
- iv. Any proposal of permission of merger and acquisition should not be entertained till the roll out obligation is met.”

2.5 DoT, while examining the TRAI recommendations, made a critical deviation in respect of the roll out recommendation at 2.4.3 above as follows:

“Any proposal for permission for merger shall not be entertained till the roll out obligation is met. However, request for permission for acquisition may be entertained.” (DoT letter No.20-100/2007-AS-I dated 08.11.2007)

2.5.1 Thus a distinction has been made between merger and acquisition while accepting the recommendation of TRAI in this regard. The DoT issued revised guidelines for intra service area merger of Cellular Mobile Telephone Service (CMTS)/Unified

Access Services (UAS) Licenses vide their letter dated 22nd April, 2008.

2.5.2 The Authority sent a communication dated May, 23, 2008 to DoT stating that the guidelines of DoT dated 22.04.2008 do not bring out clearly the position on acquisitions. Accordingly, the following was suggested by TRAI for consideration of DoT:

2.5.2.1 Scope of the merger may be clarified to include acquisition so as to remove any ambiguity.

2.5.2.2 It may be clarified that merger or amalgamation or acquisition of license is only consequent to merger or amalgamation or acquisition or restructuring of the operations of the companies as reflected in paragraph 2 of the 2004 guidelines.

2.6 *The DoT, however, did not accept TRAI's suggestions and the guidelines dated 22.04.08 remain unchanged.*

CHAPTER 3

ISSUES, ANALYSIS AND RECOMMENDATIONS

3.0 Introduction

3.1 The Authority is of the view that the best test for any regulatory measure or change in an existing regulatory measure is the policy objectives it seeks to achieve. In other words, the foremost consideration in prescribing a regulatory measure or changing an existing regulatory regime is whether such prescription would serve the twin purposes of -

- (a) achieving or facilitating the achievement of the larger policy objectives of promoting competition and growth in the sector leading to consumer benefit; and
- (b) ensuring equal opportunities and a level playing field to all players in the sector leading to greater investment and expansion of services throughout the length and breadth of the country, thus enabling the weaker sections of society, particularly the rural population, to harvest the benefits of such expansion.

3.2 The National Telecom Policy 1994 envisaged suitable arrangements to protect and promote the interests of the consumers and to ensure fair competition for implementation of the policy. The objectives of the New Telecom Policy (NTP) 1999 inter alia emphasized the following:

“Access to telecommunications is of utmost importance for achievement of the country's social and economic goals. Availability of affordable and effective communications for the citizens is at the core of the vision and goal of the telecom policy.

Transform in a time bound manner, the telecommunications sector to a greater competitive environment in both urban and rural areas providing equal opportunities and level playing field for all players;

Achieve efficiency and transparency in spectrum management.”

3.3 The Authority has kept in mind the twin objectives of growth of service as well as having fair competition and level playing field in telecom sector while arriving at the present recommendations. Thus the primary focus of the Authority is on the need to promote growth of the sector in a conducive atmosphere which would attract investments in this capital intensive sector and at the same time to ensure that proper safeguards are put in place for ensuring that investments that flow into the sector are properly channeled into development and expansion of the sector. There is a need to ensure that any additional investment on the basis of certain concessions granted to the service providers by the Government with a view to promoting growth of the sector do not get converted into windfall gains for a few players or for the new investors and are indeed utilized for the purpose behind the making of such Governmental concessions. Of particular significance in this context is the fact that spectrum which is a limited national resource comes bundled with the UAS license. Any improper use of the license granted for the provision of telecom service needs to be prevented not only for the purpose of ensuring efficient utilization of this scarce resource but also for preventing any profit making by individual players on the basis of the spectrum so made available to them.

3.4 As already noted in the Consultation paper on the subject, a telecom license is issued to an entity to participate in and contribute to the growth of the telecom sector. Any acquiring of the telecom license with the intention of trading of the license, premature capitalization of equity or early exit would not only defeat the very purpose of granting the licenses but would also be against national interest. It is in this

context that the Government of India has sought the recommendations of the Authority on the question of prohibition of sale of promoters' equity for UAS license holders.

Issues, Analysis and Recommendations

3.5 Issue – Need for a Lock-in period on sale of equity of promoters who have 10% or more stakes in the company and whose net-worth has been taken in to consideration for determining the eligibility for grant of UAS License.

- ***The duration of the lock-in period;***
- ***The date from which the lock-in period is to be reckoned;***
- ***Mechanism to address the earlier licenses which did not have a lock-in condition;***
- ***Linking of sale of equity with the fulfillment of roll out obligations;***
- ***Measures to prevent entry of fly-by-night operators in the telecom sector; and***
- ***Prior intimation/permission for any change in the equity holdings.***

3.5.1 Stakeholder's Comments

3.5.1.1 Comments received from the stakeholders on the issue of lock-in indicate that they are divided on this issue. Those who have not favored a lock-in condition have however, stated that in case lock-in is to be introduced, it should be for new licenses issued after the proposed amendment.

3.5.1.2 Stakeholders who are opposed to the lock-in have commented that the lock-in period is no longer necessary since competitive

conditions already exist with 5-7 access service providers in any service area and a number of others planning to start their services soon. The lock-in period, in their view, will only hamper growth of telecom market and competition. They have further argued that despite exponential growth and the intense competition, the telecom industry even after 15 years of operation is cash flow negative. Capital efficiency of the sector is an important pre-requisite for achieving consumer interest in a sustainable manner. Further growth and coverage of the rural and remote areas would entail huge investment. Against the backdrop of economic downturn, it is a challenge to raise investible funds, and there is a need for valuable foreign investments. It has also been suggested that what is required is that the bi-annual intimation of shareholding pattern of the company be further strengthened by additional post-intimation of change in shareholding pattern, immediately when such a change occurs.

3.5.1.3 Some stakeholders have expressed a view that as long as the shares of the promoter (who have 10% or more stake in the Licensee Company and whose net worth have been taken into consideration for determining the eligibility for grant of license) are purchased by a third party who continues to meet the net worth requirement under the license and continues to hold 10% or more of the total shares of the Licensee Company, transfers should be freely permitted in accordance with all the relevant laws of the country. Further since the sector is highly capital-intensive, therefore in the event that the promoters fall short of capital and the lock-in period is applicable, the roll-out obligations of the company may not be met.

3.5.1.4 Stakeholders' have also argued that the issue of lock-in should not be considered in isolation and the entire competition policy needs to be reviewed holistically and the guidelines for mergers and acquisitions form a key element of that holistic review. That the

current M&A guidelines are very restrictive by international standards and the Indian customers would benefit from the greater operational efficiency that could be realized through consolidation. The stakeholders have also argued that as existing operators are not allowed to trade spectrum; it is inappropriate to allow operators to trade spectrum via the back-door through mergers and acquisitions. M&A should therefore be restricted to ongoing businesses, not shell companies that hold only spectrum. The concept of introducing a lock-in period for licensees who have just acquired spectrum is understandable pending the introduction of a comprehensive policy on spectrum trading, spectrum entitlements and M&A.

- 3.5.1.5 A group of stakeholders have suggested that since the UAS licenses have been bundled with spectrum and allocated prices that do not reflect the true market value of the scarce resource, a lock-in of promoters' equity may be necessary in order to prevent speculative profiteering.
- 3.5.1.6 One stakeholder has stated that policy and regulation should allow for free and natural play of market forces along with adequate safeguards to ensure that the interest of subscribers is protected. One view has also been that if the concern is about promoters who obtain a UAS License, and associated GSM spectrum at an administered price, and try to use the License as an arbitrage opportunity, then the Regulator may like to have the promoters see the project through, and they should be able to access debt, public equity etc. But change of management control for arbitrage must be strictly disallowed for 2 to 5 years.
- 3.5.1.7 Some stakeholders have opposed any such measure arguing that the concept of fly-by-night operators has not been experienced in the telecom arena so far and there is no need to impose any new

condition on any of the telecom service providers whether new or old.

- 3.5.1.8 Others have argued that to call some licensees as fly by night operators for undertaking transactions, which are well within their license terms, is unfair. Companies that have been providing CMTS and Basic services since 1995 and now have a pan-India presence cannot be termed as fly-by-night operators. The licenses are issued to the companies and not to any specific promoter of a licensee company. The sale of equity by any promoter(s) to another experienced investor, does not change the roll out obligation of the licensee company who remains bound to roll out the services as per the license conditions.
- 3.5.1.9 Some stakeholders have stated that the extremely high net worth requirements for promoters set out in the UAS license, by their very nature demand that dedicated and committed players enter the sector. Therefore, there is no requirement to add any additional measures. Others have suggested that the issue can be addressed by examining the credentials of the applicants/promoters before grant of UAS licenses. That the bi-annual intimation of shareholding pattern of the company can be strengthened by additional post-intimation of change in shareholding pattern, immediately when such a change occurs, has also been suggested.
- 3.5.1.10 One of the stakeholders has mentioned that as spectrum comes bundled with the UAS License, which is issued to a company at a fixed price, mergers and acquisitions should be restricted to ongoing businesses, not shell companies that hold only spectrum.
- 3.5.1.11 Allocation of spectrum at market prices, requirement for submission of a business plan and proposed financing plan till the point where the licensee meets with at least 50% of the roll-out obligations, are some other measures suggested.

3.5.2 Analysis

Lock in provisions under the CMTS/UAS licenses

3.5.2.1 The Authority noted that the lock-in conditions for promoters (both foreign and Indian) were in existence when the Cellular Mobile Telephone Service (CMTS) licenses in telecom circles were initially granted in 1995. Subsequently, on migration from fixed license fee regime to revenue share as per NTP-99, the condition for lock-in of the present shareholding for a period of 5 years from the effective date was incorporated. In 2001, the CMTS licenses were amended to incorporate these revised lock-in conditions and other stipulations. The condition relating to lock-in of equity shareholding of promoters also existed for the 3rd and 4th CMTS licenses issued in 2001.

3.5.2.2 In November 2003, the UAS licensing regime was introduced. The existing Basic and CMTS licensees were allowed to migrate to UAS Licenses. The relevant conditions of the license agreement regarding promoters and their equity are reproduced below:

“Except **prior permission** in writing by Licensor there shall be no change in the foreign promoter(s) or their equity participation. Normally there will be no objection in substituting an existing foreign promoter by another foreign promoter of similar standing subject to the total foreign equity being below the prescribed limit.”
(Clause 1.2)

“The licensee company may, **under intimation to Licensor** replace a promoter(s) by another promoter(s) as stipulated below:

- (a) the Indian Promoter(s) or person(s) acquiring the foreign promoter’s shareholding; and
- (b) Transfer of equity between Indian promoters or person(s) including Indian employees of the company.” (Clause 1.3)

“In case of company listed at a stock exchange(s), shares bought and sold by way of any transaction through the stock exchange(s) where the Company shares or depository receipts are listed will not be treated as change of equity for the purpose of this clause subject to total prescribed foreign equity ceiling unless otherwise it leads to change in management control within the definition of SEBI Act.”
(Explanation below Clause 1.4)

- 3.5.2.3 The Authority noted that vide issuance of Press Notes No. 5 (2005 Series) and 3 (2007 Series) of Department of Industrial Policy and Promotion (DIPP), the limit of FDI in telecom sector was enhanced from 49% to 74%. The conditions regarding prior permission and intimation to the licensor were also amended, requiring a Licensee to furnish a compliance report on 1st January and 1st July to the Licensor on compliance of FDI norms and security conditions.
- 3.5.2.4 The licenses that had been awarded in 1995 and subsequently in 2001 were on the basis of a competitive bidding. The price of the license was determined through a market-discovery mechanism. There were also restrictions on FDI. Yet there was a lock-in of equity. The objective apparently was to ensure serious entrants, an objective which still holds. Paragraph 5.G (ii) of the Guidelines for UASL issued on 14th December, 2005 stated **“In order to ensure that at least one serious resident Indian promoter subscribes reasonable amount of the resident Indian shareholding, such resident Indian promoter shall hold at least 10 per cent equity of the licensee company”**.
- 3.5.2.5 The arguments opposing the lock-in condition mainly include that it would make investment in telecom unattractive, affect competition and consequent higher prices for end users. It is also argued that huge resources are required for the next phase of rollout into rural and remote areas for which foreign investment will play a key role and policy and regulation should be such that it

attracts rather than deters foreign investment. However, the stakeholders have not been able to show any correlation between lock-in of promoters' equity and reduction in investment or competition. It may be recalled that during the Interconnect Usage Charge (IUC) exercise the issue of negative cash-flow of industry was examined and the Authority noted that overall the industry have positive cash flow and EBITDA Margin, except a few companies.

3.5.2.6 As communicated by the DoT in their reference seeking recommendations of TRAI, the considered view of the Full Telecom Commission has been that “the promoters who have 10% or more stakes in the company and whose net worth has been taken into consideration for determining the eligibility for grant of UAS license should not sell their equity in the UAS Licensee Company for a period of 3 years from the effective date of license(s).”

3.5.2.7 The disclosures by the Licensee company of the details of the Indian and Foreign promoters /shareholders with their respective equity holdings in the Licensee Company and their respective net-worth as disclosed on the date of signing of the License Agreement (Condition 1.1) were done away with in the amendments in the UAS licenses through DoT letter dated 14.12.05.

3.5.2.8 Condition 10 of the Guidelines makes a mention about promoters. The word ‘Promoter(s)’ has however, not been defined either in the Guidelines for UAS License or the License Agreement. The application for License to provide UASL requires furnishing the details of promoters/partners/shareholders in the Company as follows:

“7. (a) Details of Promoters/Partners/Shareholder in the Company: The Promoters to be indicated.

S.No.	Name of Promoter/ Partner/Shareholder	Indian/ Foreign	Equity %age.	Networth
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(Complete break-up of 100% of equity must be given. Equity holding upto 5% of the total equity shared among various shareholder can be clubbed but Indian and Foreign equity must be separate.)”

Promoter (s)

3.5.2.9 The term “Promoter” finds its place in the company law. Also, there is no general definition of the expression ‘promoter’ in the Companies Act, 1956 although; the term is used expressly in Sections 62, 69, 76, 478 and 519. Sub-section (6) of Section 62 of the Companies Act, 1956 contains a definition of the expression ‘promoter’ but the said definition is limited for the purposes of that section only i.e., for purpose of civil liability for misrepresentations in the prospectus of a company. The said definition reads as follows:

“(6) For the purpose of this section ---

(a) the expression ‘promoter’ means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company; and

.....”

3.5.2.10 The judiciary in its various pronouncements has defined the term ‘promoter’ as one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose. Bowen, L.J. in *Whaley Bridge Printing Co. v. Green* [1880] 5 B.D. 109 at page 111 observed that the term promoter is “a term not of law but of

business operations familiar to the commercial world by which a company is brought into existence”.

3.5.2.11 The Authority has further noted that in USA, Rule 405(a) of the Securities Exchange Commission (SEC) defines a ‘promoter’ ‘as a person who, acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing the business enterprise’.

3.5.2.12 Indian securities market Regulator, the Securities and Exchange Board of India (SEBI) has also defined the expression “promoter” in its Regulation on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997. Regulation 2(1)(h) contain the following definition of the term “promoter”, namely:

“Promoter” means -

- (a) any person who is in control of the target company;
- (b) any person named as promoter in any offer document of the target company or any shareholding pattern filed by the target company with the stock exchanges pursuant to the Listing Agreement, whichever is later;

and includes any person belonging to the promoter group as mentioned in Explanation I:

Provided that a director or officer of the target company or any other person shall not be a promoter, if he is acting as such merely in his professional capacity.

Explanation I: For the purpose of this clause, 'promoter group' shall include:

(a) in case promoter is a body corporate -

- (i) a subsidiary or holding company of that body corporate;

(ii) any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter;

(iii) any company in which a group of individuals or companies or combinations thereof who holds 20% or more of the equity capital in that company also holds 20% or more of the equity capital of the target company; and

(b) in case the promoter is an individual -

(i) the spouse of that person, or any parent, brother, sister or child of that person or of his spouse;

(ii) any company in which 10% or more of the share capital is held by the promoter or an immediate relative of the promoter or a firm or HUF in which the promoter or any one or more of his immediate relative is a member;

(iii) any company in which a company specified in (i) above, holds 10% or more, of the share capital; and

(iv) any HUF or firm in which the aggregate share of the promoter and his immediate relatives is equal to or more than 10% of the total.

Explanation II: Financial Institutions, Scheduled Banks, Foreign Institutional Investors (FIIs) and Mutual Funds shall not be deemed to be a promoter or promoter group merely by virtue of their shareholding. Provided that the Financial Institutions, Scheduled Banks and Foreign Institutional Investors (FIIs) shall be treated as promoters or promoter group for the subsidiaries or companies promoted by them or mutual funds sponsored by them.”

3.5.2.13 The concept of promoter is also enunciated in the Securities and Exchange Board of India (Disclosure and Investor Protection)

Guidelines, 2000 (“DIP Guidelines”), which is mostly from the perspective of disclosure and investor protection.

3.5.2.14 It is important to note that the purpose behind the definition of “promoters” in Securities and Exchange Board of India (SEBI) Disclosure and Investor Protection (DIP) guidelines is multifold – to find out the direct/indirect stake of persons who are in control, performance track record of companies which are promoted by such entities and to exclude their stake to find out minimum floating stock for the company to remain listed etc.

3.5.2.15 The Authority has also noted that “to be a promoter one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter”³. A person who does not take prominent part may also have so acted in the formation of a company as to bring himself under the term promoter. [*Official Liquidator v. Velu Mudaliar* [1938] 8 Comp. Cas. 7].

3.5.2.16 It is also noted that in India, “the promoter or promoters of the principal of them are usually persons who, in forming the company, secure for themselves the management of the company in forming, or persons who convert their own private business into a limited company, public or private, and secure for themselves more or less a sinecure position and/or controlling interest in the company’s management”⁴.

3.5.2.17 Section 2 of the Income Tax Act, 1961 contains various definitions for the words used in the Act. Section 2(31) defines ‘person’ inclusively and the said clause reads as follows:

³ *Lagunas Nitrate Co.v.Lagunas Syndicate* (1899) 2 Ch. 392 (p.428,C.A.).

⁴ A.Ramaiya , *Guide to the companies Act*,16th edn.,p.790.

Definition of 'Person' as per Section 2 (31) of the Income Tax Act, 1961

"person" includes

- (i) an individual,
- (ii) a Hindu undivided family,
- (iii) a company,
- (iv) a firm,
- (v) an association of persons or a body of individuals, whether incorporated or not,
- (vi) a local authority, and
- (vii) every artificial juridical person, not falling within any of the preceding sub-clauses;
.....”

Role and responsibility of the Promoter(s)

3.5.2.18 The Authority has also examined the relationship of promoters and the company, as observed in various legal cases. It has been noted that the relationship between a promoter and the company that he has floated must be deemed to be a fiduciary relationship from the day the work of floating the company starts⁵ and continues up to the time that the directors take into their hands what remains to be done in the way of forming the company [Twycross v. Grant 1877 2 C.P.D.469]. The status of a promoter is generally terminated when the Board of Directors has been formed and they start governing the company. The legal position of a promoter is described in table given below;

Legal position of a promoter

While the accurate description of a promoter may be difficult, his legal position is quite clear. The promoters occupy an important position and have wide powers relating to the formation of a company. It is, however, interesting to note that

⁵ CIT v. Bijli Cotton Mills Ltd (1953) 23 Comp. Cas. 114.

so far as the legal position is concerned, he is neither an agent nor a trustee of the proposed company. He is not the agent, because there is no company yet in existence and he is not a trustee because there is no trust in existence. But it does not mean that the promoter does not have any legal relationship with the proposed company.

The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed. Lord Cairns has stated the position of a promoter in *Erlanger v. New Sombrero Phosphate Co.* (39 LT 269), “the promoters of a Company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the Company.” They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begins to act as a trading corporation. Similarly, it was observed in *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899 2 CH 392), that: “The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become shareholders in it.” Lord Justice Lindley in *Lidney & Wigpool Iron ore Co. v. Bird* [1866] 33 Ch. D 85 described the position of a promoter as follows:

“Although not an agent for the company, nor a trustee for it before its formation the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is perfectly well settled that a promoter of a company is accountable to it for all monies secretly obtained by him from it just as the relationship of the principal and agent or the trustee and cestui que trust had really existed between him and the company when the money was obtained.”

Source: Taxmann’s Company Law and Practice

3.5.2.19 The Authority also examined the duties of the promoters under the Companies Act and noted that the Companies Act, 1956 contains no specific provisions regarding the duties of promoters. It merely imposes liability on promoters for untrue statements in prospectus they are parties to (Sections 62 & 63), and for fraudulent trading (Section 542). The courts, however, have been conscious of the possibility of abuses inherent in the promoters' position and therefore laid down that any one, who can properly be regarded as promoter stands in a fiduciary position towards the company with all the duties of disclosure and accounting. In particular, the two fiduciary duties imposed on a promoter are:

- (1) not to make any **secret profit** out of the promotion of the company:
- (2) to disclose to the company any interest which he has in a transaction entered into by it.

Share capital

3.5.2.20 The capital of the company is divided in to a number of indivisible units of a fixed amount. These units are known as 'shares'. According to section 2 (46) of the Companies Act, 1956, a share is a share in the share capital of a company. A share reflects the contribution of a shareholder towards the share capital of the company. That is why a share is essentially a unit of measuring a member's interest in the company. Each share is required to have a sum of money assigned as its nominal value. Such a share is known as a par value share. Where no value is assigned, it is no par value share.

3.5.2.21 The Authority has noted that in India, a share is regarded as 'goods'. Section 2 (7) of the Sale of Goods Act, 1930 defines 'goods' to mean any kind of movable property other than actionable claims and money and includes stock and shares. However, section 82 of the Companies Act, 1956 while recognizing shares as movable

property, further provides that they shall be transferable only in the manner provided by the articles of the company.

3.5.2.22 In the case of Vishwanathan vs. East India Distilleries & Sugar Factories Ltd (1957) 27 comp.Cas175: AIR 1957 Mad 341, it was observed:

“A share is undoubtedly movable property but it is not movable property in the same way in which a bale of cloth or a bag of wheat is movable property. Such commodities are not brought into existence by legislation, but a share in a company belongs to a totally different category or property. It is incorporeal in nature, and it consists merely of a bundle of rights and obligations.”

3.5.2.23 As per the Companies Act, 1956, only two kinds of shares can be issued by a public company. Section 86 of the Companies Act, as amended by the Companies (Amendment) Act, 2000, provides that the new issues of share capital of a company limited by shares shall be of two kinds only, namely:-

(a) Equity Share Capital

- I. With voting rights; or
- II. With differential rights as to dividends, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed⁶;

(b) Preference share capital

3.5.2.24 The Authority has further noted that Private Companies are exempted from the provisions of Section 86⁷ unless it is a subsidiary of a public company. That means that such companies’

⁶ The prescribed Rules are Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 vide GSR SO 167 (E), dated 9th March 2001.

⁷ Section 90 of Companies Act, 1956

may create and issue any other kinds of share capital and on any terms as they may think fit.

Preference Shares or Preference share Capital

3.5.2.25 Preference share capital means that part of the share capital of the company which fulfils both the following requirements:-

- 1) During the life of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount payable to preference shareholders before anything else is paid to the equity shareholders. Alternatively, the amount payable as preference dividend may be calculated at a fixed rate, e.g., 10% of the nominal value of each share.
- 2) On the winding-up of the company it must carry a preferential right to be paid, e.g., amount paid up on preference shares must be paid back before anything is paid to equity shareholders. This preference, unless there is an agreement to the contrary, exists only up to the amount paid up or deemed to have been paid on these shares as in the case of subscribers to the Memorandum of Association.

Equity Shares

3.5.2.26 The equity shares are those shares which are not preference shares. In other words, shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital are known as equity shares. After satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable profits of the company.

3.5.2.27 The dividend on equity shares is not fixed and may vary from year to year depending upon the amount of profits available. The rate of dividend is recommended by the Board of Directors of the company and declared by shareholders in the annual general meeting (AGM).

3.5.2.28 In a public company and a deemed public company⁸ equity shareholders have a right to vote on every resolution placed in the meeting and the voting rights shall be in proportion to the paid-up equity capital. As compared to this, the holders of preference shares can vote only on such resolutions which directly affect the rights attached to the preference shares. However, if the preference dividend⁹ is not paid fully for more than two years, the preference shareholders shall also get voting right on every resolution placed before the company.

Deferred / Founders' shares

A private company may issue what are known as deferred or founders' shares. Such shares are normally held by promoters and directors of the company. That is why they are usually called founder's shares. These shares are usually of a smaller denomination, say one rupee each. However, they are generally given equal voting rights with equity shares which may be of higher denomination, say Rs. 10 each.

Source: Taxmann's Company Law and Practice

Lock-in period

3.5.2.29 It is a well-accepted fact that the regulatory enforcement agencies have introduced the concept of lock-in period to protect the interest of the various stakeholders (including the Government) and to fix the responsibility of the management or promoters.

3.5.2.30 Lock-in periods are generally intended to prevent shareholders with a large proportion of ownership (such as company executives) from flooding the market with shares during the initial trading period. An IPO (Initial Public Offer) lock-in is a common lock-in

⁸ A Private company which is subsidiary of a public company will be treated as a public company .

⁹ Section 87 of the Companies Act, 1956.

period in the equities market, used for newly issued public shares. While IPO lock-in periods are generally in the range of two to six months or so, long lock-in periods of two years or more are also common for hedge funds, etc. Such longer lock-in periods are meant to protect majority of assets in the funds and to enable portfolio managers to keep a lower amount of cash on hand.

3.5.2.31 Long lock-in periods under ESOP schemes also help prevent employees' attrition, as the concerned employees would generally wait for the end of such lock-in period so that they can sell the shares before leaving the company. Lock-in periods prescribed for various purposes can be based on either the purpose sought to be achieved by the company in prescribing them as part of the offers or the requirement of law/regulatory framework. The Securities and Exchange Board of India (SEBI) has, as a part of its Guidelines on "Disclosure and Investor Protection" (DIP), prescribed certain requirements as to minimum promoters' contribution and lock-in period for (a) minimum promoters' contribution and (b) excess promoters' contribution. According to these guidelines, in case of any issue of capital to the public, the minimum promoters' contribution shall be locked in for a period of 3 years. An extract of the relevant provisions of these guidelines is as follows:

Extracts from Chapter IV of SEBI (DIP) Guidelines on Promoters' Contribution and Lock-in Requirements

Promoters' Contribution

- In a public issue by an unlisted company, the promoters shall contribute not less than 20% of the post issue capital.
- The promoters' shareholding after offer for sale shall not be less than 20% of the post issue capital.
- In case of public issues by listed companies, the

promoters shall participate either to the extent of 20% of the proposed issue or ensure post-issue share holding to the extent of 20% of the post-issue capital.

- Pledged securities held by promoters shall not be eligible for computation of promoters' contribution.
- The requirement of promoters' contribution shall not be applicable:
 - in case of public issue of securities by a company which has been listed on a stock exchange for at least 3 years and has a track record of dividend payment for at least 3 immediately preceding years.
 - In case of companies where no identifiable promoter or promoter group exists.

LOCK-IN REQUIREMENTS

- In case of any issue of capital to the public the minimum promoters' contribution shall be locked in for a period of 3 years.
- The lock-in shall start from the date of allotment in the proposed public issue and the last date of the lock-in shall be reckoned as three years from the date of commencement of commercial production or the date of allotment in the public issue whichever is later.
- In case of a public issue by unlisted company, if the promoters' contribution in the proposed issue exceeds the required minimum contribution, such excess contribution shall also be locked in for a period of one year.
- In case of a public issue by a listed company, participation by promoters in the proposed public issue in excess of the required minimum percentage shall also be locked-in for a period of one year as per the lock-in provisions as

specified in Guidelines on Preferential issue.

- The entire pre-issue capital, other than that locked-in as minimum promoters' contribution, shall be locked-in for a period of one year from the date of allotment in the proposed public issue.
- Securities issued on firm allotment basis shall be locked-in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.
- Locked-in Securities held by promoters may be pledged only with banks or financial institutions as collateral security for loans granted by such banks or financial institutions, provided the pledge of shares is one of the terms of sanction of loan.
- If securities are locked in as minimum promoters' contribution, the same may be pledged, only if, in addition to fulfilling the requirements of this clause, the loan has been granted by such banks or financial institutions for the purpose of financing one or more of the objects of the issue.
- Shares held by promoter(s) which are locked in as per the relevant provisions of this chapter, may be transferred to and amongst promoter/ promoter group or to a new promoter or persons in control of the company, subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, as applicable.'

3.5.2.32 The concept of "lock-in of equity" has to be clearly understood with a view to distinguish it from that of "lock-in of equity percentage". While the former denotes an embargo to be placed on the

sale/transfer of any equity in real terms during a specified period, the latter denotes a requirement by which the equity holder has to keep his stake in a company at a specified minimum percentage. While the “lock-in of equity” is aimed at prevention of sale or transfer of the existing equity holdings held by the particular equity holder, the “lock-in of equity percentage” requires the particular equity holder to maintain a prescribed minimum percentage of his equity holdings vis-à-vis the total equity capital of the company, by requiring equity holder to acquire a certain part of additional equity whenever raised with a view to maintain the specified minimum percentage after issuance of such fresh equity. Depending upon the purpose sought to be achieved, a requirement may be to –

- (a) either freeze the present equity capital of the promoters in a company with a view to ensure that the original promoters still remain with the company with their respective shareholdings; and/or
- (b) impose an obligation on the promoters to maintain a specified minimum percentage of equity participation by requiring them, whenever the company raises additional equity by issuance of fresh equity or by way of private placement, to correspondingly increase their own equity participation, if needed, so as to maintain the specified minimum percentage of promoters’ equity in the post issue scenario with a view to ensure that the promoters have the same significant say in the management and control of the company.

3.5.2.33 The Authority has endeavored to address both the above scenarios. The issue at (b) above arises on issue of additional equity and is discussed in the later part of this Chapter.

3.5.2.34 In the Telecom Sector stipulating a lock-in period has significance since it ensures that the promoter (s) whose net-worth has been considered to determine the eligibility for grant of license is a

serious entrant, and does not trade spectrum which is a scarce resource that comes bundled with the license and has been obtained by virtue of possessing a UAS license. This position holds true even with heightened competition in the telecom sector. This is particularly relevant as the earlier provision regarding technical knowledge and experience in telecom sector no longer exists.

3.5.2.35 The Authority has noted that as per the prescribed application form for grant of UAS licence, the applicant company is required to submit details of business plan along with the funding arrangement for financing the project. It clearly implies that before applying for a UAS license, the applicant should have a proper and definite plan in place to finance and execute the project. Therefore, situations requiring the need to sell equity in the licensee company immediately on receipt of the licence to fund and/or execute the project should be viewed with great care and caution as any sale of equity in the wake of the grant of licence would raise concerns regarding the intent of such sale. Trading of license and spectrum, either directly or indirectly, with profit making as the sole objective of obtaining a license rather than provision of telecom service and improvement in accessibility, has to be prevented by putting in place adequate safeguards against it. A lock-in period for promoter's equity would not only ensure the participation by serious players, but also make certain their commitment to the telecom sector. It can also be said in favour of lock-in that lock-in of promoters' equity instills confidence in the licensee company, ensures commitment and seriousness of the promoters and also provides stability to the sector.

3.5.2.36 Any transaction in the equity of a licensee company (whether sale of equity by promoters or the issue of fresh/additional equity) has a bearing on ownership of the licensee company and, in certain circumstances, might result in indirect transfer of license, which is

prohibited as per the licence condition on restriction on transfer of license. The need to have a lock-in of promoters' equity for a specified period is therefore, obvious.

3.5.2.37 As regards the contention of some of the stakeholders that lock-in condition cannot be applied to existing licenses and such condition should be for new licenses issued after such amendments in license agreement, the Authority has noted that as per Clause 5 (Modifications in the Terms and Conditions of Licence) of Unified Access License Agreement, it is open to the Licensor to amend the terms and conditions of the license at any time. The relevant clause (clause 5.1) of the UAS license agreement reads as under:

“The LICENSOR reserves the right to modify at any time the terms and conditions of the LICENCE, if in the opinion of the LICENSOR it is necessary or expedient to do so in public interest or in the interest of the security of the State or for the proper conduct of the telegraphs”.

3.5.2.38 In the light of this clause and the fact that an opinion is formed by the Licensor after the issuance of the licence does not take away the right of the licensor to make amendments to the terms and conditions of licence. Therefore, the contention that any amendment in the terms and conditions of licence in respect of “lock-in” of promoters' equity should be made applicable only to licences to be issued in future and not to licences already issued is not found legally tenable and flies in the face of the express provisions of the licence agreement. In fact, there have been a number of amendments in the licence agreements in the past to effect modifications in terms and conditions of the license. The Authority believes that the lock-in of promoters' equity is in the best interest of the telecom sector as well as in the public interest and the Licensor, in exercise of the rights reserved to it under clause 5.1 of the licence agreement, can modify the terms and

conditions of the existing license agreements to prescribe such lock-in period in the interest of the telecom sector and in the larger interest.

Roll Out obligations

3.5.2.39 The Authority in its recommendations on “Review of license terms and conditions and capping of number of access providers” (August 28, 2007), after seriously evaluating/examining the need for continuance or otherwise of roll out obligations, had concluded that:

“5.11 The roll out obligations is justified in terms of stability and level playing field. DoT has recently granted new UAS licensees and the telecom operators/licensees have yet to initiate/complete roll out obligations. A non-discriminatory treatment would require that all the licensees are subjected to similar obligations as it has cost implications in addition to other financial and technical considerations.

5.12 The stipulation of roll out obligation reduces the scope for spectrum hoarding. It is particularly relevant as the existing UAS license has inbuilt arrangement for allocation of first tranche of spectrum in a specified band. The roll out obligation discourages non-serious players and promotes well dispersed efficient usage of spectrum. It also avoids cherry picking, ensures faster spread of telecom infrastructure and discourage concentration in lucrative pockets thus bridging the digital divide.”

3.5.2.40 Since roll out of service is part and parcel of the execution of the project as well as a condition in the license agreement, arguments, that the roll out obligations of the licensee company may not be met in case the promoters fall short of capital and the lock-in

period is applicable, are not well founded. Linking of lock-in with fulfillment of roll out obligations also makes sense, as it would ensure provision of telecom service, for which the license is granted, before any sale/transaction of promoters' equity and would guarantee the earnestness of promoters.

3.5.2.41 The provisions of roll out obligations in the license agreements specify at least 10% of the District Headquarters (DHQs) to be covered in the first year and 50% of the District Headquarters within three years of effective date of License in case of Category "A", "B" and "C" Service Areas and 90% of the service area, street as well as in-building coverage within one year of the effective date in case of Metro Service Areas.

3.5.2.42 The Authority noted that the DoT as Licensor has recently amended the CMTS/UAS License Agreements for Roll-out obligations (DoT letters No. 842-320/2005-VAS-II(Vol.III)/25, 27 dated 10th Feb., 2009, available on DoT website – www.dot.gov.in). The amendments inter-alia include:

- “(i) Roll-out obligations shall apply for wireless network only and not for wireline network.
- (ii) The Licensee shall ensure that metro service area of Delhi, Mumbai, Kolkata and Chennai are covered **within one year of date of allocation of start up spectrum**.
- (iii) In non-metro service areas, the licensee shall ensure that in first phase of roll out obligation **at least 10% of DHQs where start up spectrum has been allocated are covered within one year of such spectrum**. The date of allocation of frequency shall be considered for computing a final date of roll-out obligation.

- (iv) Further, in second phase of roll out obligation, the licensee shall ensure that at least 50% of DHQs, where start up spectrum has been allocated are covered within three years of date of allocation of such spectrum in non-metro service areas.
- (vi) While computing the period of one year under sub-para (ii) to (iv) above the average delay in SACFA clearance shall be excluded.”

3.5.2.43 Thus the above amendments stipulate two important changes from the existing provisions – one; applicability of roll out obligations to wireless network only and two; reckoning of period of one/three years for roll out obligation from date of allocation of spectrum instead of effective date of license. It is understood that the roll out obligations would uniformly apply to all UAS licensees including those who have started out with a wireline network pending spectrum allocation.

3.5.2.44 The commitment of a service provider towards telecom sector and achievement of tele-density targets set by the Government (600 million lines by the year 2012) can be ensured by meeting of roll out obligations. Authority, therefore, considers that promoters of such of those licensees, who have fulfilled their roll out obligations, may be permitted to sell their stake during the lock-in period with the prior written approval of the Licensor subject to certain conditions that would safeguard against the sale of equity merely for windfall earnings.

Fly-by-night / windfall gains

3.5.2.45 The concept of fly-by-night operator and windfall gains come into the picture only when there is an early exit of a promoter by selling its equity/stake in the licensee company at a premium without doing whatsoever to establish the infrastructure and/or to provide

the telecom service. In case, any sale or exit takes place after the desired activities under the license, there shall neither be any question of fly-by-night operator nor will there be any objection on any gains obtained by the promoters by selling their equity/stake.

3.5.2.46 The Authority noted the meaning of ‘windfall Gain’ from the Economic Dictionary¹⁰ as “unexpected profit from a business or other source. The term connotes gaining huge profits without working for them — for example, when oil companies profit from a temporary scarcity of oil”.

3.5.2.47 The Authority further noted the prevailing practice in the telecom sector, where the acquirer pays heavy valuation to acquire an entity and the “Enterprise value” placed is much higher than “Accounting value”. It is important to note that the promoters strive hard to enhance the enterprise value of their project by adopting a multi-pronged strategy. This involves a careful incubation of network across the licensed service areas, hiring a strong management team, installing robust billing system, strong channel partners and above all, an aggressive selling strategy to build a critical mass of customer base. In their aggression to inflate enterprise value, some operators end up creating “ghost subscribers¹¹” to attract better valuation.

3.5.2.48 The Enterprise value (EV) refers to the market capitalization of a company plus debts. When an investor acquires a company, it takes over not only the assets of the company, but also assumes the liability to pay the existing debts and liabilities of the company.

¹⁰ <http://www.answers.com/topic/windfall> (*The New Dictionary of Cultural Literacy, edited by James Trefil, Joseph F. Kett, and E. D. Hirsch, published by Houghton Mifflin Company, "Business and Economics"*)

¹¹ Ghost subscribers refer to low value prepaid cards, which are sold by channel partners to unwilling end users. These cards are not likely to yield much revenue to the operator, but just retained as customers to show an inflated subscriber base and fetch higher valuations.

Thus, Enterprise value is the sum total of all fair value of assets and the liabilities of the acquired entity.

3.5.2.49 In the context of the expression, “fly-by-night operators” and “windfall gains” used by the DoT in their reference letter seeking recommendations of TRAI, the DoT had been requested to furnish various information/ documents relating to any transaction involving sale of/change in equity of a UAS Licensee that has taken place after the grant of new licenses (Annexure B). The DoT has informed that the information sought by TRAI are exhaustive and it would take time to provide the same. In the absence of such information, the Authority was unable to take a view on the transactions that may have taken place.

3.5.2.50 It has been widely reported in newspapers that transactions of exceptionally high value for the shares in some telecom companies have taken place even before commencement of the service leading to perceptions/conjectures that the UAS licenses which come bundled with spectrum had been obtained at below market rates. In this regard, the DoT’s position expressed through their Press Note¹² dated 7th November, 2008 has been –

“... it is clarified that the foreign companies have entered into agreement to subscribe to the new equity shares of the Company. No share of the founding promoters of the companies have been sold. Hence, the question of **windfall** gain or for that matter any gain for the promoters does not arise. ... These funds in the company will be utilized for the establishment of network including infrastructure. It is clarified that it is necessary for such licensees to seek technical, managerial and financial support from suitable collaborators in order to successfully comply with

¹² Source: <http://pib.nic.in/release/release.asp?relid=44661&kwd=windfall>

licence conditions which involves telecommunication operations. The valuations being quoted are “post-money” – it reflects the value of the funds applied to the business and not the value of the licence or spectrum. ...”

3.5.2.51 Authority has noted that in the Income Tax Act, 1961, there are various provisions, which prescribe creation of special reserves or reserve accounts and their usage for designated purposes in accordance with the Act. The Indian Accounting Standard (AS) 14 deals with the accounting for amalgamations. Paragraph 18 of the Standard deals with treatment of reserves on amalgamation. It inter alia states that certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income Tax Act, 1961; for example, Development Allowance Reserve or Investment Allowance Reserve. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation in the nature of purchase, the identity of reserves is not preserved, an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as ‘statutory reserves’) and such reserves retain their identity in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statutes.

Provisions in Income Tax Act, 1961 regarding “Reserve Accounts” or “Special Reserve”

- **Section 32A** regarding Investment Allowance allows a deduction by way of investment allowance equal to twenty-five per cent of the actual cost of the ship, aircraft,

machinery or plant subject to fulfillment of a condition that an amount equal to seventy-five per cent of the investment allowance to be actually allowed is debited to the profit and loss account and credited to a **reserve account (to be called the Investment Allowance Reserve Account)** to be utilised for the purposes of acquiring a new ship or a new aircraft or new machinery or plant and until the acquisition of a new ship or a new aircraft or new machinery or plant, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

- **Section 115VT** provides for Transfer of profits to Tonnage Tax Reserve Account wherein a tonnage tax company is required to credit to a reserve account an amount not less than twenty per cent of the book profit to be utilised for acquiring a new ship for the purposes of the business of the company; and until the acquisition of a new ship, for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India.

3.5.2.52 The Authority is of the opinion that any profits arising out of sale of promoters' stake during the lock-in period should be transferred to the Consolidated Fund of India since the Central Government has transferred its "exclusive privilege of establishing, maintaining and working telegraphs ...". The Authority also recognizes that the notable growth in the Indian Telecom sector and provision of affordable service to the consumers is largely due to the effort of service providers, the liberalized policy regime and positive regulatory environment. The Authority does not wish to disturb the healthy growth environment and would therefore suggest that

50% of such gains arising from the sale of promoters' stakes during the lock-in period should be ploughed back to the Licensee Company for investment for telecom network expansion only.

3.5.2.53 The Authority further feels that there should be a strong reporting system for any changes in the management or change in the stake of promoters in the Licensee Company during the license period.

3.5.3 The Authority makes the following recommendations:

- (i) The expression 'Promoter' should be defined in the License Agreement. The suggested definition is "A person who, acting alone or in conjunction with other persons, directly or indirectly takes the initiative in founding or organizing the business enterprise to establish, maintain or work a telegraph within any part of India." The expression 'person' shall have the same meaning as defined in the Income Tax Act, as amended from time to time and 'telegraph' as in the Indian Telegraph Act, 1885 as amended from time to time.**
- (ii) The details of the promoters, whose net-worth has been taken into consideration for determining the eligibility for grant of UAS license, should be clearly identified and indicated separately in the license agreement. Complete break-up of 100% of equity and net-worth (which was considered for eligibility) must be given. Suggested format for details of equity of the licensee company on the effective date of license (i.e., the effective date so specified in the license agreement) is given below:**

S.No.	Name & address of Promoter/ Partner/ Shareholder	Specify whether Promoter/ Partner/ Shareholder	Indian/ Foreign	No. of equity shares held (Face value of each share)	Amount of equity capital (Rs.)	Share in total Equity share capital (%)	If Networth considered for eligibility, then amount of Networth (Rs. in
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							crore)
1
...
				(Total shares)	(Total equity capital)	(100%)	(Total networth)

(iii) There should be a lock-in of the equity share capital of promoter(s), whose net-worth has been taken into consideration for determining the eligibility for grant of UAS license, for a period of three years from the effective date.

However, with prior written approval of the Licensor and on fulfillment of roll out obligations, the promoters may be permitted to sell their equity share even during the lock-in period, subject to the following condition:

(a) 50% of the profit earned on sale transaction of promoter(s) equity shall be retained in the business as a special reserve and utilized for telecom network expansion only. The balance 50% of the profit shall be transferred to the Licensor. The profit on sale of such shares shall be defined as “the difference between sale value/agreed value of equity shares on the date on which the transfer of such shares takes place and their face value on the date of application for UAS Licence.”

The DoT should, in consultation with the Ministry of Law and Ministry of Finance, explore the possibility of imposing this condition (iii (a) above) on the sale transactions, if any, that have already taken place.

(iv) Where the present promoter (s) is/are different from the promoter (s) based on whose net-worth the license was granted, the stake of such present promoter (s) shall also be subject to the above lock-in conditions.

- (v) **In addition to the present reporting system, any change or dilution in the stake of promoters' share in the total equity share capital of the licensee company shall be informed by the Board of Directors to the Licensor within 2 days of such change taking place. A Certificate from the Company Secretary and Statutory Auditors shall be filed within 15 days from the date of transaction.**

3.6 Issue – *Additional equity share capital by the licensee companies/their holding companies by way of private placement/public issues*

- ***Dilution of equity of promoters, having 10% or more stakes and whose net worth was taken into consideration for determining the eligibility for grant of UAS license***
- ***Restrictions on change in management control***

3.6.1 Stakeholders' comments

- 3.6.1.1 Some stakeholders are of the view that additional equity may be allowed without observing any lock-in period. They have stated that the telecom sector is a capital intensive sector. In such a case it is necessary for the development of the sector that the companies be allowed to access the widest possible sources of funds to carry out their projects. A company should not be restricted from infusion of more capital from the market / private placement necessary for expansion of the business. Also the provisions of the Companies Act, 1956 relating to issue of additional share capital do not restrict any company from issuing further share capital.
- 3.6.1.2 One of the stakeholders is of the view that this should not be allowed because this may pave a gateway to fly-by-night operators to reduce their stake in the licensee company. Another stakeholder

has stated that if issue of additional/fresh equity by a licensee company is a loophole to dilute holding, it should be regulated under lock-in norms. A stakeholder has also stated that issue of additional/fresh equity be permitted during lock-in period subject to existing Promoters maintaining certain threshold holding i.e. 10% and above by subscribing to new shares.

3.6.1.3 As regards the issue of restriction on dilution of equity of promoters in terms of percentage of shareholding and/or the number of shares held at the time of grant of license, most of the stakeholders are of the opinion that the Promoter or Promoter Group should be expected to maintain at least 10% equity even in the enlarged equity capital. Another stakeholder has commented that dilution of stake of promoters should be restricted both in terms of percentage of shareholding as well as the number of shares held at the time of grant of license. One stakeholder has also stated that since telecom is such a capital intensive sector, the companies should be allowed to access capital through dilution of equity holding of the promoters. The provisions in relation to transfer in clause 6.3 of the license agreement could be extended to dilution of the original promoters' shareholding. A stakeholder is of the opinion that there is no need for any modification of the existing provisions of the UASL. However, if imposed, restriction should be limited to 10% of the paid up equity of the company at any given time or the number of shares held at the time of issue of UASL, whichever is less.

3.6.1.4 On the issue of restriction on change in management control in addition to conditions restricting dilution of equity, most of the stakeholders have commented that there should be no restriction on change in management control. They have argued that the new infusion of capital and consequent change in management will boost the company and lead to renewed competition within the service area. Any serious player making an investment in the

telecom company would rightfully like to participate in the management of the affairs of the company.

- 3.6.1.5 Some stakeholders have favoured more restrictions on change in management to prevent the backdoor entry of other stakeholders and that change of management control for arbitrage must be strictly disallowed, say for 3 or 5 years.

3.6.2 Analysis

- 3.6.2.1 Issue of additional equity shares arise when a company wants to bring in additional resources for capital investment, diversification/ growth of business. This could be either within the existing authorized but yet unsubscribed share capital, or through increase in the authorized share capital, if the shares are already subscribed to the extent of existing authorized shares. In the Public Issue, the amount of equity (capital) is raised by a public company by issue of shares to the public after complying with the provisions of the Companies Act and SEBI Guidelines in this regard.

Board of Directors' responsibility

- 3.6.2.2 The Authority noted that it is the responsibility of the Licensee Company to ensure the compliance of various terms and conditions as given in the license agreement. It is important to note that a Company works through its Board of Directors / the directors. A company is indeed a person, but a juridical person and the directors as a body endow the juridical person with human face that can act and react. Under the scheme of the Companies Act, the Company itself and its directors or the Board of the directors are primary agents of the company to transact its operations.
- 3.6.2.3 The Authority noted that companies can procure their capital fund through issue of additional shares. Issues of shares may be made in the several ways discussed below:

- By Private placement of shares;
- By allotting entire shares to an 'issue-house', which in turn, offers the shares for sales to the public; and
- By inviting public to subscribe for shares in the company through a prospectus.

Private Placement of Shares

- 3.6.2.4 The Authority noted from the Companies Act that a private company limited by shares is prohibited by the Act and the articles from inviting the public for subscription of shares or debentures. Its shares are generally issued privately to a small number of persons known to the promoters or related to them.
- 3.6.2.5 A public company can also raise its capital by placing the shares privately and without inviting the public for subscription of its shares or debentures. In this kind of arrangement, an underwriter or a broker finds person, normally his clients who wish to buy the shares. He acts merely as an agent and his function is simply to procure a buyer for the shares, i.e., to place them. Since no public offer is made for shares, there is no need to issue any prospectus. However, under Section 70 of Companies Act, such a company is required to file with the Registrar, a statement in lieu of prospectus at least three days before making allotment of any shares or debentures.
- 3.6.2.6 The Authority further noted that as per the guideline issued by the SEBI, private placement by a public company of its shares should not be made by subscription of shares from unrelated investor through any kind of market intermediaries. This means that promoter shares should not be contributed by subscription of those shares by unrelated investors through brokers, merchant banker etc. However, subscription of such shares by friends, relatives and associates is allowed.

By allotting entire shares to an 'Issue-House'

3.6.2.7 Under such type of arrangement, the company allots or agrees to allot shares at a price to a financial institution(s) or an issue house for sale to the public. The Issue House publishes a document called an offer for sale, with an application form attached, offering to the public, shares for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus (Section 64 (1)). On receipt of applications from the public, the Issue-House renounces the allotment of the number of shares mentioned in the application in favour of the applicant purchaser who becomes a direct allottee of the shares.

Inviting public through prospectus

3.6.2.8 Inviting public through prospectus is the most common method by which a company seeks to raise capital from the public. The company invites offers from members of the public to subscribe for the shares through prospectus. An investor is expected to study the prospectus and if convinced about the prospects of the company, may apply for shares.

Issue of Shares to the existing shareholders

3.6.2.9 Capital may also be raised by issue of 'rights shares' to the existing shareholders (Section 81 of the Companies Act, 1956). In this case, the shares are allotted to the existing shareholders in proportion to their original their shareholding.

Rights shares

3.6.2.10 Section 81 of the Companies Act lays down certain conditions for further issue of shares to be first offered to the existing members of the company. Such shares are known as 'rights shares' and the right of the members to be so offered is called the 'right of pre-emption'.

- 3.6.2.11 Section 81 of the Act provides that where at any time after the expiration of two years from the date of incorporation of the company or after one year from the date of the first allotment of shares, whichever is earlier, a public company limited by shares, issues further shares within the limits of the authorized capital, its directors must first offer the shares to the existing holders of equity shares in proportion, as nearly as circumstances admit to the capital paid up on the shares at the time of the further issue.
- 3.6.2.12 The Authority agrees that telecom is a capital intensive sector and issue of additional equity share is one of the primary sources of funding for a company apart from debt. The Authority is of the view that it may be left to the wisdom of the licensee companies as to when and which source they want to tap for execution of licensed activities. The licensee company/its holding company may be allowed to issue additional/fresh equity share capital in accordance with the statutory provisions.
- 3.6.2.13 The Authority also recognizes that the issue of fresh/additional equity shares has direct bearing on ownership of the licensee company. Generally, in such cases, where founder promoters do not participate in the issue of additional equity shares through private placement or any other mode, such transactions will naturally dilute the stake of promoters in the concerned company/licensee Company and may also be a cause for change in management control if their stake is diluted substantially. It might result in indirect transfer of license, which is prohibited as per the condition on restriction on transfer of license. As regards the issue of management control, the existing provisions in UASL agreement provide that management control of the Licensee Company shall remain in Indian hands [Clause 1.4 (iii)]. Clause 10 of the Guidelines for UAS license also provides that “The minimum net-worth and paid-up capital shall be maintained during currency of the Licence.” Clause 5G of the Guidelines further provides “...to

ensure that at least one serious resident Indian promoter subscribes reasonable amount of the resident Indian shareholding, such resident Indian promoter shall hold at least 10 per cent equity of the licensee company.”

3.6.3 The Authority recommends:

- (i) Issue of additional equity share capital by the licensee companies/their holding companies by way of private placement/public issues should be permitted in accordance with statutory provisions (SEBI and Companies Act) subject to the condition that during the period coinciding with the lock-in period on sale of promoters' equity, the equity of the promoter (s) shall not fall below 10% of the total aggregate equity share holdings after such private placement or public issue, as the case may be. This requirement shall be in addition, and without prejudice, to any requirement as to lock-in of promoter's equity under the SEBI (DIP) guidelines.**
- (ii) Management control of the licensee company shall be governed by the terms and conditions of the License Agreement.**

3.7 Issue – *Applicability of lock-in provisions to the shares transferred pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers*

3.7.1 Stakeholders' Comments

3.7.1.1 Stakeholders have suggested that lock-in provision shall not be applicable to transfer of such shares. They have also stated that no change is required in existing conditions on transfer of license. One stakeholder has suggested that under license condition, it should be provided that FII/Bank can further sale/transfer such securities

to parties who comply with the eligibility conditions for allotment of a fresh license. They have also suggested that in case of lock-in, any pledge of promoters' shares during the currency of lock-in period be permitted with the prior written consent of the DOT. After completion of lock-in period, promoter may be required to intimate pledge of shares by promoters to DOT.

3.7.2 Analysis

3.7.2.1 Authority recognizes that pledging of shares with the FIs/banks could be one of the means to raise resources to finance the project. The existing terms and conditions in UAS License Agreement provide certain restrictions on transfer of license.

3.7.2.2 Condition 6.1 of the Agreement stipulates that “The LICENSEE shall not, without prior written consent as described below, of the LICENSOR, either directly or indirectly, assign or transfer this LICENSE in any manner whatsoever to a third party or enter into any agreement for sub Licence and/or partnership relating to any subject matter of the LICENCE to any third party either in whole or in part i.e. no sub leasing/partnership/third party interest shall be created”. As per Condition 6.3, “Further, the Licensee may transfer or assign the License Agreement with prior written approval of the Licensor to be granted on fulfillment of the following conditions and if otherwise, no compromise in competition occurs in the provisions of Telecom Services:

- (i) When transfer or assignment is requested in accordance with the terms and conditions on fulfillment of procedures of Tripartite Agreement if already executed amongst the Licensor, Licensee and Lenders.”.
- (ii) A format for tripartite agreement between the Licensor, the Licensee and the Agent (the lender itself or an Agent for the lenders) is also prescribed in the license agreement. The

tripartite agreement provides for transfer or assignment of the license in favour of the selectee (an Indian Company) selected by the lenders in case of default committed by the licensee.

3.7.2.3 The License conditions cover transfer of License and not transfer of share of promoters. As discussed earlier, the Guidelines for UAS License provide: “In order to ensure that at least one serious resident Indian promoter subscribes reasonable amount of the resident Indian shareholding, such resident Indian promoter shall hold at least 10 per cent equity of the licensee company.” (Clause 5.G). Press Note No. 5 (2005 Series) of the Department of Industrial Policy and Promotion also contains the following stipulations in this regard, namely:

“

G. Department of Telecommunications (DoT) will enforce the above and the conditions mentioned below through appropriate amendment in licence:-

.....

(ii) In order to ensure that at least one serious resident Indian promoter subscribes reasonable amount of the resident Indian shareholding, such resident Indian promoter shall hold at least 10 per cent equity of the licensee company.

.....”

3.7.2.4 The amendment to the UASL agreement made in 2005 introduced the said clause in the licence agreement. However, the existing UASL agreement (2008) does not contain this clause.

3.7.2.5 For the purpose of meeting the eligibility criteria on equity and networth, the net worth of only those promoters shall be counted who have at least 10% equity stake or more in the total equity of

the company. As a lock-in condition has been recommended to ensure participation of the promoters' in the licensee company for a minimum period of three years, invoking of pledge during the lock-in period would tantamount to diluting the condition of lock-in.

- 3.7.2.6 It may also be stated that the Securities and Exchange Board of India (SEBI) "Disclosure and Investor Protection" (DIP) Guidelines provide that securities pledged by promoters shall not be eligible for computation of promoters' contribution. It means that the promoters are required to maintain the minimum contribution towards equity capital after excluding the shares pledged by them. It also implies that only the promoters' contribution in excess of their minimum contribution can be pledged.
- 3.7.2.7 Ideally, the pledged shares should not be counted towards networth of the promoters to determine eligibility for grant of license. Where the licenses have already been granted, this is no longer possible. In order to ensure participation of promoters in the company for a minimum period of three years, pledging of locked-in shares should not be allowed or if allowed, the pledgee should not be allowed to invoke the pledge during the lock-in period.
- 3.7.2.8 The transfer of shares pursuant to enforcement of pledge by the lending FIs/Banks due to events of defaults committed by the borrowers might also have a bearing on ownership of the licensee company in case a large number of shares were pledged. The provisions relating to transfer/assignment of license in accordance with the terms and conditions and procedures of tripartite agreement between the Licensor, Licensee and lenders already take care of raising of funds/loans for execution of licensed project and transfer/assignment of license in the event of defaults by the licensee. There is no case, therefore, for permitting transfer of promoters' shares pledged to the lending institutions in pursuance of enforcement of pledge during the lock-in period.

3.7.3 The Authority, therefore, recommends that transfer of shares of promoters, whose net-worth has been considered to determine eligibility for grant of UAS license, pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers, shall not be allowed during the lock-in period without prior written approval of the Licensor. This provision shall also apply to the present promoters where they are different from the original promoters.

3.8 Issue – *Restriction on declaration of special dividend by the company for a period coinciding with the lock-in period in case of issue of fresh equity*

3.8.1 Stakeholders' comments

3.8.1.1 Some of the stakeholders have stated that such restriction should apply to future licenses. Some others, that there should not be any restriction on declaration of special dividend by the company.

3.8.1.2 A stakeholder has stated that such restriction should also apply to existing licensees who have obtained their first telecom license in the last 3 years and have not yet rolled out services. One stakeholder has argued that declaration of special dividend may just be another loophole to reward promoters via transference of excess cash gained from issue of fresh equity. Such practice should be restricted till the lock-in clause is in play. The new licensees need all the funds they have for rolling out services and any kind of dividend must be avoided at this juncture. The end use of proceeds is for growth of business and not for special dividends. Also as per Companies Act, any dividend is to be paid out of profits only, after taking into account depreciation etc. When the business is yet to be established, the stakeholders have argued that there is no case for dividend.

3.8.2 Analysis

- 3.8.2.1 The Authority noted that under the Companies Act, there is no such word as “Special dividend”. “Special dividend”, can therefore, be considered as an “extra dividend”, in the form of interim dividend or otherwise. In general parlance, special dividend is considered as a kind of non-recurring distribution of company’s assets or profits, usually in the form of cash or bonus shares to its shareholders.
- 3.8.2.2 Having regard to the fact that the Companies Act, 1956 does not define the term “special dividend”, it has become necessary to discuss the concept of special dividend in the *context* of the said Act and the principles governing declaration of special dividends as culled out from various commentaries on the subject. A dividend, as is understood by the commercial world, is the return on the investment of a shareholder in a company. A company is a channel through which capital flows from individuals to industry and hence, the law does not prescribe any restrictions on the payment of dividends by companies to their shareholders which may act as an impediment to such flow of capital from individual to enterprise. The law, however, puts a general restriction that only profits must be distributed by way of dividends and that in working out profits, depreciation must be provided and that previous losses should be made up. The result is a liberal concept of profit for dividend purposes.
- 3.8.2.3 It is a cardinal principle of company law that dividends can be paid only out of profits. The Companies Act, 1956 specifically provides that no dividend shall be declared or paid by a company for any financial year except out of the profits of the company after providing for depreciation. The intention behind the provision for depreciation is that the assets of the company should be maintained for the benefit of the creditors and should not be given

away to the shareholders by way of dividends. The legal meaning of “profits” is maintaining the capital intact and taking out the surplus of current year’s receipts over expenses. (Dent V. London Tamways Co. (1880) 16 Ch D 344 as quoted in A Ramaiya – Guide to the Companies Act, 16th Edition - Page 1904).

- 3.8.2.4 Special dividends are most often used to return capital to shareholders. Generally, special dividends are declared after exceptionally strong company earnings as a way to distribute the profits directly to shareholders. Special dividends can also occur when a company wishes to make changes to its financial structure or spin off a subsidiary company for its shareholders.
- 3.8.2.5 The Authority’s concern is for situations where declaration of special dividends by a licensee company is resorted to as a method to return back a significant part of additional inflow of cash to its promoters or initial shareholders, which company has obtained through its issue of additional/fresh equity, particularly in case of private placement of additional equity.
- 3.8.2.6 The Authority noted that the dictionary meaning of ‘dividend’ is “sum payable as interest on loan or as profit of a company to the creditors of an insolvent’s estate or an individual’s share of it”. In commercial usage, however, ‘dividend’ is the share of the company’s profits distributed among the members¹³.
- 3.8.2.7 The Institute of Chartered Accountants of India (ICAI)¹⁴ has defined ‘dividend’ as “a distribution to shareholders out of profits or reserves available for this purpose”.
- 3.8.2.8 The Authority noted that the term ‘dividend’ is also used to include distribution of the company’s assets, in cash or *in specie*, which remain with the liquidator after he has realized all the assets and

¹³ *Barior Hoshangi Vakil v. Mettur Chemical & Industrial Corporation Ltd.* [1963] 33 Comp. Cas. 932.

¹⁴ *Guidance Note on Terms used in Financial Statements.*

discharged all the liabilities, in the event of its winding up. In the matter of “Commissioner of Income Tax v. Girdhar Das & Co. (P) Ltd”. [1967] 21 Comp. L.J. the Hon’ble Supreme Court defined the expression ‘dividend’ as follows:

“As applied to a company which is a going concern, it ordinarily means the portion of the profits of the company which is allocated to the holders of shares in the company. In the case of winding-up, it means a division of the realized assets among creditors and contributories according to their respective rights”.

Provisions under the Companies Act, 1956

3.8.2.9 Though the question of determining the amounts out of the profits of the company which is to be distributed by way of dividends is generally left to the company, the provisions of Section 205 statutorily lay down the principles that should guide companies in the matter of determination of profits for purposes of distribution by way of dividend.

3.8.2.10 As per the Companies (Amendment) Act, 2000, the term ‘dividend’ includes any interim dividend also. This definition assumes that the term should be understood only in its commercial sense and has only widened its scope to include “interim dividend. However, issue of bonus shares by capitalizing accumulated profits is not construed as dividend.

3.8.2.11 It is important to note that all the profits of a company cannot be said to be divisible. Only those profits, which can legally be distributed to the shareholders of the company in the form of dividend, are called as ‘divisible profits’. However, specific definition of ‘divisible profits’ has not been laid down even by the Companies Act. In *Buenos Ayres Great Southern Rly. Co., In re* [1947] Ch. 384 ‘divisible profits’ were described to mean the profits which the directors consider should be distributed after making provision for past losses, reserves and for other purpose.

3.8.2.12 The Authority noted that as per Section 205 of the Companies Act, dividends may be declared out of the following three sources:

1. Current profits
2. Past reserves created out of profits or credit balance in the profit and loss account brought forward.
3. Out of moneys provided by Government, if any.

3.8.2.13 According to Section 205 of the Act, no dividend can be declared or paid except out of profits¹⁵ of the company arrived at after providing depreciation or out of money's provided by the Central or State Government for the payment of dividends in pursuance of a guarantee given by the Government. Before declaring dividends, Section 205 (2A) of the Companies Act requires that a company must transfer a prescribed percentage of its profit (not exceeding 10%) to its reserves¹⁶. However, if the rate of dividend proposed is 10% or less, then no transfer to reserve is required.

Payment of dividend out of Capital

3.8.2.14 The Authority noted that dividends are not allowed to be declared out of capital. The only situation where a return on investment may be allowed out of capital is where interest is paid out of capital on the shares of the company, with the previous approval of the Central Government under section 208 of the Companies Act.

3.8.2.15 Section 208 provides that where shares are issued to raise money to defray the cost of works or building or of plant which cannot be made profitable for a long period, the company may pay interest on the amount of the capital paid-up in respect of such shares, and may charge the same to capital as part of the cost of works, buildings or plant provided. The following conditions are required to be satisfied:

¹⁵ Only out of current profit, past reserves created out of profits or credit balance in the Profit and Loss Account brought forwarded.

¹⁶ According to "The Companies (Transfer of Profits to Reserves) Rules, 1975"

- (a) The payment is authorized by the articles and prior sanction of the Central Government obtained.
- (b) The payment of interest is made only for such period as may be determined by the Central Government and that period shall in no case extend beyond the close of the half year next after the half year during the work or building has been actually completed or the plant provided.
- (c) The rate of interest shall, in no case, exceed four percent per annum or such other rate as the Central Government may notify in the official Gazette.
- (d) The payment of interest must not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

Provisions under the Income Tax Act, 1961

3.8.2.16 The Authority also examined the various provisions of Income Tax Act, 1961 and noted that under section 2(22) of the Income Tax Act, the following payments or distributions by a company to its shareholders are deemed as dividends to the extent of accumulated profits of the company:

- a. any distribution entailing the release of the company's assets [sec. 2(22)(a)];
- b. any distribution of debentures, debenture-stock, deposit certificates and bonus to preference shareholders [sec. 2(22)(b)];
- c. distribution on liquidation of the company [sec. 2(22)(c)];
- d. distribution on reduction of capital [sec. 2(22)(d)];
- e. any payment by way of advance or loan to the following:

- i) a shareholder (being a person who is beneficial owner of equity shares holding not less than 10 percent of the voting power; or
- ii) any concern in which such shareholder is a member or a partner and in which he has substantial interest [sec. 2 (22) (e)].

Explanations to dividends under the Income Tax Act.

1. Any subsequent dividend to the extent it is set off against any loan or advance [deemed as dividend under section 2(22) (e)] is not treated as “dividend”
2. The expression “concern” for the purpose of this provision, means a Hindu undivided family or a firm or an association of persons or a body of individual or a company. Further, a person shall be deemed to have a substantial interest in a concern, other than a company, if such person is at any time during the previous year beneficially entitled to not less than 20 per cent of the income of such concern. In relation to a company, the provisions of section 2(32) will apply.
3. With effect from the assessment year 2000-01, the following shall not be treated as “dividend”-
 - a) any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77 (A) of the Companies Act; or
 - b) any distribution of shares made in

accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.

3.8.2.17 The intent of the Government is to prevent non-serious players in enriching themselves by first getting license and then issuing additional shares and returning the capital by paying extraordinary dividends for the augmented equity. The Authority, however, feels that after the recommendation for lock-in of promoters' stake, the provisions in the Companies Act and Income tax Act should govern the declaration of payment of Dividend on the new share capital/fresh equity or promoter's share capital.

3.8.3 The Authority recommends that the declaration of dividend/special dividend shall be governed by the statutory provisions under the Companies Act, 1956.

3.9 Issue – *Applicability of conditions for licensees holding UAS/CMTS licenses for a period of 3 years on acquiring any new UAS licenses in some service areas in order to enlarge their area of operations –*

- ***Lock-in on sale of equity;***
- ***Issue of additional equity share capital;***
- ***Transfer of shares pursuant to enforcement of pledge by the lending FIs/Banks; and***
- ***Declaration of special dividend***

3.9.1 Stakeholders' comments

3.9.1.1 Most of the stakeholders have stated that existing UAS/CMTS licensees should be allowed to acquire any UAS license in some other service area for enlarging their area of operations without any additional conditions like lock-in period etc. One stakeholder has stated that the distinction between mergers and acquisitions is artificial and makes the policy vulnerable to creative deal arbitrage. Mergers and acquisitions have a common economic impact which is to reduce the number of licensees in a service area and combine the network, assets and customer bases of the licensees. Mergers and acquisitions should be restricted to ongoing businesses, not shell companies that hold only spectrum. Another stakeholder has commented that issue of fresh equity for acquisition of a new license in another service may be permitted if it was a part of the original business plan submitted by the licensee. Under no circumstance, should issue of additional equity be allowed to finance payment of special dividend. Another stakeholder has commented that the issue of lock in should not be considered in isolation, the entire competition policy needs to be reviewed holistically and the guidelines for mergers and acquisitions form a key element of that holistic review.

3.9.2 Analysis

3.9.2.1 The DoT's proposal states that the restriction on sale of equity of promoters in UAS Licensee Company and declaration of special dividend in case money is brought into the company by issue of fresh equity would not be applicable to the licensees holding UAS/CMTS licenses for a period of 3 years if they acquire any new UAS licenses in some service areas in order to enlarge their area of operations.

3.9.2.2 In dealing with this issue the Authority's understanding of DoT's reference has been:

- The UAS/CMTS licensee has been in existence for three years;
- The acquisition is through applying to the Licensor by such licensee(s) for a new UAS license in another service area and not through merger and acquisitions;
- In case such licensees acquire a new UAS license, exemption from the conditions listed above would apply equally to their existing licenses as well as their newly acquired licenses.

3.9.2.3 The issue of M&A has been dealt with extensively in the recommendations dated 28.08.2007 on "Review of License terms and conditions and capping of number of access providers". Subsequently, the DoT issued guidelines for intra service area merger of CMTS/UAS Licenses on 22nd April 2008. These guidelines stipulate prior approval of the DoT for merger of the licenses and also provide that merger shall be restricted to the same service area. One of the conditions in these guidelines stipulates that any permission for merger shall be accorded only after completion of 3 years from the effective date of License. The Authority has already suggested vide letter dated May 23, 2008 to the DoT to include acquisition within the scope of the merger to remove any ambiguity in this regard and to clarify that merger is only consequent to merger or amalgamation or acquisition or restructuring of operations as was the case in 2004 guidelines.

3.9.2.4 In view of these developments, provisions relating to merger and acquisition are not being addressed through these recommendations and the Authority's consideration has been limited to the issues raised in the reference received from the DoT.

3.9.2.5 Since the new licenses are being acquired by the existing licensee (s) in order to enlarge their area of operations, i.e., to expand business, any exemption from any of the conditions applicable to other licensees would be against the notion of fair play and a level playing field.

3.9.3 The Authority, therefore, recommends that all the above recommendations shall apply mutatis mutandis to the licensees holding UAS/CMTS licenses for a period of three years, if they acquire from the Licensor any new UAS license in some other service area in order to enlarge their area of operations.

CHAPTER 4

SUMMARY OF RECOMMENDATIONS

The Authority recommends the following:

- 4.1 *Need for a Lock-in period on sale of equity of promoters who have 10% or more stakes in the company and whose net-worth has been taken in to consideration for determining the eligibility for grant of UAS License.***

Recommendations

- (i) The expression ‘Promoter’ should be defined in the License Agreement. The suggested definition is “A person who, acting alone or in conjunction with other persons, directly or indirectly takes the initiative in founding or organizing the business enterprise to establish, maintain or work a telegraph within any part of India.” The expression ‘person’ shall have the same meaning as defined in the Income Tax Act, as amended from time to time and ‘telegraph’ as in the Indian Telegraph Act, 1885 as amended from time to time.**
- (ii) The details of the promoters, whose net-worth has been taken into consideration for determining the eligibility for grant of UAS license, should be clearly identified and indicated separately in the license agreement. Complete break-up of 100% of equity and networth (which was considered for eligibility) must be given. Suggested format for details of equity of the licensee company on the effective date of license (i.e., the effective date so specified in the license agreement) is given below:**

S.No.	Name & address of Promoter/ Partner/ Shareholder	Specify whether Promoter/ Partner/ Shareholder	Indian/ Foreign	No. of equity shares held (Face value of each share)	Amount of equity capital (Rs.)	Share in total Equity share capital (%)	If Networth considered for eligibility, then amount of Networth (Rs. in crore)
1
...
				(Total shares)	(Total equity capital)	(100%)	(Total networth)

(iii) There should be a lock-in of the equity share capital of promoter(s), whose net-worth has been taken into consideration for determining the eligibility for grant of UAS license, for a period of three years from the effective date.

However, with prior written approval of the Licensor and on fulfillment of roll out obligations, the promoters may be permitted to sell their equity share during the lock-in period, subject to the following condition:

(a) 50% of the profit earned on sale transaction of promoter(s) equity shall be retained in the business as a special reserve and utilized for telecom network expansion only. The balance 50% of the profit shall be transferred to the Licensor. The profit on sale of such shares shall be defined as “the difference between sale value/agreed value of equity shares on the date on which the transfer of such shares takes place and their face value on the date of application for UAS Licence.”

The DoT should, in consultation with the Ministry of Law and Ministry of Finance, explore the possibility of

imposing this condition (iii (a) above) on the sale transactions, if any, that have already taken place.

- (iv) Where the present promoter (s) is/are different from the promoter (s) based on whose net-worth the license was granted, the stake of such present promoter (s) shall also be subject to the above lock-in conditions.
- (v) In addition to the present reporting system, any change or dilution in the stake of promoters' share in the total equity share capital of the licensee company shall be informed by the Board of Directors to the Licensor within 2 days of such change taking place. A Certificate from the Company Secretary and Statutory Auditors shall be filed within 15 days from the date of transaction.

4.2 *Additional equity share capital by the licensee companies/their holding companies by way of private placement/public issues*

Recommendations:

- (i) Issue of additional equity share capital by the licensee companies/their holding companies by way of private placement/public issues should be permitted in accordance with statutory provisions (SEBI and Companies Act) subject to the condition that during the period coinciding with the lock-in period on sale of promoters' equity, the equity of the promoter (s) shall not fall below 10% of the total aggregate equity share holdings after such private placement or public issue, as the case may be. This requirement shall be in addition, and without prejudice, to any requirement as to lock-in of promoter's equity under the SEBI (DIP) guidelines.

- (ii) **Management control of the licensee company shall be governed by the terms and conditions of the License Agreement.**

4.3 *Restriction on declaration of special dividend by the company for a period coinciding with the lock-in period in case of issue of fresh equity.*

Recommendation:

The declaration of dividend/special dividend shall be governed by the statutory provisions under the Companies Act, 1956.

4.4 *Applicability of lock-in provisions to the shares transferred pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers*

Recommendations:

Transfer of shares of promoters, whose net-worth has been considered to determine eligibility for grant of UAS license, pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers, shall not be allowed during the lock-in period without prior written approval of the Licensor. This provision shall also apply to the present promoters where they are different from the original promoters.

4.5 *Applicability of conditions for licensees holding UAS/CMTS licenses for a period of 3 years on acquiring any new UAS licenses in some service areas in order to enlarge their area of operations –*

Recommendations:

All the above recommendations shall apply mutatis mutandis to the licensees holding UAS/CMTS licenses for a period of three years, if they acquire from the Licensor any new UAS license in some other service area in order to enlarge their area of operations.

Table 1 (Refer Chapter 2/Para 2.2)

Terms and conditions in License Agreements over the years relating to lock-in, M&A, Substantial Equity and Transfer/Assignment of License

Circle CMTS Agreement in 1995	Amendment in CMTS Agreement under Migration to Revenue sharing Regime of NTP 1999	Circle CMTS Agreement in 2001	UASL Agreement in 2003	Amendment in UASL Agreement in 2005	Existing UASL Agreement (2008)
CONDITIONS RELATING TO LOCK-IN					
<p>The License is granted on the express condition that the equity of foreign promoter (s) whose network or experience or both have been taken into consideration for determining the eligibility of the licensee shall not fall below 10% of the total aggregate for a period of 3 years from the effective date. Further, the equity of the Indian promoter (s) shall not fall below 10% of the total aggregate or the equity held at the time of bidding whichever is lower, for a period of 3 years from the effective date. (Clause 16)</p>	<p>There shall be a lock-in of the present share holding for a period of five years counted from the date of license agreement i.e. effective date.</p> <p>During that period, any transfer of share holding directly or indirectly through subsidiary or holding companies shall not be permitted. However, issue of additional equity share capital by the licensee company/its holding company by way of private placement/public issue was permitted. Further, the aforesaid lock-in provisions were not applicable in case the shares were transferred pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers with the condition that such shares should have been pledged for investment only in the particular licensed project.</p> <p>Provided always that with</p>	<p>“There shall be no change in the Indian and Foreign promoter(s) or their equity participation unless permitted by the LICENSOR in writing.” (Clause 1.2)</p> <p>“The licensee company may, with prior written consent of the Licensor replace a promoter(s) by another promoter(s) of equal or higher standing as stipulated below:</p> <p>(a) an existing foreign promoter may be substituted by another foreign promoter of similar standing;</p> <p>(b) the existing Indian Promoter(s) may also be allowed to acquire the foreign promoter’s shareholding; and</p> <p>(c) transfer of equity inter-se between existing Indian promoters may be permitted, provided the majority Indian</p>	<p>“Except prior permission in writing by Licensor there shall be no change in the Foreign promoter(s) or their equity participation. Normally there will be no objection in substituting an existing foreign promoter by another foreign promoter of similar standing subject to the total foreign equity being below the prescribed limit.” (Clause 1.2)</p> <p>“The licensee company may, under intimation to Licensor replace a promoter(s) by another promoter(s) as stipulated below:</p> <p>(a) the Indian Promoter(s) or person(s) acquiring the foreign promoter’s shareholding; and</p> <p>(b) transfer of equity between Indian promoters or person(s) including Indian employees of the company.” (Clause 1.3)</p>	<p>No clause on lock-in and removal of permission for change in foreign promoters or their equity participation and removal of intimation for transfer of equity between Indian Promoter(s) acquiring the foreign promoter’s shareholding. Instead, it was amended to the effect:</p> <p>In order to ensure that at least one serious resident Indian promoter subscribes reasonable amount of the resident Indian shareholding, such resident Indian promoter shall hold at least 10 per cent equity of the licensee company.</p>	<p>No lock-in condition.</p> <p>The LICENSEE shall declare the Indian & Foreign equity holdings (both direct and indirect) in the Licensee Company and submit a compliance report regarding compliance of FDI norms and security conditions on 1st day of January and 1st day of July on six monthly basis to the LICENSOR. This is to be certified by the LICENSEE Company’s Company Secretary or Statutory Auditor. (Clause 1.2)</p> <p>Any change in share holding shall be subject to all applicable statutory permissions (Clause 1.4 (i))</p>

	<p>prior written approval of Licensor:</p> <p>(a) an existing foreign promoter can be substituted by another foreign promoter of identical or similar standing and experience;</p> <p>(b) Any existing Indian Promoter can acquire the foreign partner's shareholding;</p> <p>(c) Transfer of equity, inter-se, amongst Indian promoters can be permitted subject to the condition that the majority holding Indian partner continues to hold the original shareholding for a period of five years from the effective date of licence agreement.</p>	<p>promoter continues to hold at least the present shareholding for a period of five years from the effective date of licence agreement. (Clause 1.3)</p> <p>Any change in shareholding shall be subject to all necessary statutory requirements. (Clause 1.4 (i))</p>	<p>"In case of company listed at a stock exchange(s), shares bought and sold by way of any transaction through the stock exchange(s) where the Company shares or depository receipts are listed will not be treated as change of equity for the purpose of this clause subject to total prescribed foreign equity ceiling unless otherwise it leads to change in management control within the definition of SEBI Act." (Explanation below Clause 1.3)</p> <p>Any change in shareholding shall be subject to all applicable statutory permissions (Clause 1.4 (i))</p>	<p>The Indian & Foreign equity holdings in the LICENSEE company as disclosed by the LICENSEE company on the date of signing of the LICENCE AGREEMENT, are as follows:</p> <p>INDIAN EQUITY.....</p> <p>FOREIGN EQUITY.....</p> <p>The LICENSEE shall declare the above information as on 1st January and 1st July by 7th January and 7th July respectively to LICENSOR. This is to be certified by the LICENSEE company's company secretary or statutory auditor.</p> <p>The LICENSEE shall also ensure that any change in share holding shall be subject to all necessary statutory requirements.</p>	
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MERGER AND ACQUISITION AND SUBSTANTIAL EQUITY

No such condition	Merger of Indian companies can be permitted as long as competition is not compromised.	The merger of Indian companies may be permitted as long as competition is not compromised; TRAI will be consulted by the licensor in	The merger of Indian companies may be permitted as long as competition is not compromised as defined in	The merger of Indian companies may be permitted as long as competition is not compromised as	The merger of Indian companies may be permitted as long as competition is not compromised as defined
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	<p>No single company/entity shall have any equity in more than one licensee company in the same service area for same service.</p>	<p>this matter. (Clause 1.2(c)</p> <p>“No single company/legal person, either directly or through its associates, shall have substantial equity holding in more than one licensee company in the same service area for the same service. ‘Substantial equity’ herein will mean ‘an equity of 10% or more’. A promoter company cannot have stakes in more than one licensee company for the same service area.” (Clause 1.4 (ii))</p>	<p>condition 1.4(ii).” (Clause 1.3.1)</p> <p>“No single company/legal person, either directly or through its associates, shall have substantial equity holding in more than one licensee company in the same service area for the Access Services namely; Basic, Cellular and Unified Access Service. ‘Substantial equity’ herein will mean ‘an equity of 10% or more’. A promoter company/Legal person cannot have stakes in more than one Licensee Company for the same service area.” (Clause 1.4 (ii))</p> <p>Note: Clause 1.4(ii) shall not be applicable to Basic and Cellular Licensees existing as on 11.11.2003, and in case one of them migrates to UASL it shall not be necessary to surrender the other License. Further, Basic and Cellular Licensees existing as on 11.11.2003, shall not be eligible for a new UASL in the same service area either directly or through it’s associates. Further, any legal entity having substantial equity in existing Basic/ Cellular licensees shall not be eligible for new UASL.</p>	<p>defined below:</p> <p>“No single company/ legal person, either directly or through its associates, shall have substantial equity holding in more than one LICENSEE Company in the same service area for the Access Services namely; Basic, Cellular and Unified Access Service. ‘Substantial equity’ herein will mean ‘an equity of 10% or more’. A promoter company/ Legal person cannot have stakes in more than one LICENSEE Company for the same service area”.</p> <p>Note : above clause(1.3) shall not be applicable to Basic and Cellular Licensees existing as on 11.11.2003, and in case one of them migrates to UASL it shall not be necessary to surrender the other Licence. Further, Basic and Cellular Licensees existing as on 11.11.2003, shall</p>	<p>in condition 1.4 (ii). (Clause 1.3)</p> <p>No single company/ legal person, either directly or through its associates, shall have substantial equity holding in more than one LICENSEE Company in the same service area for the Access Services namely; Basic, Cellular and Unified Access Service. ‘Substantial equity’ herein will mean ‘an equity of 10% or more’. A promoter company/ Legal person cannot have stakes in more than one LICENSEE Company for the same service area. (Clause 1.4 (ii))</p> <p>Note: Clause 1.4(ii) shall not be applicable to Basic and Cellular Licensees existing as on 11.11.2003, and in case one of them migrates to UASL it shall not be necessary to surrender the other License. Further, Basic and Cellular Licensees existing as on 11.11.2003, shall not be eligible for a new UASL in the same service area either directly or</p>
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			Intra service area mergers and acquisitions as well as transfer of licences may be allowed subject to there being not less than three operators providing Access Services in a Service Area to ensure healthy competition as per the guidelines issued on the subject from time to time. (Clause 6.2)	not be eligible for a new UASL in the same service area either directly or through its associates. Further, any legal entity having substantial equity in existing Basic / Cellular licensees shall not be eligible for new UASL	through its associates. Further, any legal entity having substantial equity in existing Basic/ Cellular licensees shall not be eligible for new UASL. Intra service area mergers and acquisitions as well as transfer of licences may be allowed subject to there being not less than three operators providing Access Services in a Service Area to ensure healthy competition as per the guidelines issued on the subject from time to time. (Clause 6.2)
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TRANSFER/ASSIGNMENT OF LICENSE

The Licensee shall not, assign or transfer the licensing rights in any manner whatsoever under the license to a third party or enter into any agreement for sub-license and/or partnership relating to any subject matter of the license to any third party either in whole or in part i.e. no sub-leasing/partnership/third party interest shall be created. Provided that the licensee can	The Licensee shall not, without the prior written consent (can be granted only as described below) of the Licensor, either directly or indirectly, assign or transfer its rights in any manner whatsoever to any other party or enter into any agreement for sub-license and/or partnership relating to any subject matter of the license to any third party either in whole or in part. Any violation of this term shall be construed as a breach of License Agreement and the license shall be liable for termination. Provided, however that installation of	The Licensee shall not, without the prior written consent (can be granted only as described below) of the Licensor, either directly or indirectly, assign or transfer its rights in any manner whatsoever to any other party or enter into any agreement for sub-license and/or partnership relating to any subject matter of the license to any third party either in whole or in part. Any violation of this term shall be construed as a breach of License Agreement and the license shall be liable for termination.	6.1 "The LICENSEE shall not, without the prior written consent as described below, of the LICENSOR, either directly or indirectly, assign or transfer this LICENCE in any manner whatsoever to a third party or enter into any agreement for sub Licence and/or partnership relating to any subject matter of the LICENCE to any third party either in whole or in part i.e. no sub leasing/partnership/third party interest shall be created. Provided that the LICENSEE can always	No Change	Same as in UASL Agreement in 2003
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<p>always employ or appoint or appoint agents and servants. (Clause 10)</p> <p>The LICENSEE shall not transfer the licensing rights granted to him, to any other party. Any violation will be construed as a breach of licensing rights and the license will be terminated ... (Clause 15.7)</p>	<p>systems, equipment and network can be given on contract, but, providing the SERVICE can not be given to another party on contract. Provided that the licensee can always employ or appoint agents or servants. (Clause 6.1)</p> <p>Provided that the aforesaid written consent permitting transfer or assignment will be granted:</p> <p>(i) in accordance with the terms and conditions and procedures described in Tripartite Agreement if duly executed amongst LICENSOR, LICENSEE and LENDERS.</p> <p>(ii) Whenever a merger of two licensee (Indian) companies is approved by a High Court but no compromise in competition occurs in the provision of telecom service.</p>	<p>Provided, however that installation of systems, equipment and network can be given on contract, but, providing the SERVICE can not be given to another party on contract. Provided that the licensee can always employ or appoint agents or servants. (Clause 6.1)</p> <p>Provided that the aforesaid written consent permitting transfer or assignment will be granted:</p> <p>(i) in accordance with the terms and conditions and procedures described in Tripartite Agreement if duly executed amongst LICENSOR, LICENSEE and LENDERS.</p> <p>(ii) Whenever a merger of two licensee (Indian) companies is approved by a High Court but no compromise in competition occurs in the provision of telecom service.</p>	<p>employ or appoint agents and employees for provision of the service.</p> <p>6.2 Intra service area mergers and acquisitions as well as transfer of licences may be allowed subject to there being not less than three operators providing Access Services in a Service Area to ensure healthy competition as per the guidelines issued on the subject from time to time.</p> <p>6.3 Further, the Licensee may transfer or assign the License Agreement with prior written approval of the Licensor to be granted on fulfillment of the following conditions and if otherwise, no compromise in competition occurs in the provisions of Telecom Services :-</p> <p>(i) When transfer or assignment is requested in accordance with the terms and conditions on fulfillment of procedures of Tripartite Agreement if already executed amongst the Licensor, Licensee and Lenders; or</p> <p>(ii) Whenever amalgamation or restructuring i.e. merger or demerger is sanctioned and approved by the High Court or Tribunal as per the law in force; in accordance with</p>		
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			<p>the provisions; more particularly Sections 391 to 394 of Companies Act, 1956; and</p> <p>(iii) The transferee/ assignee is fully eligible in accordance with eligibility criteria contained in tender conditions or in any other document for grant of fresh license in that area and show its willingness in writing to comply with the terms and conditions of the license agreement including past and future roll out obligations; and</p> <p>(iv) All the past dues are fully paid till the date of transfer/assignment by the transferor company and its associate(s) / sister concern(s) / promoter(s) and thereafter the transferee company undertakes to pay all future dues inclusive of anything remained unpaid of the past period by the outgoing company.”</p>		
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Annexure A
(Refer Chapter 1/Para 1.3)

DOT Letter dated 24.11.2008

No.20-100/2007-AS-I(Pt)
Government of India
Ministry of Communications
Sanchar Bhawan, 20, Ashoka Road, New Delhi-110 001.

Dated 24th November, 2008

To

The Secretary,
TRAI,
MTNL Exchange Building,
Jawahar Lal Nehru Marg, Minto Road,
New Delhi.

Sir,

The issue regarding prohibition of sale of promoter's equity for Unified Access Service (UAS) License holders is under consideration in the Government. It is pertinent to mention that presently there is no Lock-in condition of equity shareholding in the UAS Licenses. However, Government reserves the right under the license agreement for modification of the terms and conditions of the licenses in public interest.

2. The matter was deliberated in the Full Telecom Commission meeting held on 11.11.2008. The Telecom Commission was of the considered view that there should be following restriction in the license agreements in order to prevent fly-by-night operators making a windfall gain.

i) The promoters who have 10% or more stakes in the company and whose networth has been taken into consideration for determining the eligibility for grant of UAS license should not sell their equity in the UAS Licensee Company for a period of 3 years from the effective date of license (s). However, issue of additional equity share capital by the licensee companies/their holding companies by way of private placement/public issues shall be permitted. Further, the lock-in provisions shall not be applicable in case the shares are transferred pursuant to enforcement of pledge by the lending financial institutions/banks due to events of defaults committed by the borrowers with the condition that such shares should have been pledged for investment only in the particular licensed project.

ii) In cases, where money is brought into the company by issue of fresh equity, there shall be a restriction on declaration of special dividend by the company for a period of 3 years.

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iii) The above conditions (i) and (ii) would not be applicable to the licensees holding UAS/CMTS licenses for a period of 3 years if they acquire any new UAS licenses in some service areas in order to enlarge their area of operations.

3. TRAI is requested to furnish their recommendations in terms of clause 11(1)(a)(iv) of TRAI Act 1997 as amended by TRAI Amendment Act, 2000, on the issue of prohibition of sale of promoter's equity for Unified Access Service (UAS) License holders and other issues as mentioned in para 2 above.

(A.K. Srivastava)
DDG(Access Services-I)
Tel: 23716874
Fax: 23372201

Annexure B
(Refer Chapter 3/Para 3.5.2.49)

TRAI letter dated December 31, 2008

Shri R. N. Choubey
Secretary-In-Charge
Phone: 2323 7448

D.O. No.11-3/2008-FA

December 31, 2008

Dear Shri Srivastava,

Please refer to your office letter No. 20-100/2007-AS-I (Pt) dated 1st December, 2008 in the context of recommendations sought from TRAI on the issue of lock-in for sale of promoter's equity in Unified Access Service Licensee Company etc.

2. It may please be seen that Section 11(1)(a)(ii) pertains to recommendations on "terms and conditions of license to a service provider". The DoT itself has stated its intent to modify the terms and conditions of the UAS licenses in the letter dated 24.11.08. Accordingly, TRAI is examining the matter both under clause 11(1)(a)(ii) and clause 11(1)(a)(iv) of TRAI Act, 1997.

3. Further, in the context of the phrase, "...to prevent fly-by-night operators making a windfall gain" in your letter dated 24.11.08, it may be clarified whether any transaction involving sale of / change in equity of a UAS Licensee has taken place after the grant of new licenses. If so, the following information/documents may please be furnished:

- (i) Details of such transactions including Domestic/Foreign parties/holding companies involved;
- (ii) List of promoters along with their respective shareholding;
- (iii) List of promoters after selling of / change in equity along with their respective shareholding;
- (iv) Networth of promoters, who have 10% or more stake in the company and whose networth has been taken into consideration for determining the eligibility for grant of UAS License, at the time of grant of license and their present networth;
- (v) Paid up equity capital at the time of grant of license and present paid up equity capital;
- (vi) A copy of the license agreement. In case the license agreements signed for all service areas/service providers are similarly worded, one copy of the license agreement for any service area may be provided);
- (vii) Dividend/Special Dividend declared/paid, if any, after sale of equity;
- (viii) Any other information relevant in the matter.

With regards,

Yours sincerely,

(R. N. Choubey)

SHRI A. K. SRIVASTAVA
DDG (Access Services-I)
Ministry of Communications,
Department of Telecommunications
Sanchar Bhawan, 20, Ashoka Road, New Delhi – 110 001.

LIST OF ACRONYMS

Sl. No.	Acronyms	Full Text
1.	CMTS	Cellular Mobile Telephone Service
2.	DIP Guidelines	Securities Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000
3.	DIPP	Department of Industrial Policy and Promotion
4.	DoT	Department of Telecommunications
5.	FDI	Foreign Direct Investment
6.	FIs	Financial Institutions
7.	FIPB	Foreign Investment Promotion Board
8.	GR	Gross Revenue
9.	HUF	Hindu Undivided Family
10.	IPO	Initial Public Offer
11.	M&A	Mergers & Acquisitions
12.	NTP 1999	New Telecom Policy, 1999
13.	SEBI	Securities and Exchange Board of India
14.	TRAI	Telecom Regulatory Authority of India
15.	UASL	Unified Access Service Licenses