2016 - Problem Eight

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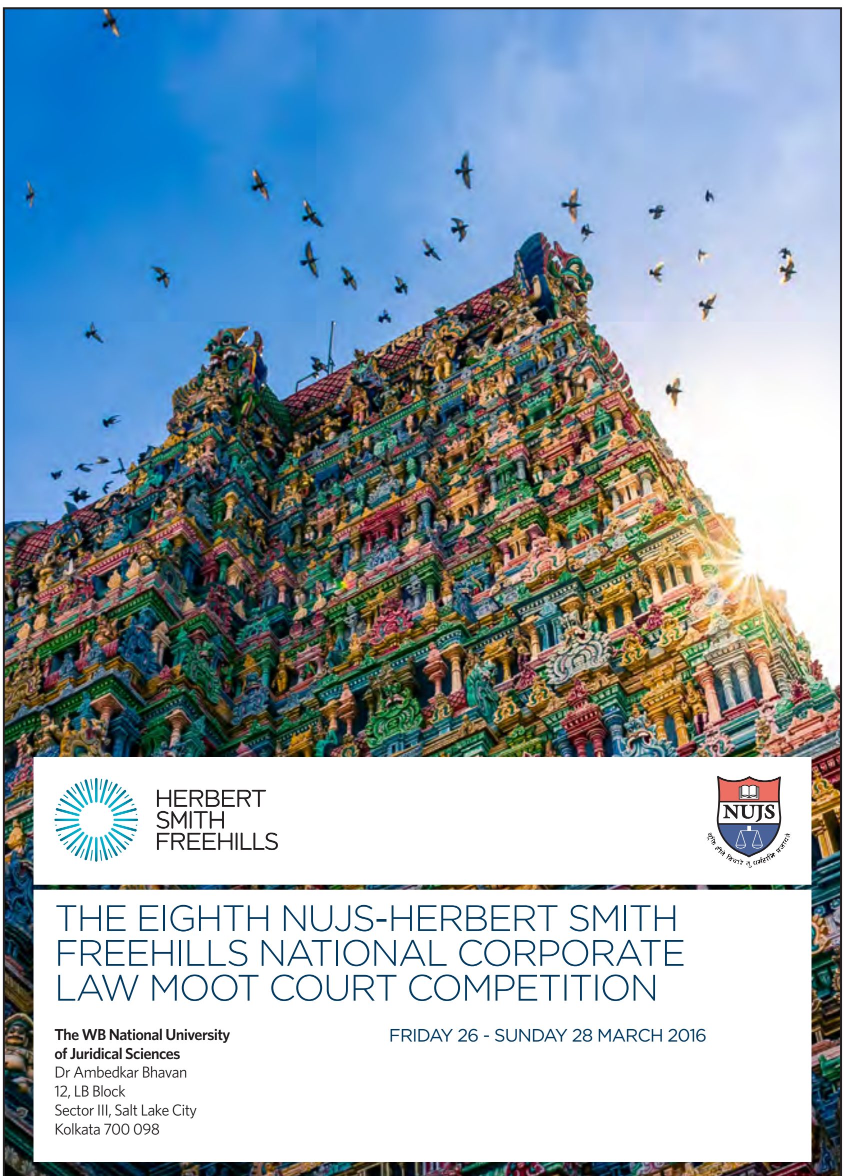

Overview

Winning team
National Law School of India University, Bangalore
Megha Mehta, Sharwari Kothawade, Ayushi Agarwal

Runners up team
National Law University, Odisha
Priyanka Murali, Anant Gupta, Prateek Suri

Best speaker
Ishan Khanna
Hidayatullah National Law University, Raipur

Best memorandum
Nirma Universtiy
Saakshi Sharma, Alaukik Shrivastava, Sarthak Sonwalkar

Abhijit and Piyush (Appellants) v. Flume Capital, Nurture Capital, Arcot, (Respondent) Smith & Brown Limited & Flyabhi.com Pvt Ltd

1. Abhijit, a final year student at a leading engineering school and Piyush, his roommate who comes from a wealthy family in Lucknow got talking about how Uber and Ola had become successful in India. Inspired by Netjets they came up with the idea of making air travel more efficient in India by maximising the use of private aircraft owned by air charter companies and private aircraft owned by the rich and famous to make private air travel more easily accessible to the rich. Piyush's family contributed a dozen aircraft that it owned (valued at about Rs. 40 Crores) and Abhijit assigned all the current and future copyright in the software, all rights to the idea, the business plan and processes and all other IPR (as commonly understood around the world), whether registerable in India or not, to the company. Flyabhi.com Pvt Ltd was established in Lucknow with Abhijit and Piyush each owning 50% of the Rs 2,000,000 invested as initial share capital.

2. A recent change in government civil aviation policy to encourage the use of old airports, including those in the heart of the city like the ones in Bangalore and Hyderabad greatly helped their business prospects. Other airstrips like the one in Simla were also opened up for charter and private flights and ground facilities there improved with private investment. Corporate houses which owned private aircraft and a few air charter companies expressed interest in the idea. Abhijit and Piyush researched the business of many companies in India, China and the United States before developing their own business plan which they believe addressed an unmet need in the Indian market.

3. With some financial help from Piyush's family and Abhijit's programming skills they were able to create a prototype and design for their online service which they presented to a group of potential investors at an event organised by a local angel network in Bangalore in August 2010. While there was interest from several investors in their idea, Flume Capital (**Flume**) and Nurture Capital (**Nurture**), both angel investors incorporated in Singapore convinced the founders that they were best placed to partner with them. Flume and Nurture convinced the founders that they were long term investors who fully supported the founders' vision and would be able to provide not just cash but also expertise to rapidly grow the young company. After months of negotiations, on December 31, 2010 Flume and Nurture beat Snowflake Capital to invest in optionally convertible debt of flyabhi.com for a cash consideration of Rs.100 Crores. The debt was convertible into Class B equity shares, at the investors' option over a three year period based on the EBITDA of the company and subject to the company meeting business targets and milestones. Piyush was keen to invest additional equity and convertible debt in the company but Abhijit and the investors dissuaded him from doing so.

4. When the founders were presented the complex convertible debt financing structure with a myriad of government approvals, rather than plain equity investment which they had been expecting, they were apprehensive about their interests being protected. However, they were assured by the investors as well as BESTCO, a leading Indian law firm, that this was commonplace in the VC community and BESTCO was acting as "transaction counsel" to protect the interests of all stakeholders and ensure efficient closing of the deal. The founders were also informed that BESTCO's fees were to be paid by flyabhi.com. BESTCO was a well-recognised name, consistently ranked among the top 4 law firms (together with SAMSHOR, CAMDO & JSK) for venture capital and start up work, primarily representing investors in Indian start ups.

5. While the process of drafting the investment agreement and seeking various government approvals was under way, Ms. K.S. Kumar, an employee of Flume, and Ms. Sush Iyer, a partner at BESTCO were inducted on to the board of directors of the company so that the founders could benefit from the immense experience of experts while fine-tuning the business plan for the company and preparing the company for the investment by the two angel investors.

6. The founders, Abhijit and Piyush, and the investors, Flume and Nurture, and the company represented by Ms. Iyer signed the investment agreement in the offices of BESTCO. The key terms of the investment agreement included:
   - 6.1.1 Key business milestones and financial targets for each fiscal quarter.
   - 6.1.2 Abhijit was designated as the CTO and Piyush as the Chief Marketing Officer.
   - 6.1.3 Consequences of company failing to achieve the key business targets were: (i) adjustment in the conversion price of the debt to equity to the investors and (ii) preferential right, by themselves or their affiliates, to provide all further equity and debt to the company (iii) at the option of the investors, either put or call all the securities owned by the founders and their assignees.
   - 6.1.4 Founders and investors' directors had to approve the appointment of all key management personnel.
   - 6.1.5 Tabula Rasa, a well known global consulting firm and an affiliate of Flume, would provide advisory services at the cost of Rs. 25 lakhs per month (net of taxes and disbursements) to help the founders develop and execute the business plan.
   - 6.1.6 Founders' and investor directors' consent was required for key decisions involving the company.
   - 6.1.7 The two founders, two nominees of the investors and an experienced independent person who would be chairman of the company would form the first board of directors. Each party had the right to nominate a director so long as it held at least 10% shareholding in the company.
   - 6.1.8 All rights granted by the investment agreement to a party would terminate if that party (together with affiliates and permitted assignees) held less than 10% shareholding in the company on a fully diluted basis assuming conversion of investor debt based on the EBITDA of the preceding fiscal quarter. However, each of the parties was bound to offer company's securities to the others before selling it to any person who was not a shareholder in the company.
   - 6.1.9 All disputes would be subject to SIAC arbitration in Singapore.

7. The company's articles of association were amended by BESTCO to incorporate all these terms and were effective on January 01, 2011. In addition to Abhijit and Piyush, the board of directors included Ms. K.S. Kumar, Ms. Sush Iyer, a partner at BESTCO nominated by Nurture, and Ms. Scarlet Lester, a well known tech entrepreneur who was on the board of many companies in which Flume and Nurture had invested.

8. Abhijit, with his geeky charm was able to attract some of the best software talent to work with him. Flyabhi.com was the place for software coders, graphic designers and artists to hang out. The office was set up in an old, disused warehouse in the industrial part of old Bombay that was owned by a friend of Piyush's family. The atmosphere was relaxed and informal with almost no rules and looked very much like the hostel of the engineering college that several of those who worked there were attending.

9. While the app for the service was being developed, Tabula Rasa began a national publicity campaign to socialise flyabhi.com's business plan amongst prospective users and aircraft owners. Flyabhi.com was the title sponsor of fashion shows in the key Indian cities. It sponsored music festivals and artists' shows and even a spectacular Valentines Day fireworks display throughout the country.

10. Despite all of this marketing and publicity, business was slow and the investors, based on the data and analysis provided by Tabula Rasa, felt that there was significant scepticism about the business model, the young inexperienced management team and whether the company could deliver on this promises. While it was still early days for the business, the company was not even close to reaching the business and financial targets set out in the investment agreement and the articles of association.

11. The board had been meeting every month to discuss the state of the business. By a majority vote, on July 21, 2011, it was decided that the company needed an experienced CEO for the business to be credible. After a global search process conducted by a leading search firm, Arjun Iyer was shortlisted to be the CEO. Arjun had studied at the American School of Bombay and then went to the US where he had undergraduate degrees in computer science and finance with a post graduate degree in management from Wharton. He was a brilliant student and was hired by McKinsey & Co to work with fast growing tech startups. During his five years at McKinsey & Co, he completed assignments in the US, China and Europe. Both clients and colleagues considered him a superstar.

12. The two founders did not see any value in such an expensive hire and voted in the board meeting on September 22, 2011 against the appointment of Arjun Iyer. Abhijit stated in the board meeting that he had conceived of the idea of the company, handpicked all the developers and Piyush, with his family connections was capable of developing the business across the country. However, the majority of the directors on the board of the company disagreed with them and Arjun Iyer was appointed as the CEO with immediate effect. He was given 5% Class A equity stake (same class as the founders) in the company, $1 million per annum of stock options which would vest at a nominal price of Rs. 100 over a period of 3 years and an annual salary of Rs. 1 Crore. He was free to sell the shares to the investor, founders or the company at the fair market value immediately upon exercise of the stock options.

13. Arjun hit the ground running; immediately contacting the leading owners of private aircraft and signing up a few of them to participate in the service by agreeing to sell a fixed number of flying hours each month. A few industrialists, sports stars and Bollywood celebrities also subscribed to the service by "purchasing" a fixed number of flying hours each year. By December 2011, the service was ready for launch and flyabhi.com made news all over the country. Sports stars, industrialists, fellow entrepreneurs, Bollywood celebrities and socialites were full of praise on social media. Arjun Iyer was featured on technology, lifestyle and business TV shows and magazines for the "unique business" that he was creating. The media was quick to report the names and publish pictures of the impressive list of Indian and international clients using the flyabhi.com service.

14. In an unexpected turn of events, flyabhi.com had stiff competition from Airavata, a joint venture between Netwings, the leading global fractional share ownership company and Suyodh, a leading Indian business house. Suyodh was one of India's leading conglomerates and was trusted as a brand for its customer service. It was beginning to enter the luxury goods segment with joint ventures with global brands for the Indian market.

15. Airavata was able to raise over Rs. 500 Crores in initial equity and also obtain additional finance from Indian and international finance companies. With these financial resources, it was able to buy, or in some cases, get long term leases from global small and medium size business jet manufacturers. Airavata was also able to use the many aircraft and helicopters owned by Suyodh and also register several foreign aircraft in India to start a service on January 01, 2012 with more aircraft than flyabhi.com. This was quite a surprise for the founders and investors of flyabhi.com since Suyodh had, several times in the past two decades, tried, extremely unsuccessfully, to enter the aviation sector and its entry was a complete shock to everyone following the aviation industry in India.

16. In the board meeting on February 07, 2012 it was obvious to all the directors that the company needed more money very quickly to take on the unexpected competition. The management team led by Arjun Iyer was ready with a financing plan and immediately set about on an elaborate international road show to raise Rs. 500 Crores, which, in addition to paying for the expenses of the company would be used to (i) buy up "inventory" of flying hours from air charter companies and owners of private aircraft and (ii) purchase or lease business jets.

17. Piyush, supported by his family, was willing to provide equity, convertible debt or even bridge finance on preferential terms but he was told, once again, by the investors and their nominee directors that it would be better for the company's image as a young professional tech start up if the cash was injected by investors and not his family. The board of directors also obtained a legal opinion from BESTCO, as the company's counsel, that the investors had the right under the investment agreement and the articles to make further investment in equity and debt.

18. Instead, the board approved, by a majority vote (the founders dissenting), a financing arrangement with Arcot, Smith & Brown Limited, a 100 year old listed Indian NBFC and affiliate of the two angel investors to provide a bridge loan of Rs. 20 Crores to enable the company to pay its routine expenses until next round of equity was successfully raised. Key terms of the bridge finance were:

    18.1.1 The maximum tenure of the loan was 1 year.

    18.1.2 The interest was 18% per annum.

    18.1.3 The security for the loan was the hypothecation of the aircraft owned by the company.

    18.1.4 Right to veto key decisions affecting the finances of the company.

19. Drawdown of the bridge loan occurred on February 14, 2012 and most of the cash was used to finance the dry lease of aircraft from Brazil, Argentina and other South American countries. At the board meeting held on April 10, 2012, the investors' nominee directors expressed concern that the road shows had not yielded any positive result and the company was in financial difficulty again despite the bridge finance.

20. On July 21, 2012, Flume and Nurture novated the investment agreement to over 20 of their affiliates since they had reached the end of the investment term and were required, under the terms of their constitution, to liquidate and distribute all their assets to their investors. The founders were extremely concerned that the relationship with the angel investors was now virtually over and they now had to deal with over 20 investors who didn't know them, their business and their journey at all. BESTCO provided an opinion to the company that the novation was valid under the articles of association and the transfer of shares by Flume and Nurture should be registered. Flume and Nurture assured the founders that the change in shareholding was merely a legal requirement and as the composition of the board of directors remained unchanged, for all practical purposes, nothing had changed at an operational level for the founders.

21. On August 07, 2012, all the affiliates of Flume and Nurture notified the company that they wished to convert 50% their debt into equity with immediate effect based on the EBITDA as set out in the unaudited accounts dated June 30, 2012. On the same day, their nominee directors gave notice of a board meeting to be held at 0900 hrs on August 14, 2012 in the offices of BESTCO to allot and issue Class B equity shares to the investors, calling an EGM on the same day and venue at 1600 hrs to amend to the articles of association and reconstitute the board of directors. Despite the founders' protest, all three resolutions were approved by a majority of the board of directors. The company issued shares in demat form to the investors immediately after the board meeting and as a result the shareholding of each of Piyush and Abhijit was reduced to 6% of the equity share capital. In the EGM held that same afternoon, new articles of association were adopted by the company and Piyush and Abhijit were removed from the board. The articles of association allowed all decisions to be taken by a majority vote of shareholders. Abhijit and Piyush did not attend the EGM, in protest against the recent actions of the other shareholders.

22. On August 16, 2012, JSK Law, instructed by Piyush and Abhijit wrote to BESTCO that the termination of the investment agreement, the amendments to the articles of association and the removal of the founders from the board of directors was illegal. The letter also contained an offer by the founders to purchase all the securities of the company owned by the investors at a fair market value. Legal proceedings were threatened if these actions were not immediately reversed.

23. On August 24, 2012, the founders filed an application before the Company Law Board (**CLB**) complaining of continuing acts of oppression and mismanagement by the majority shareholder. Rather than responding to these allegations, on September 26, 2012 each of the investors filed identical applications under s.45 of the Arbitration and Conciliation Act, 1996 seeking the referral of this dispute to arbitration. The CLB heard all the parties on October 04, 2012 and in a long and detailed decision delivered on November 05, 2012 referred the dispute to arbitration.

24. As news of the disputes between the founders and investors made front page news, there were reports of the company's financial position worsening, employees leaving the company, customers getting more and more concerned and creditors and service partners getting nervous. By December 2012, it was clear to Arjun Iyer that there was no future for him in the company. He left flyabhi.com on December 06, 2012 to join Airavat, now a successful listed company, as its Chief Commercial & Operating Officer. He sold all the Class A equity shares that he received from the periodic exercise of his stock options to the investors. The investors now held a little over 50% of the Class A equity shares of the company. Ms Kumar and Ms Lester also resigned from the board of directors and Mr. Rane, the company's mild mannered chartered accountant was appointed as a director of the company.

25. In February 2013, the founders appealed this decision of the CLB to the High Court. During his submissions, counsel for the appellant, sensing that the appeal may be dismissed, asked the court to consider this matter as a writ petition. In the interest of justice and to expedite the disposal of the matter, the court agreed to consider this as a writ petition. In a judgment delivered on April 11, 2014 the High Court dismissed the appeal and the writ. The founders immediately appealed this decision to the division bench of the High Court which, after hearing all parties, dismissed the writ appeal on July 04, 2014. As the decision was read out in court, counsel for the founders sought leave to appeal to the Supreme Court since there was a conflicting decision of another high court coincidentally involving Nurture, Flume and a start-up based in Bangalore and an appeal from the decision of the High Court was pending in the Supreme Court. The court allowed this oral application. On July 05, 2014, the 3 directors of flyabhi.com met in the offices of BESTCO at 0900 hrs and resolved that the business of flyabhi.com needed to be restructured. They recommended to the shareholders that the business of aircraft operation and all business connected therewith be separated from the warehouse and other land assets that the company owned. It was proposed that the aircraft business be demerged from flyabhi.com and merged into Arcot, Smith & Brown Limited, a listed NBFC with its registered office in Calcutta. The auditors of the company had suggested a share exchange ratio that was also confirmed by the auditors of Arcot, Smith & Brown and an independent merchant bank. The directors

of flyabhi.com met again at 1400 hrs to record receipt of the letters of consent for the scheme of arrangement of (i) all the Class B equity shareholders, (ii) more than 50% of Class A shareholders and (iii) all secured and unsecured creditors. The board immediately instructed BESTCO to file the scheme of arrangement before the Allahabad High Court, Lucknow Bench.

26. On July 14, 2014, Arcot, Smith & Brown Limited began the process of seeking approval for the scheme of arrangement. On December 06, 2014, the Calcutta High Court approved the scheme. The founders challenged the scheme of arrangement before the Allahabad High Court, Lucknow Bench. On July 15, 2014, Arcot, Smith & Brown sent a notice to the founders exercising their right under s. 245 of the Companies Act. The founders immediately applied to the Allahabad High Court, Lucknow Bench to hear them before allowing the notice to take effect. Pending the disposal of the scheme of arrangement, the court allowed the founders' application and injuncted Arcot, Smith & Brown from taking any action pursuant to the notice or the scheme. Arcot, Smith & Brown approached the Supreme Court under Article 136 of the constitution of India against this order and although leave to appeal was granted, the injunction remained. After hearing all the parties, the Allahabad High Court approved the scheme of arrangement on April 11, 2015 but stayed the implementation of the scheme for a period of 90 days to enable the founders to appeal the decision to the Supreme Court. The appeal by the founders to the Supreme Court was heard and the injunction granted by the High Court continued until further orders.

27. The Supreme Court has now listed all matters connected with flyabhi for final hearing on all procedural and substantive issues.