

With the IndiGo indictment, has SEBI changed the rules of the game? - The Morning Context

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Back in July 2019, newspapers were awash in headlines carrying every juicy titbit of the very public spat between Rakesh Gangwal and Rahul Bhatia, promoters of InterGlobe Aviation Ltd, which operates IndiGo, India's largest airline.

Cut to February 2021 and Gangwal is a man vindicated. Despite taking on the IndiGo management, his allegations of questionable related-party transactions and lapses in governance regulations at the airline have found a ringing endorsement in the settlement order issued by the Securities and Exchange Board of India on Tuesday.

While the settlement itself is a measly Rs 2 crore and change, the order is unique in many respects: 1) A promoter shareholder whose grievances could not be redressed by the company board and other shareholders has found a sympathetic ear in the markets regulator; 2) SEBI has pretty much taken Gangwal's side as the order finds no mention of the defence put up by the IndiGo management; 3) In a first, it details the role played by InterGlobe chairman (and former SEBI chairman SEBI) M. Damodaran in the entire affair; and 4) It is pretty much an outlier when compared to the regulator's earlier orders as it lists all of the lapses of the company as well as findings of its investigations.

At this point a quick refresher on what played out in July 2019 may be in order. InterGlobe Aviation announced that Gangwal, who along with his associates holds about 37% in the company, had filed a complaint with the markets regulator. The complaint alleged non-compliance with governance norms, related-party transactions with the IGE Group (short for InterGlobe Enterprises Group, which holds 38% of the company and is privately owned by Bhatia and his associates), not disclosing pertinent information to the board on time, misrepresentations in the public offer papers back in October 2015, and failure to address a one-sided shareholder agreement, among a number of other violations.

This sent the stock crashing. What followed were allegations and counter-allegations from both parties. The IndiGo management fully backed the denials and assertions made by the IGE Group.

The contentious shareholder agreement between the co-promoters, which gave the Bhatia faction the right of first refusal to buy Gangwal's stake if the latter decided to sell, as well as greater rights in key appointments, was not amended, as 51.44% of shareholders opposed any change to it during the shareholder meet on 29 January 2019.

Tuesday's order is pretty much an endorsement of every accusation levelled by Gangwal. One such accusation, to do with related-party transactions, a review of which was commissioned by EY in early 2019, said the report was not shared with the board or the audit committee; only Damodaran saw it and the findings were communicated by him to the board in March 2019.

"The EY report *inter alia* contained important information regarding an independent analysis of the RPTs [related-party transactions] undertaken by the Noticee. Such information was necessary for the board of directors in order to fulfil their responsibilities," said the SEBI order. It went on to state that Gangwal had made multiple requests for the report, but the company never shared it with him.

In May 2019, Gangwal had sought an extraordinary general meeting to enforce higher governance and transparency standards. The meeting was never convened, on the basis of a legal opinion that was communicated a "mere six minutes before" the scheduled board meeting.

One of the related-party transactions referred to in the SEBI order involved the ticketing vendor—InterGlobe Air Transport Ltd. The airline was to receive Rs 299.24 crore from the ticketing vendor against the sale of tickets as on 31 March 2019. This was termed as not a related-party transaction by IndiGo. SEBI did not buy the argument and held that it needed the audit committee's approval. The order lists several such transactions involving lease agreements with third-party vendors like Pegasus Buildtech Pvt. Ltd and Caddie Hotels Pvt. Ltd.

In some cases, the audit committee's nod was obtained post facto.

The so-called one-sided shareholder agreement also drew SEBI's ire. In the public offer papers in 2015, the company had said that rights of first refusal would cease to exist post 10 November 2019. But

considering that the shareholders did not vote in favour of any change, the agreement has continued till date. SEBI held this as a violation of disclosure norms.

“The Noticee, by failing to remove these rights from the articles, had allegedly not complied with the statement made in its prospectus and had thus misrepresented facts before its shareholders,” the order said.

Given SEBI’s stinging indictment, the company needs to spell out how it will rectify its past omissions, says Amit Tandon, chief executive, Institutional Investor Advisory Services. “The question is how does IndiGo lift itself from here, and address the issues that SEBI has highlighted in its settlement order— which cannot be happy reading for the company or its board. Clearly the company needs to bring its governance processes up to the same level as its operational systems, including revisiting some of its assumptions. A robust checklist while flying an aircraft is what ensures its passengers remain safe and an equally robust checklist will ensure its investors do too.”

The order, to someone who follows SEBI pretty closely, is nothing short of exceptional. The basic premise of a settlement or consent order is to settle any matter without admission or denial of guilt. With the regulator listing out the major findings of its investigations, I wonder whether the whole idea of consent has been negated here.

Sumit Agrawal, founder, RegStreet Law Advisors, and someone who has represented IndiGo in the past, says that for now, it can’t be said whether this is a one-off. “This order is at variance with the other settlement orders passed by SEBI. Usually settlement orders do not carry details of allegations as these orders are without prejudice to the merits of the case. It needs to be seen if SEBI has changed its stand and henceforth all settlement orders will carry detailed allegations or this settlement order is an outlier.”

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