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Evolving Precepts of Corporate Governance: Lessons to Learn and Unlearn

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<u>'G' IN ESG – THE STEERING FORCE OF THE COMPANY</u>

Manendra Singh & Tanvi Goyal [*]

<u>ABSTRACT</u>

E, S and G, just three random alphabets of English language, but when put together have given businesses across the globe something to think about, especially in the wake of COVID-19 and the changing regulatory regime. ESG – Environment, Social and Governance factors are becoming increasingly important as investors are moving towards impact investing and sustainable development. This shift is evident from the number of ESG initiatives taken across the globe. Of late we have even seen funds launching specific ESG related products for investment as an answer to the public demand for sustainable investments. The inflows in ESG funds increased 76% to INR 3,686 Crores in financial year 2021 against INR 2,094 Crores in financial year 2020 and ESG funds together had an asset base of nearly INR 9,900 Crores as of March-end.[1] *In another research publication by Bloomberg Intelligence, it stated that global ESG assets are on track to exceed USD 53 trillion by 2025, representing more than a third of the USD 140.5 trillion in projected total assets under management.*[2]

The ESG reporting in India has been recently revised by the Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") *and a new reporting format, the Business Responsibility and Sustainability Report (hereinafter referred to as* "**BRSR**")*, has been introduced by SEBI on May 10, 2021. The concept of ESG, however, is not new in India. One of the first notable step in the area of social responsibility of businesses was the release of the Corporate Governance Voluntary Guidelines in 2009 by the Indian Ministry of Corporate Affairs* (*hereinafter* referred to as "**MCA**")*, which encouraged corporates to voluntarily achieve high standards of*

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[*] The authors are Associate Partner and Principal Associate, respectively, at Economic Laws Practice, Advocates & Solicitors.

[1] Suresh P. Iyengar, *India must devise its own ESG investment strategy,* BUS. LINE (June 19, 2021) https://www.thehindubusinessline.com/news/national/india-must-devise-its-own-esg-investment-strategy/article34861443.ece.

[2] Adeline Diab & Gina Martin Adams, *ESG assets may hit $53 trillion by 2025, a third of global AUM,* BLOOMBERG (Feb. 23, 2021) https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.

corporate governance. This was followed by the release of the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (*hereinafter* referred to as "**NVGs**") *in 2011, which were subsequently used by SEBI to frame the Business Responsibility Reports* (*hereinafter* referred to as "**BRR**") *in 2012. The BRR has now been replaced with BRSR, which will be implemented in a phased manner, and aims at further strengthening the social responsibility of businesses. The BRSR requires reporting on various Governance aspects and is likely to help business to be more organized and help in monitoring their compliances in a more effective manner. In this article we look at the Governance aspect of ESG reporting under the BRSR.*

Keywords: Business Responsibility and Sustainability Report, Corporate Governance, ESG.

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I. CORPORATE GOVERNANCE IN INDIA

Corporate governance is the system by which companies are directed and controlled.[3] There is no single legislation which presently predominates the corporate governance framework in India, but it is encompassed within various legislations including the key legislations such as Companies Act, 2013 (*hereinafter* referred to as "**CA 2013**") and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement) Regulations, 2015 (*hereinafter* referred to as

[3] CADBURY, A., COMM. FIN. ASPECTS CORP. GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992), https://ecgi.global/sites/default/files/codes/documents/cadbury.pdf

"**LODR Regulations**").

The concept of governance is however not new to India. Over the years, various committees have been constituted to give recommendations for improving the governance of companies in India. One such major milestone was the report issued by the Committee on Corporate Governance under the chairmanship of Shri Kumar Mangalam Birla based on which Clause 49 of the listing agreement was issued by SEBI in February 2000. Such clause dealt with several aspects including board constitution and independent directors, constitution of audit committee, report on corporate governance, etc. Several other committees have been constituted over the years to review and recommend changes to the corporate governance framework, including those under the chairmanship of Mr. Narayana Murthy, Mr. Naresh Chandra, and Mr. Uday Kotak.

The report of the Committee on Corporate Governance under the chairmanship of Mr. Uday Kotak dated October 5, 2017, *inter alia* looked into the aspect of why corporate governance really matters. The said committee noted that based on the research it is evident that the companies that exhibit sound corporate governance generate significantly greater returns when compared to companies that exhibit poor corporate governance.[4] Mr. Uday Kotak had stated that the report is "*a sincere attempt to support and enable sustainable growth of enterprise, while safeguarding interests of various stakeholders. It is an endeavour to facilitate the true spirit of governance. Under the leadership of a vigilant market regulator -SEBI, and with the persistent efforts of key stakeholders, corporate governance standards in India will continue to improve. A stronger corporate governance code will enhance the overall confidence in Indian markets and in India.*"[5]

The corporate governance framework under CA 2013 (including the erstwhile Companies Act, 1956) has also over the years evolved to include

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[4] KOTAK COMM., SEBI, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (2017), https://www.sebi.gov.in/reports/reports/oct2017/report-of-the-committee-on-corporate-governance_36177.html.
[5] *Id.,* at 2.

directors' responsibility statement, from "voluntary" to "mandatory" corporate social responsibility spending, etc. Recently, SEBI overhauled the regulatory framework for independent directors, which is to come into effect from January 01, 2022, increasing their participation in composition of audit committee and nomination and remuneration committee, requiring approval of related party transactions to be given only by independent directors, etc.

II. UNDERSTANDING "G" - GOVERNANCE ASPECT UNDER ESG

G - governance, is an integral part of company's performance and effective leadership helps steering the company in the right direction. The Report of the CII Task Force on Corporate Governance chaired by Mr Naresh Chandra noted that "*Good corporate governance involves a commitment of a company to run its businesses in a legal, ethical and transparent manner - a dedication that must come from the very top and permeate throughout the organisation. That being so, much of what constitutes good corporate governance has to be voluntary. Law and regulations can, at best, define the basic framework - boundary conditions that cannot be crossed.*"[6]

In many ways the G in the ESG is not new and has evolved and coupled into a reporting requirement of such existing obligations in an organized manner. Different regions around the globe have adopted different approaches to achieve sustainable development and impact investments. The European Commission in its Action Plan: Financing Sustainable Growth dated Mach 8, 2018[7] recognized one of the action points as fostering sustainable corporate governance and attenuating

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[6] CONFEDERATION IND. INDUS., REPORT OF THE CII TASK FORCE ON CORPORATE GOVERNANCE CHAIRED BY MR. NARESH CHANDRA (Nov. 2002), https://www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.

[7] EUR. COMM'N, COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS FINANCING SUSTAINABLE GROWTH 12 (2018), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN.

short-termism in capital markets. It recognizes that "*Corporate governance can significantly contribute to a more sustainable economy, allowing companies to take the strategic steps necessary to develop new technologies, to strengthen business models and to improve performance. This would in turn improve their risk management practices and competitiveness, thus creating jobs and spurring innovation."* On February 25, 2019, the European Parliament and Member States agreed on a new generation of low-carbon benchmarks needed to help boost investment in sustainable projects and assets. On 18 June, 2020, the Taxonomy Regulation for climate change mitigation and adaptation was published by the European Commission which establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable.[8] The Taxonomy Regulation deals with various aspects of sustainable economic activities, including requiring transparency of environmentally sustainable investments in pre-contractual disclosures and in periodic reports, transparency of financial products that promote environmental characteristics in pre-contractual disclosures and in periodic reports, contribution towards climate and climate adaptation.

In the Indian context, the Indian regulators, MCA and SEBI have in recent years increased focus on sustainable investment and reporting with the introduction of corporate social responsibility (CSR) norms under CA 2013 and the recent replacement of the BRR (Business Responsibility Report) with BRSR.

Some of the key governance related disclosures provides under BRSR read with the guidance note for ESG reporting format released by SEBI have been discussed below.

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[8] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, 2020 O.J. (L 198) 13.

A. GRIEVANCE REDRESSAL MECHANISM FOR STAKEHOLDERS

The National Guidelines on Responsible Business Conduct (*hereinafter* referred to as “**NGRBC**”)[9] defined the term “*Stakeholder*” as an “*Individual or group concerned or interested with or impacted by the activities of the businesses and vice-versa, now or in the future. Typically, stakeholders of a business include, but is not limited to, its investors/shareholders, employees (and their families), customers, communities, value chain members and other business partners, regulators, civil society actors, and media.*” Grievance Redressal Mechanism refers to a mechanism for any stakeholder individually or collectively to raise and resolve reasonable concerns affecting them without impeding access to other judicial or administrative remedies.[10] A transparent and unbiased grievance mechanism often helps in reducing legal disputes and making company to be more accessible and connected with its stakeholders.

The BRSR reporting requires disclosure of grievance redressal mechanism adopted by the company for each of the stakeholders, disclosure of comprehensive data on the total number of complaints received in the financial year and number of such complaints resolved or pending.

B. BUSINESS RESPONSIBILITY POLICY AND REPORT

The BRSR reporting requires that a statement to be provided by director responsible for the business responsibility report, highlighting ESG related challenges, targets, and achievements.[11] Even details of highest authority responsible for implementation and oversight of the business responsibility policy(ies) is required to be reported. Even before

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[9] MINISTRY CORP. AFFAIRS, NATIONAL GUIDELINES ON RESPONSIBLE BUSINESS CONDUCT 7 (2019), https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf.

[10] *Id.,* at 8.

[11] SEC. & EXCH. BD. IND., BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING FORMAT 6 (2021), https://www.sebi.gov.in/sebi_data/commondocs/may-2021/Business%20responsibility%20and%20sustainability%20reporting%20by%20listed%20entitiesAnnexure1_p.PDF.

BRSR, in many mergers and acquisition transactions we have seen investors/ purchaser insisting on ESG diligence on the target companies before investment.

C. ETHICAL, TRANSPARENT AND ACCOUNTABLE CONDUCT

Principle 1 of the National Guidelines for Responsible Business Conduct (*hereinafter* referred to as "**NGRBC**") incorporated under BRSR requires businesses to conduct and govern themselves with integrity and in a manner that is ethical, transparent, and accountable. Under this segment, company is required to disclose *inter alia* details of fines/penalties /punishment/ award/ compounding fees/settlement amount paid in proceedings (by the entity or by directors/key managerial personnel) with regulators/ law enforcement agencies/judicial institutions, in the financial year. This requirement to disclose details of fines /penalties/punishment/ award/compounding fees/settlement amount is to be made based on materiality specified under Regulation 30 of LODR Regulations. Now, the companies will need to revisit their materiality policy drafted under Regulation 30 of LODR and accordingly, collate such information relating to fines/penalties/awards, etc.[12]

In addition, under this principle, companies are also required to make disclosure on the anti-corruption or anti-bribery policy, which may include details of risk assessment procedures and internal controls, mechanism to deal with complaints on bribery/corruption and details of trainings on anti-corruption issues and make available a web-link to the policy. Today, companies are required to take efforts and ensure compliance with the anti-corruption and anti-bribery laws of India, however, now the anti-corruption and anti-bribery policy will need to be drafted in a manner to specifically cover aspects of risk assessment procedures and internal controls, mechanism to deal with complaints on bribery/corruption and details of trainings on anti-corruption issues undertaken by the company.

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[12] *Id.,* at 8.

Another aspect that is required to be disclosed under Principle 1 is details of number of complaints received in relation to issues of conflict of interest of the directors and key managerial personnel.[13] Conflict of interest simply put refers to a situation where an individual is confronted with choosing between the requirements of his or her function and his or her own private interests. Presently, Section 166 of CA 2013 requires directors to act in the best interest of the company and to not involve himself/ herself in a situation in which he/she may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.[14] Section 184 of CA 2013 has further mandated that every director of the company to disclose, at the first meeting of the board in which he/ she participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the disclosures already made, his/ her concern or interest in any company or companies or bodies corporate, firms, or other association of individuals.[15] In addition, the section also requires directors of a company to disclose nature of his/her concern or interest at the meeting of the board in which the contract or arrangement in which he/she is directly or indirectly concerned or interested is being considered. As apart from directors, key managerial personnel play a key role in the management and governance of the company, details of complaints in relation to issues of conflict of interest of key managerial personnel under the BRSR reporting will help in increasing transparency in the management decisions.

D. SAFEGUARDING INTEREST OF ALL STAKEHOLDERS

Another governance aspect incorporated under the BRSR reporting relates to Principle 4 of NGRBC which requires businesses to respect the interest of and be responsive to all its stakeholders. Under this segment, company is required to disclose the process for identification of key stakeholders, identification of vulnerable and marginalized groups, using

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[13] *Supra* note 11.
[14] Companies Act, No. 18 of 2013, §166 (Ind.).
[15] *Id.*, §184.

stakeholder consultation to support the identification and management of environmental and social topics, etc.

Over years, we have seen a shift from shareholder centric need to protect the interest of various stakeholders involved with a company. The duties of directors were for the first time codified under Section 166 of CA 2013, which *inter alia* requires director of a company to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment. Even the code for independent directors provided under CA 2013 requires independent directors to *inter alia* safeguard the interest of all stakeholders. Now under the BRSR reporting, engagement by the company with each stakeholder group will need to be disclosed by the company. Such disclosures will help all stakeholders, especially the potential investors in identifying the key concerns raised by the stakeholders and how the company has responded to the same, thus indulging more faith in the company's internal controls and management.

III. "G" – SUPPORTING THE "E" AND "S" IN ESG

While "E" and "S" in ESG are important aspects, they cannot function without an effective and efficient "G" and all are intertwined with each other.

The E – Environmental reporting of the company is aimed at ensuring that the company is contributing towards sustainable development and is committed to reducing discharge of pollutant in the environment. Under this segment, various disclosures are covered such as resource usage (energy and water), air pollutant emissions, green-house emissions, waste generated and waste management practices, biodiversity etc.

The S – Social related disclosures cover the workforce, value chain, communities, and consumers. For employees/workers, one needs to

disclose the gender and social diversity including measures for differently abled employees and workers, turnover rates, median wages, welfare benefits to permanent and contractual employees/workers, occupational health and safety, trainings etc. It also includes disclosures on Social Impact Assessments, Rehabilitation and Resettlement, Corporate Social Responsibility, disclosures on product labelling, product recall, consumer complaints in respect of data privacy, cyber security, etc.[16]

However, the E and S aspect cannot be achieved without effective "*Governance*". To put it simply, there needs to be in place effective corporate governance framework requiring board and management to promote sustainable business conduct, encourage sustainable research projects, adopt environment friendly business policies, implement worker/employee centric benefits and measures, etc., thus making corporate governance the key aspect of ESG compliance.

IV. CLOSER LOOK REQUIRED AT GOVERNANCE REQUIREMENTS AND WAY FORWARD

Although the BRSR is presently applicable to the top 1000 listed entities (by market capitalization calculated as on 31st day of March of every financial year), for reporting on a voluntary basis for financial year 2021–22 and on a mandatory basis from financial year 2022–23, the attraction that ESG principles have globally is huge and one should not get deluded by selective enforcement on specified companies by SEBI. Even the corporate social responsibility spending under CA 2013 which started as a voluntary requirement has with time been made mandatory.

In the ESG sector, many countries are moving towards mandatory ESG disclosure, and this is likely to become one of the major

[16] SEC. & EXCH. BD. IND., CIRCULAR FOR BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING BY LISTED ENTITIES, SEBI/HO/CFD/CMD-2/P/CIR/2021/562 (May 10, 2021), https://www.sebi.gov.in/sebi_data/meetingfiles/apr-2021/1619067265752_1.pdf.

considerations for investors evaluating investment opportunities. Transparency through reporting and disclosure gives comfort to stakeholders and it is imperative that companies evaluate to what extent they can comply with BRSR reporting. This will not only reflect highly on the transparent conduct of the organization but also attract more stakeholders to partner with the company.

INDEPENDENT DIRECTORS: GUARDING THE GUARDIANS

Dr. Ashish Kumar Srivastava[*]

ABSTRACT

Transparency and accountability are two pillars of Indian Corporate Governance structure. Independent directors are qui vive of shareholders' democracy in corporate governance. The abuse of corporate veil for the biggest corporate scams and crisis raises a question about the robustness of the system guarded by regulators like SEBI, RBI and Ministry of Corporate Affairs. The normative structure of corporate governance has been more or less confined to listed public companies. Private companies have been aloof to the idea of corporate governance. This leads to cultural issues when a private company graduates to become a public company and goes for listing. The listing agreement, especially clause 49 along with SEBI LODR Regulations provide for norms of good corporate governance. The Uday Kotak Committee in 2017 recommended for time-bound changes in many aspects of corporate governance. But due to the COVID-19 pandemic, there has been huge disruptions. The SEBI on March 01, 2021 floated a consultation paper wherein it proposed the idea of 'Dual Approval System'. The Dual Voting Structure has been adopted in United Kingdom. On June 29, 2021 SEBI proposed many changes based on the consultation paper in the present corporate governance norms for making the institution of independent directors more authoritative which shall be effective from January 1, 2022. In this paper, the author has attempted to examine the institution of independent directors and its evolution in Indian Corporate Regime and changes proposed by SEBI recently, especially the utility of dual approval system.

Keywords: Independent Directors, Corporate Governance, Dual Approval System.

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I. INTRODUCTION

Corporate Governance in India stands for accountability and transparency. Entrepreneurs in India have always used corporate personalities for 'maximization of profits.' Corporations have equally played a pivotal role in providing quality goods and services to people of India and realization of social, economic and political justice. The corporate entities have been means and ends of economic justice. After liberalization, privatization and globalization, the corporate entities got bigger due to investment of public capital. Regulators like RBI and SEBI fostered economic growth of Indian Companies by creating a conducive environment. The current market cap of Indian Capital market is 3.1 trillion US$.[1] Reliance Industries and TATA became one of the top 100 companies in the world. It shows the robustness of Indian corporations.

However, the scams and crisis like Satyam, Sahara, PNB, IL&FS, PMC have also shown the dark side of corporate entities whereby the rogues robbed Indian people of their legitimate money and Indian corporate structure limped under the mammoth NPA which amounted to Rs. 7,17,850 crores in 2019-20.[2] Writing off NPA of big PSBs like Punjab National Bank attracted criticism from people. This vicious cycle of scam

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[1] *Live Stock Market*, BOMBAY STOCK EXCHANGE, https://www.bseindia.com/ (last visited Oct. 23, 2021).

[2] RES. BANK IND., GOV'T OF IND., REPORT ON TREND AND PROGRESS OF BANKING IN INDIA (2019-20), https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP2020_F3D078985540A4179B62B7734C7B445C9.PDF.

infested corporate regime of India is a blot on the face of shining India. The incessant strive for the betterment of normative structure of corporate governance has been very fruitful but it has made entrepreneurship a hydra-headed task in the process. Industrial growth, start-ups, entrepreneurship has been hampered due to stringent norms mandated by SEBI, RBI and Ministry of Corporate Affairs (*hereinafter* referred to as "**MCA**"). Transparency & accountability are two important norms which are secured by many instruments like independent directors, periodic disclosures, compliances and vetting to regulators, prohibition of insider trading, fraudulent & unfair trading, abuse of trust, promoter's shareholding, related party transactions, whistle-blower's protection.

Corporate Governance in India was introduced with clause 49 of Listing Agreement which was confined to listing public companies attempting to infuse capital through Initial Public Offer (*hereinafter* referred to as "**IPO**") or debentures. Public shareholding commands transparency in dealing as the corporate entities after raising capitals have often been found deviating from their goal and focus resulting in loss of money of honest and innocent investors. After emergence, SEBI, with the tagline 'Har Investor Ki Taqat', took the central position as a regulator of investor, intermediaries and issuer. It issued various guidelines and regulations to manage & regulate IPO process like the SEBI Disclosure and Investor Protection Guidelines, 1992 (*hereinafter* referred to as "**DIP**"), SEBI Disclosure and Investor Protection Guidelines 2000, SEBI Issue of Capital and Disclosure Requirement Regulations, 2009 (*hereinafter* referred to as "**ICDR**"), SEBI Listing Obligation & Disclosure Requirement Regulations, 2015 (*hereinafter* referred to as "**LODR**"). Alongside regulations, The Securities Contracts (Regulation) Act, 1956 and Companies Act, 1956 were realigned and Depositories Act, 1996 was passed to create an environment for infusing capital in corporations via issuing shares. In 2013, the new sleek Companies Act was passed and Department of Company Affairs changed to Ministry of Corporate Affairs in 2004. Scams and crisis between 2009 and 2020 became very ugly when we saw thousands of crores of rupees being siphoned off.

Scamsters and fraudsters fleeing away resulted in legislative responses like Fugitive Economic Offenders Act, 2018.

Various commissions and committees were appointed for betterment of norms of corporate governance and they recommended on various aspects of corporate governance. In 1978, Sachar Committee submitted on various issues of corporate governance, in 1992, Cadbury Committee (United Kingdom) submitted a report on various aspects of corporate Governance, in 1998, Rahul Bajaj Committee under the aegis of CII submitted Desirable Code of Corporate Governance, in 1999, Kumar Mangalam Birla Committee submitted its report relating to various issues of corporate governance, in 2003, Naresh Chandra Committee Report and Narayan Murthy Committee Report submitted on many aspects of corporate governance, in 2005 J.J. Irani Committee responded on various issues of corporate governance, in 2017, Uday Kotak Committee on Corporate Governance submitted a very comprehensive report on various aspects of corporate governance. In United Kingdom, Corporate Governance Code, 2018 was enacted. On June 16, 2020, the High Level Committee in chairmanship of Justice (Retd.) Anil R. Dave[3] submitted a report on 'The Measures for Strengthening Enforce Mechanism of The Board and Incidental Issues'.

The Ministry of Corporate Affairs in 2009 made National Corporate Governance Voluntary Guidelines which was given a rejig in 2011 and was replaced by National Voluntary Guidelines of Responsible Business Conduct, 2018. SFIO, NFRA and NCLT were created in new corporate regime for better regulation.

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[3] SEC. & EXCH. BD. IND., MEASURES FOR STRENGTHENING THE ENFORCING MECHANISM OF BOARD & INCIDENTAL ISSUES (2020-2021), https://www.sebi.gov.in/reports-and-statistics/reports/jun-2020/report-of-high-level-committee-under-the-chairmanship-of-justice-retd-anil-r-dave-on-the-measures-for-strengthening-the-enforcement-mechanism-of-the-board-and-incidental-issues_46863.html.

Corporate Governance stands for accountability and transparency of corporate entities. Many jurists and institutions have given many definitions of corporate governance and certain are worth mentioning as Milton Friedman has defined the Corporate Governance as, "Corporate Governance is to conduct the business in accordance with the owner's or shareholder's desires which generally will be to make as much money as possible while conforming the basic rules of the society embodied in law and local customs."[4] Palmer defines it as, "Corporate Governance rules are concerned with the manner in which a company conducts its internal business mainly focusing at this level on the inter-action of the various organs of the complex corporate entities which issue securities on such regulated markets and their debt and equity investors."[5] Shardul S. Shroff explains that, "The central feature of corporate governance is recognition of the fact that the shareholders are true owners of the company and hence while the board of directors/managers should have freedom to take operational decisions, they remain accountable at all times and are in fact trustees of shareholders." OECD says that, "Corporate Governance involves a set of relationships between a company's management and its board, its shareholders and other stakeholders. Corporate Governance also provides the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are determined."[6] With these definitions one may conclude that corporate governance stands for shareholder's democracy, business based on ethics, running corporations on trusteeship model instead of ownership model and above all transparency and accountability. The author in this article is making an attempt to identify the importance of Independent Directors in Corporate Governance, shortcomings and demerits of this institution and critical appraisal of current changes by SEBI to strengthen its position.

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[4] INDIAN INSTITUTE OF CORPORATE AFFAIRS, CORPORATE GOVERNANCE (1st ed. 2015).

[5] PALMER'S COMPANY LAW 5155 (Prof. Geoffrey Moss ed., 2013).

[6] ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PRINCIPLES OF CORPORATE GOVERNANCE, G20/OECD (2015), https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf.

II. INDEPENDENT DIRECTORS

The institution of independent directors was introduced on the recommendation of the Kumar Mangalam Birla Committee into the Indian corporate regime to bring the values of dissent, democracy, diversity on board. The element of independence, fearlessness, impartiality, risk management, independent judgment, strategy making, regulation of key appointment and standards of conduct could be met only when outsiders are brought on board. The issues of greed, malfeasance, misfeasance, nonfeasance, embezzlement, gorging, guzzling and gulping of public money, social responsibility of corporations, conflict of interests, sidekicks in related party transactions, fudging of books and accounts, partiality, biases etc. could be addressed by the institution of independent directors. In Companies Act, 2013, under Section 149(6), a proper definition of independent director has been given which is ever-expanding over the years via many amendments. Searching ability, standing, integrity, loyalty, impartiality, fearlessness like qualities in a society facing dwindling and deterioration of values like never before was like searching a diamond in a coal mine. Madhuryya Arindam writes that IDs were introduced in 1950 in US[7] and UK for different reasons. Indian corporate entities mostly are 'Gharana Controlled' and are not suited to it. As the families promoting companies appointed kith & kin as IDs having no expertise or experience to run companies but now in changed times the companies are appointing IDs for separation of management and control of companies which serves many purposes meant to better corporate governance by bringing dissent and expertise to board.[8]

Section 149 itself is a complete code for independent directors (*hereinafter* referred to as "**IDs**"). According to section 149(6) an independent director means a director who is not an executive director

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[7] Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1473 (2010).
[8] Madhurrya Arindam, *The Independent Director: Has it been Indianized Enough?,* 6 NUJS L. REV. 231, 271 (2013).

and is a person of integrity having relevant expertise & experience, is not promoter or related to promoter in company or its subsidiaries or associate and who has or had pecuniary interest up to 10% in two immediately preceding financial years or current FY. His relatives are not holding more than 2% shares in company or its subsidiaries in last two FYs or current FY. He is not borrower of company or its subsidiaries or surety of a third person to company. He has a pecuniary interest up to 2% of income or gross turnover of company or its subsidiary. He is not or has been KMP or employee of company or its subsidiary. He has not been member of auditing firm or legal firm which transacted with the company up to 10% of turnover of company. He alone or along with his relative holds 2% of voting power in the company. He is a CEO of a non-profit organization which receives 25% of total receipt from company.[9]

Such an elaborate and complicated definition which has been amended in 2018 is itself a proof of the complications involved in the institution of independent director. In the USA, the New York Stock Exchange Listed Company Manual lays down a comprehensive definition of who can be an independent director.[10] In short, he must be a person of integrity having no pecuniary, official biases and his relatives must not have the same. The word 'relative' has been given wide meaning in section 2(77) of Companies Act, 2013.

III. UDAY KOTAK COMMITTEE REPORT

In 2017, the Uday Kotak Committee on Corporate Governance made several time bound (to be incorporated between 2018 and 2022) recommendations many of which have been duly incorporated via amendments in SEBI LODR Regulations 2015.[11] Many recommendations missed the deadline due to COVID-19. Many exemptions were given to

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[9] Companies Act, No. 18 of 2013, §149 (Ind.).
[10] *Listed Company Manual,* NEW YORK STOCK EXCHANGE, https://nyseguide.srorules.com/listed-company-manual (last visited Oct. 23, 2021).
[11] Bhumesh Verma & Soumya Shekhar, *Strengthening Corporate Governance in India*, PRAC. L. 93 (2015).

many firms from compliance of clause 49.[12] Clause 49 and LODR Regulation provide for proper blending of executive and non-executive directors/independent directors. It provides for 4 meetings of board in a year with a maximum gap of 120 days. The board must have a code of conduct and it must maintain due diligence and proper compliance of regulators.

Uday Kotak Committee recommended for a minimum board size of 6 without differentiating between private and public company. The size must be logical, strategic and it must avoid celebrity ornamental people as director.[13] Directors are like the captain of a ship and if there are more outsiders and diversity on board then interests of various stakeholders can be taken care of. In the USA around 2005, several CEOs were fired on account of lack lustre results and insider trading issues.[14] Uday Kotak Committee recommended for one woman executive or independent director in top 500 listed entities from April 01, 2019 and one-woman independent director in top 1000 listed entities from April 01, 2019. Both the recommendations have been inserted in LODR Regulations.[15]

The Committee further recommended that director must attend at least half of the board's meeting and NED/IDs must be appointed after 75 years of age only after confirmation of shareholders which has been inserted in LODR Regulations.[16]

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[12] Dhammika Dharmapala & Vikramaditya Khanna, *Corporate Governance Enforcement and Firm Value: Evidence from India*, 29 J. L. ECON. & ORG. 1056, 1082 (2013).

[13] MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMPANIES LAW COMMITTEE (2015-16), https://www.mca.gov.in/Ministry/pdf/Report_Companies_Law_Committee_01022016.pdf.

[14] A.C. FERNANDO, CORPORATE GOVERNANCE: PRINCIPLES, POLICIES AND PRACTISES 204 (1st ed. 2016).

[15] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

[16] *Id.*

Committee recommended for five board's meeting in a year but this recommendation was not implemented. The committee recommended for meeting of NED/IDs once in a year for understanding corporate business, corporate capacity and managerial capacity. Committee recommended that listed entities, having 40% public shares w.e.f. April 01, 2020, shall appoint NED/ID as chairperson of the board. All listed entities w.e.f. April 01, 2022 shall appoint NED/ID as chairperson of the board. The committee recommended for cap for listed entities directorship to eight including seven as IDs and if he is Whole Time Director or Managing Director then he can serve three listed entities as IDs. The committee recommended that director's report must be submitted as part of corporate governance report.

The committee also recommended that w.e.f. April 01, 2019 in top 500 listed entities depending upon market capitalization and w.e.f. April 01, 2020 all listed entities shall appoint NED/IDs at least half of size of the board. The IDs must not be a member of promoter group. The performance and independence of IDs shall be evaluated by subjective and objective assessment by the board. IDs will disclose their conflict of interests on first meeting. The committee recommended for good remuneration to IDs to attract best people on the board and also for detailed reasons for resignation. All these recommendations have been inserted in LODR Regulations.[17] Few companies like City Union Bank, Ramco Cements, Dr. Reddy Labs has more than 80% IDs on its board.[18]

Due to increasing risk, more and more IDs are resigning on account of pre-occupation and personal reasons. In the year 2017, 2018 and 2019 ,717, 767, 1393 IDs resigned respectively.[19] We have witnessed such an

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[17] *Id.*

[18] CFA INST., INDEPENDENT DIRECTORS IN ASIA PACIFIC REGULATIONS AND PRACTICE IN SELECTED MARKETS (2020), https://www.arx.cfa/-/media/regional/arx/post-pdf/2021/06/18/independent-directors-in-asia-pacific.ashx?sc_lang=en.

[19] Ricca Bhattacharya, *Resignations by Independent Directors Double in 2019 as Risk Grow*, ECON. TIMES (Dec. 26, 2019)

exodus in 2009 post Satyam scandal when 620 IDs resigned.[20] In the light of the same, the Ministry of Corporate Affairs issued a circular no. 01/2020 dated March 02, 2020 on clarification on prosecutions against IDs for certain non-compliance and exempted the IDs from unnecessary civil and criminal prosecution.[21]

The committee recommended for D&O insurance for IDs in top 500 listed entities. The IDs must be formally inducted and trained once in every five years about nature of business industry, business model, their role & responsibilities in governance. We know that in capital market, once in five-year training is just a drop in ocean as the regulatory norms change very fast. The committee recommended for appointing lead ID. The vacancy of ID must be filled by a new ID in next board's meeting or within three months whichever is later subject to confirmation in next AGM.

Auditing fiasco puts corporations in bizarre situations. Auditing has been a matter of concern in corporate governance therefore, the Kotak committee recommended that the audit committee, which has a minimum three directors and 2/3 of which is IDs, must meet five times a year and nomination & remuneration committee (*hereinafter* referred to as "**NRC**"), stakeholder relationship committee (*hereinafter* referred to as "**SRC**"), risk management committee (*hereinafter* referred to as "**RMC**") must meet once in a year. Frequent meeting of audit committee will focus the issues of audit. The chairman of NRC shall be ID. All these recommendations

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https://economictimes.indiatimes.com/news/company/corporate-trends/resignations-by-independent-directors-double-in-2019-as-risks-grow/articleshow/72972968.cms.

[20] Vikramaditya Khanna & Shaun J. Mathew, *The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence,* 22 NLSIU REV. 35, 36 (2010).

[21] MINISTRY CORP. AFFAIRS, GOV'T OF IND., CLARIFICATION ON PROSECUTIONS FILED OR INTERNAL ADJUDICATION PROCEEDINGS INITIATED AGAINST INDEPENDENT DIRECTORS, NON-PROMOTERS AND NON-KMP NON-EXECUTIVE DIRECTORS – REG., F. No. 16/1/2020- Legal (Mar. 02, 2020), https://www.mca.gov.in/Ministry/pdf/Circular_03032020.pdf.

mentioned above have been added in LODR regulations.[22] The audit committee should review investment of 100 crores or 10 % of asset size in unlisted subsidiary including foreign company. In NRC 2/3rd members must be IDs. The NRC shall also recommend on remuneration of senior management. The SRC shall have three directors and one of them shall be ID. The quorum of NRC and SRC shall be two members or 1/3 whichever is greater and one of them shall be ID.[23] The committee recommended that Risk Management Committee in top 500 listed entities shall also address the issues of cyber security. It also recommended that companies may constitute Information Technology Committee to confirm digital and technology developments. The ID of listed entities shall be on board of subsidiaries including foreign company.

Insider trading and related party transaction have been the most pinching issues in capital market. Vishwanathan Committee in 2018[24] recommended that SEBI must be empowered for tapping phone calls to curb the menace of frauds, insider trading, surveillance and investigation etc.

The Kotak Committee on the issue of insider trading and related party transaction recommended that where promoters are not identified, then person holding 10% paid up equity shall be promoter. The promoter must disclose his shareholding pattern under SEBI PIT Regulations 2015. Any reclassification of shares of promoters on account of transfer or opt out shall be ratified by the board and shareholder where promoter and person acting in concert (*hereinafter* referred to as "**PAC**") shall not vote.[25] The

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22 Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

23 *Id.*

24 SEC. & EXCH. BD. IND., COMMITTEE ON FAIR MARKET CONDUCT (2017-18), http://www.caparivaar.in/sebi-report-of-committee-on-fair-market-conduct-for-public-comments/sebi-report/.

25 Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

disclosure requirement of related party transactions (*hereinafter* referred to as "**RPT**") in case of promoters and PAC holding 10% paid up equity was recommended by Kotak committee.[26] In reference to RPT any party who belongs to promoter group holding 20% of paid-up equity has been included. Royalty payment has also been covered in RPT.[27] These recommendations have been implemented. The committee recommended for cap on remuneration on executive promoter director up to 5 crores or 2.5% of net profit whichever is higher for one and 5% of net profit for all such directors. If an ID/NED is paid 50% of designated remuneration for NED/IDs, then confirmation of shareholder is required. The RTP requires adoption of materiality policy which shall be reviewed once in three years. Annual Report of the companies must be published on website and sent to members in case of AGMs. Disclosure in XBRL or other searchable format in case of GDR, disclosure regarding key changes including debtors' turnover, inventory turnover, interest coverage ratio, current ratio, debt equity ratio, operating profit margin, net profit margin, return or net worth compared to previous financial years, utilization of funds raised though preferential placement and QIP must be made. All these recommendations have been implemented.[28]

The committee recommended for filing of details of director working as director of all companies and due certification by CS regarding his qualification must be submitted in corporate governance section in annual report. This must be also notified on the website. Listed public entities and its subsidiaries audited financial statement of relevant financial year must be uploaded on website 21 days before the AGM. The committee recommended that prior intimation to stock exchange of bonus share must be made due to being price sensitive information. The committee recommended disclosure requiring quantification of audit qualifications to

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[26] Ami Galani & Nathan Rehn, *Related Party Transactions Empowering Boards and Minority Shareholders to Prevent Abuses*, 22 NLSIU REV. 29, 38 (2010).

[27] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

[28] *Id.*

be mandatory with exception of sub-judice matters. Group auditing standards in line of International Standard 600 was recommended. Many recommendations regarding financial results were made. Reasons of resignation by auditors must be given and fees paid to auditors must be disclosed in annual report.[29] The committee recommended on various issues of audit quality indicators, appointment of auditors, credentials of statutory auditors. The committee recommended for IND-AS accounting standards, revival of qualified audit report review committee. The committee recommended on power of SEBI regarding auditors based on PWC case. It also recommended for enhanced penal power of ICAI and separate cell to monitor disciplinary action against listed entities. Rajesh Chakrabarti argues that board quality depends on auditor quality.[30] The committee recommended for Quality Review Board (*hereinafter* referred to as "**QRB**") as an independent oversight of auditors based on criteria of International Forum of Independent Audit Regulators. QRB must have financial resources and operational liberty to carry out responsibilities.

The committee recommended for live webcasting of meeting in top 100 listed entities by market capitalization and opening of e-voting till midnight of AGM. Committee recommended that w.e.f. April 1, 2021 no voting rights attached to treasury stock shall be exercised. The committee generally recommended for enhancing corporate governance in public sector enterprises like evaluation of government stake, avoidance of conflict of interests and autonomy. The committee recommended for leniency mechanism in whistle-blower system. The committee recommended for strengthening of SEBI for induction of people from private sector, formation of data science department, establishing a sub-unit for reviewing quality of audit (including forensic audit) to investigate. Most of these recommendations of the Uday Kotak Committee Report have been duly incorporated by 2019 amendment in LODR Regulations. Certain recommendations could not be relied due to Covid-19 pandemic disruptions.

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[29] *Id.*

[30] Rajesh Chakrabarti, *Audit Quality and Board Independence*, 30 NLSIU REV. 51, 58 (2018).

IV. AFTERMATH OF KOTAK COMMITTEE

Searching IDs was one of the most difficult tasks at hand. In pursuance of duties casted under Section 150, the Central Government notified on October 22, 2019 the Companies (Creation and Maintenance of Databank of Independent Directors), 2019, known as Databank Rules for maintaining data of IDs and eligible person for IDs their name, DIN, gender, nationality, educational and professional qualifications, directorships and email address. The databank is being maintained by Indian Institute of Corporate Affairs (IICA).[31] A person can enrol and after passing the test with 60% marks, the person can act as an ID. However, passing the course has found little support in people ready to act as an ID By January 2020, 1000 persons registered as ID on this databank.[32] This was a very welcoming step by IICA.

On March 01, 2021, SEBI floated a 'Consultation Paper on Review of Regulatory Provisions Related to Independent Directors'.[33] The consultation paper focused on eligibility of IDs, process of appointment/reappointment, removal of IDs, transparency in nomination and resignation of IDs, strengthening the composition of board committees.

The definition of ID in section 149(6) and Regulation 16 of LODR provides for many disqualifications and one of the same is that a person who has been KMP or employee or his relative has been KMP of employee in the company or its subsidiary/holding or associate including

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[31] *Independent Director's Databank*, IND. INST. CORPORATE AFF., https://www.independentdirectorsdatabank.in/(last visited Oct. 23, 2021).

[32] Press Trust of India, *More than 1,000 Individuals Register with Independent Directors' Databank,* BUS. STANDARD (Jan. 7, 2020) https://www.business-standard.com/article/pti-stories/over-1-000-individuals-register-with-independent-directors-databank- 120010600732_1.html

[33] SEC. & EXCH. BD. IND., CONSULTATION PAPER ON REVIEW OF REGULATORY PROVISIONS RELATED TO INDEPENDENT DIRECTORS (Mar. 1, 2021), https://www.sebi.gov.in/reports-and-statistics/reports/mar-2021/consultation-paper-on-review-of-regulatory-provisions-related-to-independent-directors_49336.html.

foreign company then different cooling off period for employment and material pecuniary relationship is provided which the consultation paper proposes to be made as uniform for three years. Relating to appointment or reappointment, in order to keep the appointment and re-appointment process uninfluenced by the promoters, SEBI in the consultation paper similar to Israel's model, proposed for appointment and re-appointment by minority shareholders.[34] SEBI alike United Kingdom proposed that appointment and re-appointment of IDs shall be subject to 'Dual Approval'[35] taken through a single voting process and meeting following two thresholds; (i) approval of shareholders; (ii) approval by 'majority of minority' (simple majority) shareholders and here minority will exclude promoter and promoter group. The approval for appointment shall be through ordinary resolution and for re-appointment shall be special resolution. If dual approval is not met then appointment and re-appointment will fail and, in such a case, the listed entities may; (i) either propose a new candidate or (ii) or propose the same candidate as ID after a cooling off period of 90 days but within 120 days. Such approval will be through special reasons and notice of meeting shall include reasons for proposing the same person.

In appointment process still, the minority shareholders despite statutory provision to the contrary, don't have any substantive say. Regarding the removal of IDs, presently, he can be removed from his office by simple majority in first term and special majority in second term after giving him an opportunity of hearing and minority has no say in the process. The consultation paper of SEBI proposes that for removal of IDs also, the same dual approval mode for the first term through ordinary resolution and for the second term through special resolution can be adopted which will give a substantive say to minority shareholders in the whole process

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34 *Id.*

35 *See* FIN. CONDUCT AUTH., The Listing Rules LR 9.2.2 in the FCA Handbook (2002); *See also,* FIN. REPORTING COUNCIL, THE U.K. CORPORATE GOVERNANCE CODE (July 2018), ¶ 17.

In the Tata case, certain IDs were prematurely removed which led to amendment in Section 169 of Companies Act, 2013[36] wherein now removal can be done only by special resolution. Regarding enhancing and bringing more transparency in the role of Nomination & Remuneration Committee (*hereinafter* referred to as "**NRC**") certain proposals have been made. At present, the NRC is under an obligation to provide for the criteria of determination of qualifications, positive attributes and independence of a director, identify suitable persons for appointment and assess about extension or continuation of term on the basis of report of performance of IDs. This current system lacks transparency for choosing the right persons as IDs at NRC. SEBI proposes that for each appointment, NRC shall evaluate balance of skills, knowledge and experience on the board. In the light of this evaluation, a description shall be prepared of role and capabilities required for the particular appointment. The recommended person must have those capabilities. For identification of candidates, the NRC may use service of an external agency, consider candidate from diverse backgrounds, consider the time commitment of appointees. The notice of appointment of IDs at NRC shall include following disclosures; (i) skills and capabilities and how the candidate meets the same; (ii) channels used for searching the candidate. If he is recommended by a person, then the category of the person (viz. promoter, institutional shareholder, NED/ID, Executive Director etc.) shall be disclosed.

At present, appointment of IDs or filling up casual vacancy of IDs needs approval in next AGM which creates a huge time gap and that is not in the best interests of company especially for minority shareholder. Sometimes IDs appointment have been rejected despite the fact that they served on board for few months. The consultation paper of SEBI proposes that IDs shall be appointed on the board only with prior approval at AGM and in case of resignation, death, removal, failure to get

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[36] Tata Consultancy Services Ltd. v. Cyrus Investment Private Ltd. & Ors., (2021) SCC OnLine 272 (Ind.).

reappointed the casual vacancy shall be filled by approval taken within a time period of three months.

Regarding resignation of IDs, now LODR requires detailed reasons of resignation from such IDs and it has been seen that IDs after resignation have joined the same company as executive director without giving any proper reason of this transition. The consultation paper of SEBI proposes that the entire resignation letter of IDs shall be disclosed along with complete details of his directorship of companies and membership in board committees. If ID resigns due to pre-occupation, other commitments or personal reasons then there shall be a mandatory cooling off period of 1 year before he can join another board. The ID shall observe a mandatory cooling off period of 1 year before he transitions as executive director after resigning as ID in the same company.

Regarding the composition of the Audit Committee, at present in LODR regulations, the Audit Committee (2/3rd of directors is IDs) does all important financial review like review of financial statements, scrutiny of inter-corporate loans & investments, valuation of undertaking and assets of listed entity etc. In related party transactions, approval of Audit Committee is mandatory. Committee of IDs should give their recommendation on open offers and scheme of arrangement. SEBI evaluating the current position of audit committee proposed in the consultation paper that Audit Committee shall comprise of 2/3rd IDs and 1/3rd NEDs who are not related to the promoter, including nominee directors[37]. Amitava Banerjee writes that, "A Chartered Accountant must be independent in all aspects of his work. Persons like Bankers, prospective investors etc. who rely upon the accounts of the company must have faith in the independence and integrity of auditor. The auditor must be objective in his approach, fearless and capable of expressing an

[37] *Supra* note 33.

honest opinion based upon work undertaken by him and commensurate to his training and experience".[38]

Remuneration for IDs is an important issue. As per LODR regulations IDs are paid sitting fees (maximum Rs. 1 lakh)[39] & profit linked commission with an overall limit. IDs cannot be given stock options. Large or less payment has its own demerits. A debate has been mooted that profit linked commission must be removed and sitting fees must be increased which shall lead to IDs getting fixed fee without having any stake in long-term growth of company. On the other hand, performance linked commission may lead to short-termism and lead to conflicts and if it is supported by ESOPs to IDs with a long vesting period e.g., 5 years which is very popular these days in start-ups and technology company.[40] SEBI in its consultation paper has sought views of public about remunerating the IDs through ESOPs and maximum limit of remuneration through ESOPs. Harish Kumar, Partner, L&L Partners, has rightly expressed his concern regarding the revised remunerations limits fixed under Schedule V of the Companies Act, 2013, since they are understated considering the extensive scope of work and responsibilities of IDs.[41]

It may be concluded that the key sentiment that is echoed throughout the Paper is that by inculcating more transparency into the present system,

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[38] Amitava Banerjee, *Are Auditors Watchdogs or Bloodhounds* in CORPORATE GOVERNANCE - EMERGING DIMENSIONS 200 (Dr. Ashish Kumar Srivastava & Dr. Vikesh Ram Tripathi eds., 1st ed. 2021).

[39] Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, Gazette of India, pt. II sec.3(i), Rule 4 (Mar. 31, 2014).

[40] N. Narayanan & M. Gogate, *'Skin in the Game': A Case for Incentivising Independent Directors*, 1 J. GOVERNANCE 695 (2012).

[41] Ruchika Chitravanshi, *Profit or Loss, Independent Directors of Companies Must Get Paid: MCA*, BUS. STANDARD (Mar. 19, 2021) https://www.business-standard.com/article/economy-policy/mca-puts-limits-on-remuneration-of-non-executive-and-independent-directors 121031900599_1.html#:~:text=At%20the%20lowest%20slab%20of,board%20meetings%20in%20a%20year.

the voices and needs of minority shareholders will be more adequately heard and addressed.[42]

SEBI on June 29, 2021 in its board meeting approved almost all proposal made in Consultation Paper of March 01, 2021 via amendments to Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) pertaining to regulatory provisions related to Independent Directors (IDs). The amendments were; that appointment/Re-appointment and Removal of IDs shall be through a special resolution of shareholders for all listed entities. The process to be followed by Nomination and Remuneration Committee, while selecting candidates for appointment as IDs, has been elaborated and made more transparent including enhanced disclosures regarding the skills required for appointment as an ID and how the proposed candidate fits into that skillset. The composition of NRC has been modified to include 2/3rd IDs instead of existing requirement of majority of IDs. Shareholder approval for appointment of all directors including IDs shall be taken at the next general meeting, or within three months of the appointment on the Board, whichever is earlier. A cooling off period of three years has been introduced for Key Managerial Personnel (and their relatives) or employees of the promoter group companies, for appointment as an ID. Relatives of employees of the company, its holding, subsidiary or associate company have been permitted to become IDs, without the requirement of a cooling off period, in line with Companies Act, 2013. The entire resignation letter of an ID shall be disclosed along with a list of her/his present directorships and membership in board committees. A cooling-off period of one year has been introduced for an ID transitioning to a whole-time director in the same company/ holding/ subsidiary/ associate company or any company belonging to the promoter group.

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[42] Aarathi Das et al., *Independent Directors: SEBI Tightens the Framework*, NISHITH DESAI ASSOCIATES (Apr. 7, 2021) https://www.nishithdesai.com/information/news-storage/news-details/article/independent-directors-sebi-tightens-framework.html.

At least 2/3rd of the members of the audit committee shall be independent directors and all related party transactions shall be approved by only independent directors on the Audit Committee. The requirement of undertaking Directors and Officers insurance has been extended to the top 1000 companies (by market capitalization). These amendments shall be made applicable with effect from January 01, 2022. The Board also agreed to make a reference to the Ministry of Corporate Affairs, for giving greater flexibility to companies while deciding the remuneration for all directors (including IDs), which may include profit linked commissions, sitting fees, ESOPs, etc., within the overall prescribed limit specified under Companies Act, 2013.[43] SEBI did not approve dual approval structure for appointment, re-appointment, removal but it made it through special resolution.

UK and Israel adopted Dual Approval Structure in the light of corporate structure prevailing in the jurisdictions but Indian scepticism is relatable as corporate democracy watched by minority shareholders still is a distant dream. Minority's protection must not make corporations indecisive and stub. Special resolution will take care of minority interest for the time being.

Sushil Nathani, Managing Partner, Economic Laws Practice observed that, "The process as proposed however can create an atmosphere of potential conflict between the majority and minority shareholder." He further said that, "Given the recent experiences pertaining to management, remuneration and minority shareholder voting patterns, the construct of this methodology should permit the minority shareholder to have a voice but not make it adversarial process".[44] Anand Lakra, Partner

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[43] Press Release, Security and Exchange Board of India, SEBI Board Meeting (June 29, 2021), http://www.sebi.gov.in/media/press-releases/jun-2021/sebi-board-meeting_50771.html.

[44] Reena Zachariah, *Independent Directors on SEBI Board Meet Agenda Next Week,* ECON. TIMES (June 24, 2021) https://economictimes.indiatimes.com/markets/stocks/news/sebi-board-to-focus-on-

J. Sagar Associates on this issue observed that, "Increasing voting threshold for appointment of independent directors from 51% to 75%, public shareholders would play an important part in companies with low promoter stake".[45]

On Dual Voting Bombay Chamber of Commerce rejected the idea as it will hamper the search of good IDs and if appointment fails then searching a new replacement will become very difficult. It will also lead to benami holding to control minority shareholding.[46] Even removal by dual voting shall be counter-productive and lead to more complications. Lucian A. Bebchuk and Assaf Hamdani argue in their article that independence of IDs cannot be secured by people having controlling shares.[47] Majority has to honour and respect the value of dissent and minority however in corporate governance much depends upon 'Rule of Majority' again affirmed in TATA Case where minority has less to say.[48] Moreover, in all such moment of conflicts the best interests of company should be kept in mind.

V. CONCLUSION

Corporate Governance is an issue of culture and values. In India, Corporate Governance is based on a rule-based approach rather than a

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independent-directors-next-week-discuss-appointment-and-removal-rules/articleshow/83797214.cms.

[45] *SEBI Tightens Norms on Independent Directors,* TIMES OF IND. (June 31, 2021*)* https://timesofindia.indiatimes.com/business/india-business/sebi-tightens-norms-on-independent-directors/articleshow/83967458.cms.

[46] BOMBAY CHAMBER COM. & INDUS., RESPONSE OF LEGAL AND GOVERNANCE COMMITTEE OF BOMBAY CHAMBER ON SEBI CONSULTATION PAPER ON INDEPENDENT DIRECTORS (2021), http://bombaychamber.com/admin/uploaded/Reference%20Material/RESPONSE%20OF%20BOMBAY%20CHAMBERS%20ON%20SEBIS%20CONSULTATION%20PAPER%20ON%20INDEPENDENT%20DIRECTORS.pdf.

[47] Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders,* 165 U. PA. L. REV. 1271, 1315 (2017).

[48] Tata Consultancy Services Ltd. v. Cyrus Investment Private Ltd. & Ors., (2021) SCC OnLine 272 (Ind.).

principle-based approach. The entrepreneurs see corporations as a *modus operandi* of maximization of profits and are often oriented for short-swing profits than long term gain. The good norms of corporate governance result in brand building, customer loyalty, good environmental & sustainable governance compliance, better goodwill. Entrepreneurs with their clean image built on corporate governance can create limitless opportunities and reach to cosmic heights. Independent director is the main arc pillar of structure upon which the corporate governance stands. However, since its introduction in Indian capital, its independence has been questionable. Many committees and regulators have always attempted to empower the institution of IDs. Recent changes by SEBI after Uday Kotak Committee are laudable. Most of the changes will boost the morale of IDs. however non-adoption of dual approval mode shows the lack of confidence in minority shareholders.

These changes are going to strengthen the position of IDs in capital market. We can train people to govern corporations but developing qualities of courage, conviction, honesty, loyalty, integrity etc. is not possible. Examination and training of IDs has its own limitation and it cannot develop virtues in human beings. Strong value-driven culture is also required where business is run on ethics. However certain issues about exodus of IDs on account of large-scale resignations are a cause of concern. SEBI and MCA have to create an environment which empowers the IDs to achieve the goal of transparency and accountability. Often IDs find it hard to maintain the role of conscious keeper of corporations. Pressure of peer and promoter force them to compromise with their independence which results in poor corporate governance. Honest and dedicated IDs are often made scapegoats in corporate scandals. Copious & mammoth compliances are forcing honest IDs to exit. Rule based system has its own inherent problems like extreme norms for some listed entities and almost no compliance for others and in case any scandal happens then extreme, coercive, corrective measures adopted by Government and Regulators make it difficult to comply to regulatory

norms for budding entrepreneurs which hampers innovation and entrepreneurship.

SUSTAINABILITY REPORTING: A STEP TOWARDS THE FUTURE OR A SHOT IN THE DARK?

Noyonika Nair & Saranya Mishra[*]

ABSTRACT

The principle of sustainable development and sustainable development goals have emerged due to the realisation that economic advancement has to be balanced with the protection of the environment. Over the course of time, sustainability as a concept has become the centrepiece of attention from the corporates and regulators, across the world. The concept of ESG has also been developed to incorporate and apply the principles of sustainable development in the corporate world. Various international organisations have come up with voluntary disclosure frameworks to promote sustainability reporting. Regulatory interventions by countries have also increased in the last two decades which reflects the growing requirements for sustainability reporting.

In this paper, the authors discuss the concept of ESG and sustainable reporting, highlighting the regulatory and non-regulatory actions taken by international organisations and different countries to create awareness about ESG and promote sustainability reporting. The authors analyse these regulatory interventions and the corporate responses to the same. In conclusion, the authors argue that sustainability reporting is irreplaceable and therefore, sustainability as a way of doing business should be adopted.

Keywords: Sustainable Development, Corporate Governance, ESG.

[*] The authors are Associates at Khaitan & Co., Mumbai. The authors acknowledge and appreciate the assistance provided by Mr. Viplav Agrawal, final year student of West Bengal National University of Juridical Sciences, Kolkata, as Research Assistant for the paper. His research inputs have been valuable.

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I. INTRODUCTION

For centuries now, civilization has taken for granted notion that 'nature exists in a delicate balance'. '*An inconvenient truth*',[1] melting glaciers, extinction of species did little to deter humanity from the pursuit of industrial development and economic supremacy. Resultantly, our history is a testament to a hybrid 'environmental consciousness', but one that is limited by economic feasibility. The realisation that nature is an object of heredity for mankind as a whole, with the onus to ensure that it exists and continues to be in a state of equilibrium is on mankind, led to the conception of principles of sustainable development and subsequently recognition of sustainability development goals. What started as a soft commitment for nation states to adhere to, has now found its way as a commercial moot point in board rooms of corporate giants, more often than not at the behest of international organisations lobbying for sustainability reporting and the regulators contemplating adequate disclosures on such lines.

Among other things, regulators' interest in sustainability reporting also flared the principles of sustainable development in the concept of Environmental, Social, and (Corporate) Governance (*hereinafter* referred to as "**ESG**") and its corporate recognition, and ever since ESG has been a

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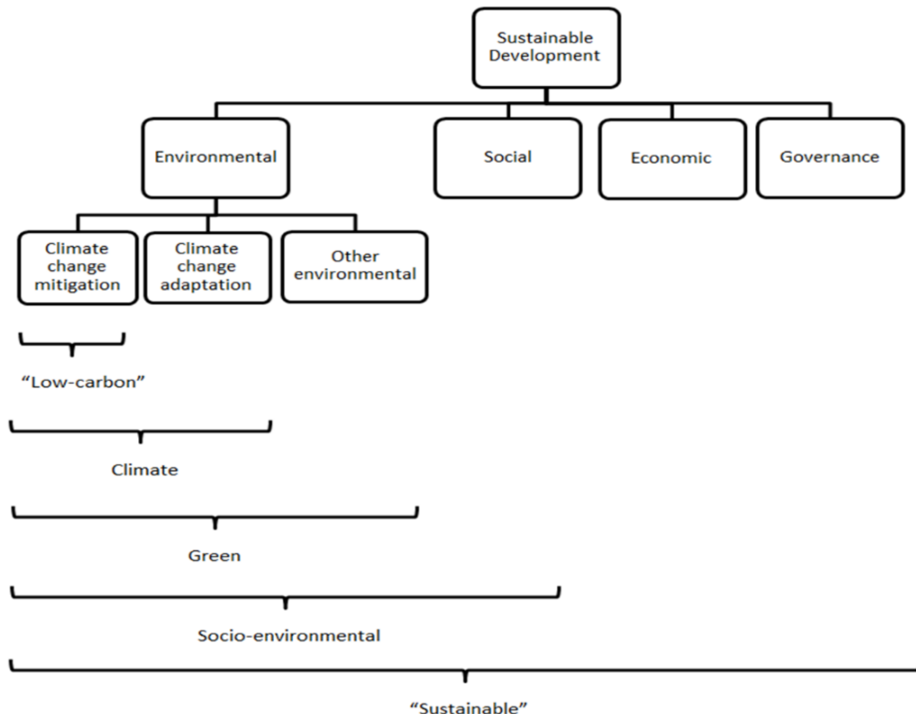
[1] AN INCONVENIENT TRUTH (Paramount 2006).

buzzword in the corporate circles, as the torch bearer of sustainable development. The ideation of sustainable development has provided sound foundation, which reigns supreme in most contexts, however the concept of ESG has gained more prominence as a commercial measure of business, probably because it is less alluding in comparison to the broad and wide abstraction of sustainability, given that ESG clearly recognises three concrete pillars for evaluation of alternatives and decision making, i.e., environmental, social and governance.

Recognising that action for sustainability and climate change advocacy is the need of the hour and the recent regulatory adoption of principles of sustainable reporting. The paper is divided into parts. In the course of the paper the authors have correlated the concept of ESG and sustainable reporting, discussed the concept of sustainability reporting, regulatory action in the US and India, revelled on the feasibility of regulatory action, and the corporate outlook in respect of adopting sustainable practices towards compliance with sustainable reporting.

II. THE 'E' AND 'S' IN ESG



SIMPLIFIED SCHEMA FOR UNDERSTANDING BROAD TERMS [UNEP 2016]

The concept of ESG consists of three primary components, i.e., environmental, social and (corporate) governance. While the governance component is quantifiable and has historically been of investor interest, the first two are non-financial parameters, which have gained prominence as risk identifiers in the 21st century. The disruption caused by COVID-19 pandemic has further provided more impetus to these two components, for them to measure at par with the governance component. Simply put, 'E' is the consideration of natural world, 'S' is the consideration of the

society in general, and 'G' is the manner in which the company is run. ESG as a concept is a measure to evaluate the sustainability of a company.

The environmental component of ESG can be further deconstructed in the following three buckets: (a) climate change mitigation, (b) climate change adaptation, and (c) other environment. The first bucket is rather precautionary and envisages mitigation methods to reduce or prevent emission of greenhouse gases, which leads to climate change. Mitigation involves adoption of energy efficient equipment or adopting such practices or inducing consumer behaviour which is acclimated to such products. This typically involves adoption of renewable energy and harnessing new technology to move towards a lower carbon emission system. The second bucket is essentially damage control measures based on the premise that climate change is already an existing overarching issue and needs to be thwarted, and also with the agenda to adjust to the actual or expected future climate. Measures for adaptation vary from region to region, based on the extent of the climate change issue, and a thorough understanding of the local risks and concerns to customise the most suited adaptation measure. This involves in depth study to understand the climate causal in the region and accordingly, tailoring a targeted approach. The third bucket is more miscellaneous and deals with all other efforts taken which indirectly contribute to the fight against climate change and more generally the environment.

Environmental consciousness of a company is a measure of its commitment to sustainability, and since there is no future without regard for sustainability, it may be arguably inferred that a company with sustainable business model and operations is prepared for the present and future of climate and maybe even future proof to the adverse effect of environmental destruction and degradation.

The 'S' stands for social component of ESG which is focused on the interplay between people, individually as well as a group, and the company. It factors in aspects like the human capital, end users/

customers, as well as geopolitical events.[2] In fact, it has also been mooted whether the 's' should instead mean stakeholder, since the use of 'social' may have led to a deviation from market alignment and orientation and assumed a character of its own.[3] Thus, the letter 'S' becomes important factor when it comes to company or a listed company as it is mainly focused on various stakeholders as part of prudent corporate governance.

III. SUSTAINABILITY REPORTING

Sustainability reporting is an admixture of environmental as well as social reporting. The concept of sustainable reporting has grown with the growing commercial adoption of sustainable principles and sensitisation of the regulators to the growing concerns over sustainability issues. The sustainable reporting has become a fortified issue for the companies due to the following factors. Firstly, stakeholders mandate the companies with disclosures on daily operations that adversely impact the environment. Another important highlight comes on the protection of the rights of citizen, particularly investors and the environment with the help of the strengthened regulatory intervention. The final contributor is market demand which forces companies to emphasise their operations towards a greater magnitude of sustainable development.[4]

Some of the globally well recognised sustainability reporting frameworks are United Nations Global Compact (UNGC), Global Reporting Initiative (GRI), CDP (formerly Carbon Disclosure Project) and ISO 26000 launched by the International Organisation for Standardisation.

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[2] *What is the "S" in ESG?,* S&P GLOBAL (Feb. 24, 2020) https://www.spglobal.com/en/research-insights/articles/what-is-the-s-in-esg.

[3] Jonathan Neilan et al., *Time to Rethink the S in ESG,* HARV. L. SCH. F. CORP. GOVERNANCE (June 28, 2020) https://corpgov.law.harvard.edu/2020/06/28/time-to-rethink-the-s-in-esg/.

[4] MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMMITTEE ON BUSINESS RESPONSIBILITY REPORTING (2020-21), https://www.mca.Gov.In/Ministry/Pdf/Brr_11082020.Pdf.

The frameworks listed above are voluntary disclosure frameworks/ standards provided by third party agencies (not being governmental agencies) to be referred to by companies to demonstrate adherence to sustainability principles.

A. INTERNATIONAL ORGANISATIONS

1. Value Reporting Foundation

The International Integrated Reporting Council and the Sustainability Accounting Standards Board merged to form the Value Reporting Foundation in June 2021 with the aim to create an international corporate reporting standard that is more credible and comprehensive to investor needs in a global era where sustainability and intangible value of investments have grown in importance.[5]

2. The International Financial Reporting Standards ("IFRS") Foundation

The IFRS Foundation, a non-profit established to develop globally accepted and adopted accounting standards which is set by the International Accounting Standards Board, which is the standard-setting body of the IFRS Foundation.[6] The Foundation in 2020 began broadening its scope to include sustainability reporting. In September 2020, the IFRS Foundation released a consultation paper on sustainability reporting[7] seeking public comments by December 31, 2020 and began formally exploring the creation of an International Sustainability Standards Board (ISSB) under the Foundation's purview, to further this

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[5] Amanda Medress, *Answering Your Questions about the Value Reporting Foundation*, VALUE REPORTING FOUND. (Dec. 21, 2020) https://www.sasb.org/blog/answering-your-questions-about-the-value-reporting-foundation/.

[6] *Who are we,* INT'L FIN. REPORTING STANDARDS FOUND., https://www.ifrs.org/about-us/who-we-are/ (last visited Oct. 19, 2021).

[7] INT'L FIN. REPORTING STANDARDS FOUND., CONSULTATION PAPER ON SUSTAINABLE REPORTING (Sep. 2020), https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf.

endeavour. In June 2021 it has been decided that ISSB shall be unveiled ahead of the COP26 U.N. climate change conference in Glasgow in November, as a single set of global norms/standards for firms reporting the impact of climate change on their business.

3. European Commission ("EC")

On October 19, 2020 the EC released a Commission Work Programme 2021 titled *A Union of vitality in a world of fragility.*[8] Through this paper, the EC highlights the twin green and digital transitions that are vital to Europe's development amidst the backdrop of the pandemic. Acknowledging the Sustainable Development Goals and Agenda of 2030,[9] and reacting to the pandemic, the EC highlighted the need to create policies that are *inter alia* future-proof. A step in this direction has been the European Green Deal which shall focus on overhaul of climate and environmental legislations to (a) cut down emissions by 55% by 2030, as compared to the existing levels in 1990; (b) introduce carbon border adjustment mechanisms; (c) smart and sustainable transport; and (d) a circular economy action plan aimed at eco-design and sustainability of products.[10]

4. Climate Disclosure Standards Board ("CDBS")

CDBS was founded in 2007 with the aim to promote and advance climate change related disclosure. Such task is sought to be achieved by creating a framework on corporate reporting on environmental information for the companies worldwide.[11] In its composition, the focus

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[8] EUR. COMM'N., COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS, Commission Work Programme 2021, A Union of vitality in a world of fragility, Brussels (Oct. 19, 2020) COM(2020) 690 final, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0690.
[9] G.A. Res. A/RES/70/1 (Oct. 21, 2015).
[10] *Supra* note 6.
[11] *About the Climate Disclosure Standards Board*, CLIMATE DISCLOSURE STANDARDS BOARD, https://www.cdsb.net/our-story (last visited Oct. 19, 2021).

remains on the risks and opportunity that climate change brings to an organisation's overall performances and goal. The particular emphasis has been started to be given to the environmental information subject to climate change on water and forest risk commodities.

The CDBS helps companies translate their sustainability information into long-term value which enables investors to make an informed decision in terms of allocation of financial capital.[12] In 2018, the update was to align the recommendation of Task Force on Climate-related Financial Disclosures and other key mainstream reporting requirement and bring uniformity in the reporting cycle for entities spread across the globe.[13]

5. Global Report Initiative ("GRI")

GRI standard represents the global best practices to publicly report a variety of economic, environmental and social impacts.[14] Any organisation irrespective of location, sector and earlier reporting experience can use the standards in a standardized comparable manner. This helps to shorten the gap between two different lines of organisation. For example, an energy consumption reporting by the automobile manufacturer is comparable with a steel company in another country. Thus, it meets the requirement of the stakeholders to have a comparable data for an informed decision making. The standards are in line with the basic UN Guiding Principles on Business and Human Rights, ILO conventions and the OECD guidelines for Multinational Enterprises.[15] The organisations can align

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[12] *Framework for reporting environmental and climate change information*, CLIMATE DISCLOSURE STANDARDS BOARD, https://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital (last visited Oct. 19, 2021).
[13] *Id.*
[14] *GRI Standards English,* GLOBAL REPORTING INITIATIVE, https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/ (last visited Oct. 19, 2021).
[15] *GRI Standard Brochure*, GLOBAL REPORTING INITIATIVE, https://www.globalreporting.org/standards/media/2458/gri_standards_brochure.pdf (last visited Oct. 19, 2021).

their goals with UN Sustainable Development Goals and report their progress and impacts based on the Standard of GRI.

IV. REGULATORY INTERVENTION

The regulators have been at the forefront of sustainability advocacy, which is evident from the studies which suggest that sustainability reporting requirements have increased tenfold in the last 25 years since the 1992 Rio Earth Summit to about a thousand,[16] indicating the complexity and need for such reporting.

A. CHINA CSRC

China's Securities Regulatory Commission (*hereinafter* referred to as "**CSRC**") requires disclosure of social responsibility-related information.[17] The local authorities in Shanghai and Shenzhen have taken the stance for inculcating the corporate sustainable development and social responsibility in the disclosures. The focus on reporting ESG risks is growing in China.[18] In 2011, the basic framework for companies to write their CSR reports was provided in Chinese CSR Report Guide 2.0.[19] The Environmental Impact Assessment Law deals with the disclosure requirements and consequence of non-compliance to assess the environmental impact of project.[20] It has provided the citizens, legal persons and other organisations with a right to obtain environmental information.

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[16] WORLD BUS. COUNCIL SUSTAINABLE DEV. & CLIMATE DISCLOSURE STANDARDS BD., INSIGHTS FROM THE REPORTING EXCHANGE: ESG REPORTING TRENDS (2017), https://docs.wbcsd.org/2018/02/Reporting_Exchange_Report_ESG_reporting_trends_2017.

[17] Dorcas Wong, *Sustainability Reporting in China: The Rise of CSR and ESG Reporting by Businesses*, CHINA BRIEFING (Sept. 27, 2021) https://www.china-briefing.com/news/sustainability-reporting-china-csr-esg-reporting-business-accountability/.

[18] *Id.*

[19] *Id.*

[20] *Id.*

In its recent consultation, CRSC increased the reporting requirements for publicly listed companies with wider area of ESG disclosures.[21] The new regulations add a new ESG chapter to financial statements, with mandatory disclosures of pollutant emissions, along with the procedures to minimise air, water and soil pollution, and governance.[22] Waste and Environmental incident reporting as well as all administrative penalties arising from environmental problems have been included as disclosure requirements.[23] Companies have been asked on voluntary basis to report the carbon emissions and measures to reduce them.[24] CSRC aims to bring the disclosures in line with global sustainable reporting standards.

B. DENMARK

The Danish Financial Statements Act provides for the necessity to comply with providing management commentary with a CSR report. The companies are to provide key figures of employees as it is considered a key subset of the ESG for the company's full-time workforce. The Act seeks to cover the investment policy for the coverage on social responsibility. In addition, at least 90% of institutional investors' investments are either directly covered by arrangements or subject to responsible investment policies. Within the framework of these policies, companies that manufacture weapons that comply with the convention will be screened and may result in their systematic exclusion.

The Danish Guidelines on Responsible Investment formulated suggests four steps for institutional investors.[25] They need to identify,

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[21] Amena Saiyid, *Chinese regulators set ESG disclosure rules as financiers eye investment opportunities*, IHS MARKIT (July 06, 2021) https://ihsmarkit.com/research-analysis/chinese-regulators-set-esg-disclosure-rules-as-financiers-eye-.html.

[22] *China Gets New ESG and other Disclosure requirements*, XBRL (July 9, 2021) https://www.xbrl.org/news/china-gets-new-esg-and-other-disclosure-requirements/.

[23] *Id.*

[24] *Id.*

[25] *Danish Guidelines on Responsible Investment*, GREEN FIN. PLATFORM (2018) https://www.greenfinanceplatform.org/policies-and-regulations/danish-guidelines-responsible-investment.

prevent and account for adverse impacts on matters covered in OECD Guidelines for environment, bribery and other integrity impacts.[26] They need to communicate ESG and engagement efforts, challenges and priorities. Denmark passed 'Climate Act' which makes it illegal when not acting on climate change.[27] The aim is to reduce the carbon emission by 70% in 2030.[28] It realises the target by taking into "account the long term green, sustainable business development and Danish competitiveness, sound public finances and employment, and the Danish business must be developed".[29] Thus, it is looking into the cost-effective measure to reduce the emission. The companies, thus, can be penalised in Denmark for not making efforts for not acting on climate change.

C. SOUTH AFRICA

Under the regime, there aren't any explicit duties on the public companies in South Africa to provide disclosures on ESG matters. However, the Johannesburg Stock Exchange (JSE) listing requirements places emphasis on general continuing disclosures applicable on financial material issues on ESG.[30]

The listed companies annually report on a "comply and explain" basis for disclosing the compliance with the King IV Code.[31] The Code focuses on ESG in short-, medium- and long-term value. It regards sustainability as the process creating value for all organisations. It recognises sustainable development as "a primary ethical and economic imperative". Some private sector initiatives such as Code of Responsible Investing in South

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[26] *Id.*
[27] Climate Act. No. 965 of 2020, §1 (Den.).
[28] *Id.*
[29] *Id.*, §3.
[30] Ezra Davids & Ryan Kitcat, *South Africa: Environment, Social & Governance Law: Setting the Scene – Sources and Overview*, ICLG.COM (Dec. 15, 2020) https://iclg.com/practice-areas/environmental-social-and-governance-law/south-africa.
[31] ORG. FOR ECON. CO-OPERATION & DEV. [OECD], INVESTMENT GOVERNANCE AND THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE FACTORS (2017), https://www.oecd.org/finance/Investment-Governance-Integration-ESG-Factors.pdf.

Africa (*hereinafter* referred to as "**CRISA**") have gained significance in ESG and sound stewardship.[32] The efforts are there to enhance the effectiveness of the CRISA.

D. US SEC

On February 08, 2010, the Security and Exchange Commission's Division of United States of America (*hereinafter* referred to as "**US SEC**") published a guidance for public companies detailing to existing disclosure requirements as they apply to climate change matters.[33] The central theme of the guidance was the terms of the Kyoto Protocol[34] that discussed greenhouse gas emissions and formulated the mechanism of 'cap and trade' system of allowances on emission of carbon dioxide and other greenhouse gases.

For the decade that followed, there was an increased demand amongst investors to require companies to disclose information in relation to the impact of climate change, risks, mitigating factors, etc. Thereafter, in 2020, the US SEC Investor Advisory Committee approved the requirement to update company disclosures and include ESG disclosures with the objective to provide information that was consistent and reliable to the investors while ensuring such disclosure requirements could be fulfilled by all companies (regardless of capital size or resources). Another pertinent factor was that the committee felt it was necessary for the SEC to control US ESG disclosure prior to a situation where such disclosures were dictated and imposed by other jurisdictions on both US companies and investors.[35] The committee came out with certain recommendations in

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[32] *Supra* note 30.

[33] Commission Guidance Regarding Disclosure Related to Climate Change Release Nos. 33-9106; 34-61469; FR-82 17 CFR PARTS 211, 231 and 241, https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[34] Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 10, 1997, 2303 U.N.T.S. 162.

[35] SEC INV'R ADVISORY COMM., U.S. SEC. & EXCH. COMM'N., RECOMMENDATION FROM THE INVESTOR-AS-OWNER SUBCOMMITTEE OF THE SEC INVESTOR ADVISORY COMMITTEE RELATING TO ESG DISCLOSURE (May 14, 2020),

December 2020.[36] In late 2020 the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission released a report on "Managing the Climate Risk in the U.S. Financial System.[37] The report unequivocally states that "*climate change poses a major risk to the stability of the U.S. financial system and its ability to sustain the American economy.*"[38] It discusses the necessity to first place a price on carbon emissions across the economy and simultaneously ensure that such price reflects the cost of such emissions on the environment. Acknowledging the existing framework, the report at its core highlights one major concern, the insufficiency in the information available by way of disclosures and compliance requirements, to assess climate change risks/exposure in relation to companies.

As a plausible causation to the above, US SEC on March 03, 2021 included climate and ESG risks under their regulatory lens. The intention as highlighted by Acting Chair Allison Herren Lee is to examine voting policies and practices and ensure these are aligned with the best interest and expectations of investors along with the sustainable growth of businesses in correlation with risks associated with climate change. While presently the US SEC has only invited comments from the public pursuant to this announcement, it appears that there are multiple hurdles/barriers that will have to be overcome prior to the US SEC releasing comprehensive guidelines/rules that are efficient in tackling future risks to investors because of climate change that do not stray from the ethos of the US SEC, i.e., protecting investments by holding businesses accountable.

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https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[36] *See* ASSET MGMT. ADVISORY COMM., U.S. SEC. & EXCH. COMM'N., POTENTIAL RECOMMENDATIONS OF ESG SUBCOMMITTEE (Dec. 1, 2020) https://www.sec.gov/files/potential-recommendations-of-the-esg-subcommittee-12012020.pdf.

[37] U.S. COMMODITY FUTURES TRADING COMM'N, MKT. RISK ADVISORY COMM., REPORT OF THE CLIMATE-RELATED MARKET RISK SUBCOMMITTEE (2020), https://bit.ly/3GrExtq.

[38] *Id* at i.

Presently, the hurdles before the US SEC include: (a) identifying missing corporate disclosures that investors are entitled to know and should be made aware of; (b) creation of relevant disclosure requirements that result in the availability of such environmental and social information; (c) identification of entities qualified to assess and provide information on such environmental and social disclosures related to such companies; and (d) regulation of such qualified entities.

E. INDIA: SEBI & MCA

MCA and SEBI are the key regulators in India, and have been at the forefront of environmental sensitisation for India Inc. The following is a short summary of the key developments in respect of ESG and sustainability reporting in India:

2009	MCA issued the National Voluntary Guidelines (*hereinafter* referred to as "**NVGs**") on corporate social responsibility.[39]
2012	SEBI under Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (*hereinafter* referred to as "**LODR**") mandated the top 100 listed companies by market capitalisation to file Business Responsibility Report (*hereinafter* referred to as "**BRR**") based on NVGs along with their annual report.[40] The BRR *inter alia* required disclosure of general information of the Company like industry, products, market competitors; financial details like paid up capital, turnover, profits, Corporate Social

[39] MINISTRY CORP. AFFAIRS, GOV'T OF IND., NATIONAL VOLUNTARY GUIDELINES ON SOCIAL, ENVIRONMENTAL & ECONOMIC RESPONSIBILITY OF BUSINESS (2011), https://www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf.

[40] SEC. & EXCH. BD. IND., BUSINESS RESPONSIBILITY REPORTS CIR/CFD/DIL/8/2012 (Aug. 13, 2012), https://www.sebi.gov.in/sebi_data/attachdocs/1344915990072.pdf.

	Responsibility (*hereinafter* referred to as "**CSR**"); business responsibility initiatives; and performance-based information.
2014	Companies Act 2013 was enacted, wherein it put the fiduciary duty on the director to promote objects of the company in line with protection of environment.[41] CSR was mandated as voluntary practice for companies with net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year. Further such a company was required to constitute a CSR committee as a board committee to oversee the CSR activities of the company. To further supplement the CSR legal regime the Companies (Corporate Social Responsibility Policy) Rules, 2014 (*hereinafter* referred to as "**CSR Rules**") were drafted and came into force. [42] The CSR Rules required a company meeting the threshold for statutory requirement of undertaking CSR to *inter alia* adopt a CSR policy as a guidance document, report CSR activities and expenditure, and ensure that CSR activities were in line with the activities listed in Schedule VII of the Companies Act 2013.
2015	SEBI by way of an amendment to the LODR extended the requirement of filing BRR to top 500 listed companies by market capitalisation, from erstwhile top 100 listed companies by market capitalisation.[43]

[41] Companies Act, No. 18 of 2013, §18 (Ind.).
[42] Companies (Corporate Social Responsibility Policy) Rules, 2014, Gazette of India, pt. II sec.3(i), (Feb. 27, 2014).
[43] SEC. & EXCH. BD. IND., EXTENSION OF APPLICABILITY OF BRRS TO TOP 100 LISTED ENTITIES FROM PRESENT REQUIREMENT TO 500 LISTED ENTITIES, BASED ON MARKET CAPITALISATION (2019), https://www.sebi.gov.in/sebi_data/meetingfiles/dec-2019/1576469077048_1.pdf.

2017	SEBI circular dated February 06, 2017 titled 'Integrated Reporting by Listed Entities' advised that the top 500 listed companies by market capitalisation, which are required to prepare and disclose BRR undertake integrated reporting on a voluntary basis from financial year 2017-18.[44] Integrated reporting views financial as well as non-financial aspects of a company and takes into consideration finance, manufacturing, intellectual property, human resources, social and relationship and natural capital, each of which is recognised as a capital, to aid investor make an informed investment decision.
2018	MCA constituted a Committee on Business Responsibility Reporting (the Committee) to finalise business responsibility reporting formats for listed and unlisted companies, based on the framework of the National Guidelines on Responsible Business Conduct (NGRBC). Through its "Report of the Committee on Business Responsibility Reporting' recommended that BRR be revamped and ESG parameters for disclosure be accommodated to encourage sustainability efforts on part of companies, being above and beyond the regulatory compliances. [45]
2019	MCA revised NVG and formulated NGBRC , which were released in March 2019. [46] The idea behind the NGBRC was to

[44] SEC. & EXCH. BD. IND., INTEGRATED REPOSTING BY LISTED ENTITIES, SEBI/HO/CFD/CMD/CIR/P/2017/10, (Feb. 6, 2017), https://www.sebi.gov.in/sebi_data/attachdocs/1486375066836.pdf

[45] MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMMITTEE ON BUSINESS RESPONSIBILITY REPORTING, 17 (May 8, 2020), https://www.mca.Gov.In/Ministry/Pdf/Brr_11082020.Pdf.

[46] MINISTRY CORP. AFFAIRS, GOV'T OF IND., NATIONAL GUIDELINES ON RESPONSIBLE BUSINESS CONDUCT (2019), https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf.

	sensitise the companies in general to the principles underlying NGBRC like ethics, sustainability, etc. in letter and spirit
2019	SEBI amended the LODR to increase the net of BRR reporting requirement and required top 1000 listed companies by market capitalisation to publish and disclose BRR. [47]
2021	SEBI replaced BRR with Business Responsibility and Sustainability Report (*hereinafter* referred to as "**BRSR**").[48]

BRSR has three sections: (a) general disclosures; (b) management and process disclosures; and (c) principle wise performance disclosures, which are further categorised into essential indicators and leadership indicators.

The BRSR was formulated to benchmark the disclosures by company on the ESG related parameters. Under the Environmental related disclosures, the essential indicators in the form of resource usage, the emission of greenhouse gases and air pollutant; and the waste management issues have been mandated. The SEBI also listed the requirement of leadership indicators on the energy consumption, water consumption, reclaimed products and the overall impact on the biodiversity. Thus, the centre of environmental disclosures has been essential and leadership indicator. In the Social related disclosure, the emphasis has been on the social security of the employees and workers along with the gender and social diversity in the work-space environment. Since, the companies extensively deal with consumer and community in

[47] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2021, Gazette of India, Pt. III, sec. 4 (Sept. 7, 2021).

[48] SEC. & EXCH. BD. IND., CIRCULAR FOR BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING BY LISTED ENTITIES, SEBI/HO/CFD/CMD-2/P/CIR/2021/562 (May 10, 2021), https://www.sebi.gov.in/sebi_data/meetingfiles/apr-2021/1619067265752_1.pdf.

furtherance of companies' objects, the disclosures related to the consumer awareness and redressal have been mandated, along with the Social Impact Assessments and CSRs. As for the governance related disclosures, the overall responsibility taken by the board in sustainability and the conduct scrutinized by the regulatory authorities have been sought.

The BRR has been replaced by BRSR to thrust the companies on sustainability and business responsibility.[49] On the scope of companies covered under BRSR as it has been made applicable to all companies.[50] Thus, the widened scope of reporting requirements in the only source of sustainable information has been the focus through the BRSR.[51]

There is also a 'BRSR Lite' format which is meant for unlisted companies for voluntary disclosure. BRSR as a first step towards accommodating quantifiable ESG metrics in regulatory disclosure is comprehensive.

V. ANALYSIS OF REGULATORY ACTION

Regulators across the world are independently making strides to incorporate principles of ESG in the way the corporate function. It would not be an overstatement to say that, at this point of time, corporates are under more scrutiny than ever.[52] In this section we reason the regulators'

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[49] *Id.*

[50] *Id.*

[51] SUSTAINABLE REPORTING STANDARDS BD., INST. CHARTERED ACCT. IND., BACKGROUND MATERIAL ON BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING 119 (2021), https://www.bakertilly.in/auth/writereaddata/tender/1902213103ICAI%20-%20Background%20Material%20on%20Business%20Responsibility%20and%20Sustainability%20Reporting.pdf.

[52] Harry Matyajaszek, *CSR is a thing of the past: Why more businesses need to invest in ESG?*, ENERGY LIVE NEWS (July 28, 2020) https://www.energylivenews.com/2020/07/28/csr-is-a-thing-of-the-past-why-more-businesses-need-to-invest-in-esg/?__cf_chl_jschl_tk__=pmd_B8kgwcZpW9GnSyT_Y3_XAfsfy4SuCbADySEzc4QOCkU-1634367143-0-gqNtZGzNAqWjcnBszQil.

action in terms of mandating top companies with the increased disclosure requirements.

With great power comes great responsibility: ESG across the globe appears to presently require reporting and compliance by those companies that have the resources to provide such information comprehensively and efficiently. Thus, globally, the reporting requirements are restricted to the top performing companies in the jurisdiction. There are voluntary sustainable reporting formats as well for companies in general, which have been prescribed by the regulators in certain jurisdictions; however the same are not mandated. The voluntary reporting requirement i.e. "comply or explain" leads to incomplete data collection and does not fulfil the purpose of providing comparable data across sectors and companies.

The regulators in Denmark mandatorily require the companies to provide environmental information and associated corporate strategy and performance with the information.[53] In the South African regime, the reporting is based on "comply or explain" basis.[54] For the publicly traded companies in the US, the disclosure of material risks to their business on account of climate change are mandatory.[55] European Commission requires the large public interest entities to disclose non-financial information over 6000 companies.[56] The reports by these companies should have environmental and social information. The Commission also published non-binding guidelines on methodologies and key performance indicators to help the disclosure become more consistent and comparable.[57]

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[53] *Supra* note 31.
[54] *Supra* note 31 at 17.
[55] *Supra* note 31.
[56] Commission Directive 2014/95/EU, OJ (L 330) 1.
[57] EUR. COMM'N, CONSULTATION DOCUMENT ON THE UPDATE OF THE NON-BINDING GUIDELINES ON NON-FINANCIAL REPORTING (2019), https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2019-non-financial-reporting-guidelines-consultation-document_en.pdf.

The efforts taken by the above countries are focused on encouraging transparency on ESG issues, however, the voluntary reporting requirements make it difficult for the companies and investors across jurisdiction to scale their operations up against each other. The reporting requirements, thus, do not serve as the metrics as would be preferred.

Not everyone's cup of tea: While environmental consciousness is commendable, it is critical to bear in mind that the motivation behind and the central theme of all businesses is profit, by any and all means possible. It is with the growth of a business and sufficient accumulation of profit, that there is room for altruistic considerations to be had, including the Robin Hood syndrome of 'giving back to the society' and environmental consciousness.

In the context of the difference between BRR and BRSR, the listed company may have to report twice because of BRSR. Firstly, in the annual report and secondly in the MCA portal as opposed to once under BRR. Earlier such information was sought under BRR[58] for subsidiaries of the companies but under BRSR, holding, subsidiary, associate, joint venture if any participates in the BR initiatives of the parent company. BRSR has increased the cost for the companies because these filings and disclosures involve lots of consultations with auditors and evaluation of the finances. Thus, even for the top companies, it is an extra burden to abide by these disclosure requirements.

It is not a phenomenon that arises from the inception of a company as a necessity but is more perceivable as an acceptable cost to company once sufficient growth is achieved. This in a way justifies the regulators requiring disclosure from the top companies.

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[58] *Supra* note 51.

VI. CORPORATE RESPONSE

While some have voluntarily embraced it as a part of their corporate agenda, there are still quite a few corporates who hesitate at the ramifications and challenges that ESG compliance will result in. In this section we have discussed examples of corporate response on both end of ESG compliance spectrum.

A. PRO-ESG

Keeping up with the evolving times: Multitude of the voices in favour of ESG regulation and sustainable reporting echo the financial burden of the COVID-19 pandemic and bring to the fore situations that are likely to arise, if sustainable practices are not adopted.[59] Most companies believe that just the way the pandemic had a significant impact on stock markets across the world, every environmental risk/change will have a ripple effect, if not an adverse impact and it is of significant relevance that investors be informed, updated and prepared for such eventualities.

Costlier affairs without the ESG Disclosure Requirement and increase in capital access: The cost recognised for having ESG disclosure requirements is countered by costs of not having ESG requirements. Investors end up getting confused on investment and voting decision when there is lack of consistency, comparability and reliability on ESG information. Investments become due and are held back in the absence of information. Being that as the state of affair, the company incurs increasing costs over time to further incentivise the investors. They are faced with numerous conflicting, redundant and frequent requests for providing information on the same topic. For the companies constrained by the capital and having small finances, the risk of higher costs becomes incumbent in the absence of ESG disclosure requirement. Moreover, the access to capital itself increases as several asset management companies have set up ESG fund. ESG performances are the metric to make

[59] *Supra* note 6.

investment decisions. The reflection can be seen in green financial products and instrument being evolved.[60]

Pre-emptive regulatory reporting: Some regulators like the US SEC are contemplating ESG compliance as a pre-emptive step in order to avoid a situation wherein the country's economy and its investors are at ideological loggerheads. Accordingly, companies are likely to be bridled with compliance and reporting requirements that are formulated by the global economy including the EC but have local implications.[61] The idea underlying pre-emptive reporting is to require companies to undertake procedures like risk analysis and projections, and allow the investors and companies alike to act with foresight.

Inevitable eventuality: Following suit from the Kyoto Protocol[62] a staggered requirement of compliance with emission reduction targets spanned across all time frames: short, medium and long is necessary to ensure ease of transition and acceptance of compliance requirements by companies and investors alike. Adoption of sustainable reporting will aid the companies in dealing with such eventualities and also achieve the Sustainable Development Goals, which are to be achieved globally by 2030.

B. NOT SO ESG FRIENDLY

1. <u>Regulatory overreach:</u>

The central responsibility of the security regulatory authorities is to protect investors and their capital, not the environment, and a corporate regulatory in general is to *inter alia* facilitate corporate growth and strengthen corporate governance. The arguments against regulators

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[60] MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMMITTEE ON BUSINESS RESPONSIBILITY REPORTING, 17 (2020), https://www.mca.Gov.In/Ministry/Pdf/Brr_11082020.Pdf.
[61] *Supra* note 8.
[62] *Supra* note 11.

delving in ESG and requiring sustainable reporting is that if regulators start regulating environmental disclosures of companies, it is a regulatory overreach and encroachment in a subject matter which is not part of their domain. A further build up to this argument is that such regulatory compliance results in increase in compliance and procedural burdens faced by companies causing a reduction in their profitability and subsequent return on investments of the investors, thereby going against the primary purpose behind which such regulatory bodies were established.

2. <u>Lack of clarity on the meaning of ESG:</u>

A valid concern of the corporates also is that increased investor and consumer interest in ESG have led to pervasive use of the term without clarity as to what it means or how ESG is calculated and comprehensively evaluated. [63] It is of relevant significance to such investors that if ESG is implemented then such implementation should be effective and comprehensive or the entire compliance regime should be avoided at all costs.

3. <u>Impact of climate change is a speculative assessment:</u>

While climate change is a significant and real threat to the environment, present indications of the impact / risk on the environment are argued to be speculative. For example, the impact of climate change will be felt differently by a developed country versus a significantly smaller country with a lower gross domestic product that may not have the resources or the capital to protect its citizens the same way a developed nation may be equipped to.

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[63] Allison Herren Lee, *Public Input Welcomed on Climate Change Disclosures*, PUBLIC STATEMENT, US SEC (Mar. 15, 2021) https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.

VII. WAY FORWARD

While the road ahead is daunting and has ample challenges, it is an eventuality that cannot be avoided. The authors acknowledge that there are a multitude of avenues available to the global citizenship to ensure sustainable development including specialised regulatory intervention (not akin to company compliance requirements) and even space exploration. In fact, Neil deGrasse Tyson in his discussion with Fareed Zakaria on July 11, 2021 took the opportunity to highlight that space may in fact be an avenue that provides multiple solutions to existing environmental risks and practical problems on earth such as large-scale industrial manufacturing.[64] However, alternatives to sustainable reporting do not successfully discard the relevance or the benefit of formulating a global regime of companies that are conscious in their carbon emissions and investors that have the tools to identify such compliance along with information to substantiate these numbers.

A common causation link through the course of generations across continents has been state intervention, followed by economic regularisation and thereafter shared responsibility between the state and private bodies. It was witnessed in the global markets, with the legal inclusion of corporate social responsibility, and presently even private players entering and providing access to space exploration. This causation link must continue, and it is critical to human development that the ideation of sustainable development and its expression through sustainability reporting shifts to a shared responsibility of both private and state players.

Since the BRSR formats can be generic and lots of scepticism may come from some sectors, the sector-specific BRSR formats can be considered with certain additions to the main content and not replacement. This is because if there are differences in the ESG

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[64] A special hour as billionaire Richard Branson blasts off to space, CNN AUDIO (July 11 2021), https://edition.cnn.com/audio/podcasts/fareed-zakaria-gps.

disclosures in different sectors, then the purpose of the international forums requiring regulators to have uniformity in ESG would come under threat.[65]

To conclude, it seems befitting to quote Mufasa's words to Simba: "*Everything you see exists together in a delicate balance. As animals (humans), we need to understand that balance and respect all the creatures, from the crawling ant to the leaping antelope.*"[66]

[65] *Supra* note 59.
[66] THE LION KING (Buena Vista Pictures, 1994).

REGULATORY & GOVERNANCE CHALLENGES ARISING DUE TO THE EMERGENCE OF SPECIAL PURPOSE ACQUISITION COMPANIES (SPACs) IN THE INDIAN CORPORATE ENVIRONMENT

Navaneet Desai[*]

ABSTRACT

A confluence of many factors which drove the popularity of SPACs in the US post the COVID-19 pandemic, also managed to quickly attract the attention of many capital-starved global companies and market regulators across other jurisdictions. As the initial global scepticism surrounding the mechanism declined and the world balked at the pace with which the US SPAC juggernaut smashed all capital raising records in 2020, market regulators across various jurisdictions jumped aboard the SPAC bandwagon in announcing a framework for their domestic capital markets. Now, even as the US SPAC market, forced on its knees by the SEC, finally cools down, there seems to be no hesitation in many global markets in accepting the fact that SPACs are a risky, yet a viable fund-raising alternative. Recently, the Indian Market Regulator, SEBI, too set up an expert group under its Primary Market Advisory Committee (PMAC) to explore the possibility of a SPAC framework in India. While the current global sentiments seem to accept SPACs as more than just a passing fad, one cannot ignore that the SEC itself has time and again expressed frustration with certain quirky issues surrounding SPACs which also make them immensely popular. In this context, this article firstly attempts to understand as to what makes SPAC IPOs so special in comparison to the traditional IPOs. Secondly, this article breaks down the basic SPAC structure in the US which, in turn, helps in understanding the inherent sticky issues surrounding US SPACs. Lastly, the article, while highlighting the regulatory challenges for implementing SPACs in India, further analyses the inherent issues surrounding US SPACs in the Indian context and attempts to provide potential workaround solutions to potential governance issues arising from adopting a US style SPAC framework in India.

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Keywords: SPAC, warrant, sponsor, promote, PIPE, dilution.

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I. INTRODUCTION – WHAT IS A SPAC?

A SPAC is in essence a company created by a sponsor that has no operations of its own (a shell company)[1] and which goes public to raise capital to acquire a non-listed operating company and in process, takes the non-listed company public via a reverse merger.[2] Since the initial capital is

[1] *See* DELOITTE, ACCOUNTING AND SEC REPORTING CONSIDERATIONS FOR SPAC TRANSACTIONS, 20(6) FIN. REPORTING ALERT (Feb. 10, 2021) https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-accounting-and-sec-reporting-considerations-for-SPAC-Transactions.pdf [hereinafter Deloitte Financial Reporting Alert]; *See* David Curtiss, *Special Purpose Acquisition Companies*, LEXIS NEXIS, https://www.lexisnexis.com/lexis-practical-guidance/the-journal/b/pa/posts/special-purpose-acquisition-companies [hereinafter Curtiss].

[2] *See* Ivana Naumovska, *The SPAC Bubble is About to Burst*, HARV. BUS. REV. (Feb. 18, 2021) https://hbr.org/2021/02/the-spac-bubble-is-about-to-burst.

raised from investors who do not know their ultimate target companies, they are sometimes, referred to as 'blank check'[3] companies.

This article, in **Part – I**, provides a brief primer on the various stages that a typical US SPAC IPO undergoes in its lifetime, which form the basis of all subsequent analysis and discussions. **Part – II** explains the circumstances that led to the sudden uptick in the popularity of SPACs in 2020 and offers the first glimpse of the advantages of a SPAC route as against a traditional IPO route. **Part – III** of the article delves into the popularity of SPACs trickling into the Indian funding ecosystem and the nascent yet evolving regulatory initiatives that seek to create a domestic framework to incorporate SPACs as a viable funding alternative. **Part – IV** highlights the various perception related issues currently plaguing the traditional US SPAC framework when compared with the traditional IPO route, while **Part – V** highlights the additional set of regulatory and governance issues that would crop up, specific to the Indian market. Lastly, **Part – VI** attempts to offer potential workarounds to the expected set of regulatory and governance challenges that may be faced while designing a tailored regulatory framework catering to the Indian market.

II. PART – I: A PRIMER ON THE VARIOUS STAGES OF A TYPICAL US SPA

A. THE PRE-IPO STAGE

SPACs in US are usually set up by 'Sponsors'. The Sponsors are usually entities (either Individuals or institutions) that have credibility in the market irrespective of their background. These Sponsors initially designate around 25% of the pre-IPO equity (20% post-IPO) to themselves and such allotment to themselves is referred to as Sponsors'

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[3] *See* Tim Jenkinson & Miguel Sousa, *Why SPAC investors should listen to the market*, J. APPLIED FIN., 2 (2009).

'Promote'[4] or sponsor compensation for the work they do in hunting and acquiring target companies.

B. THE IPO STAGE

At the time of the IPO, Sponsors also purchase units of SPACs at the same rate as that of initial IPO investors, which is usually set at $ 10 per unit.[5] At this stage, the IPO Investors do not know details of the Target Company.[6] The only information that they possess is usually either the industry or the geography or both being targeted by the SPAC.[7]

C. POST IPO – THE HUNTING STAGE

Each unit of a SPAC held by an IPO investor usually consists of one share along with one 'share warrant'. The share warrant allows the IPO investor to further purchase a fraction of a share (usually between ¼ to 1 whole share) at a later stage, usually at a pre-set price of $ 11.50 per share.[8] The proceeds of sale of such units to the sponsor as well as to initial IPO investors are placed in an interest earning trust (by investing Treasury Notes).[9]

The SPAC usually has two years to hunt and acquire target companies and this may be extended by another year based on shareholder approval. During this time, sometime post listing, the shares as well as warrants of

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4 *See* Richard Beales, *Breakingviews - The house always wins with SPACs*, REUTERS (Feb. 27, 2021) https://www.reuters.com/article/us-usa-spacs-breakingviews-idUSKBN2AQ2T8.
5 *See What You Need to Know About SPACs – Updated Investor Bulletin,* INVESTOR ALERT AND BULLETINS, US SEC (May. 25, 2021) https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin [hereinafter Investor Bulletin, US SEC]; Michael Klausner et.al., A Sober Look at SPACs, (Eur. Corp. Governance Inst., Working Paper No. 746, 2021), https://ecgi.global/sites/default/files/working_papers/documents/klausnerohlroggeruanfinal.pdf [hereinafter ECGI Working Paper].
6 Curtiss, *supra* note 1, at 1.
7 Curtiss*, supra* note 1.
8 ECGI Working Paper, *supra* note 5, at 2.
9 *Supra* note 5.

SPAC trade separately on the exchange instead of being traded as a unit.[10] Furthermore, shares can be redeemed by the IPO investors at any point of time post listing, irrespective of how they vote in case of a prospective target company.[11] What is even more exciting is that even after redeeming their shares, IPO investors can hold onto their warrants for quite some time, which can be exercised at $ 11.50 per share if the merger is successful.[12]

If the SPAC is unable to acquire any target company within the timeline granted to it by the investors, the money is returned to the investors with interest that is earned by investment in Treasury Notes.[13]

D. DE-SPAC – THE REVERSE MERGER STAGE

Once a Target Company is identified, negotiations for a reverse merger can be completed within a couple of months and put to vote before the IPO investors.[14] Post shareholder approval, irrespective of how an investor voted, every investor has an equal right to redeem their shares even during the merger stage. The Merger stage is also known as the De-SPAC stage as the SPAC drops its name and takes on the name of its Target Company.[15]

Since, there is always a possibility that initial proceeds of the IPO may turn out to be insufficient due to subsequent high redemptions by IPO investors, the US SPAC framework envisions an alternative funding

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[10] *See* Investor Bulletin, US SEC, *supra* note 5.
[11] *Supra* note 5.
[12] *Supra* note 5.
[13] *See* Jason Ye, *Special Purpose Acquisition Companies (SPACs) – Part II*, S&P GLOBAL (Mar. 23, 2021) https://www.spglobal.com/en/research-insights/articles/special-purpose-acquisition-companies-spacs-part-ii.
[14] *See* Raluca Dinu, *De-SPAC Process – Shareholder Approval, Founder Vote Requirements, and Redemption Offer*, GIGCAPITAL (Dec. 27, 2019) https://www.gigcapitalglobal.com/de-spac-process-shareholder-approval-founder-vote-requirements-and-redemption-offer/.
[15] *See* Christopher Barlow et al., *The Year of the SPAC*, SKADDEN, ARPS (Jan. 26, 2021) https://www.skadden.com/insights/publications/2021/01/2021-insights/corporate/the-year-of-the-spac.

solution to replace the cash lost through redemptions in the form of Private Investment in Public Equity (PIPE)[16] Investors. Thus, the original proceeds along with the PIPE money are used to fund the merger as well as the post-merger working capital.

III. PART – II: THE SUDDEN SPAC BOOM - THE GLOBAL CONTEXT

Now that the various stages of a SPAC have been elucidated, it is important to first understand the circumstances that led to a sudden interest in SPACs in 2020 before comparing them to the traditional IPOs.

As a once in a century pandemic quickly engulfed the world at the start of 2020, it marked a watershed moment in history that not only tested the human resolve for social distancing but also fundamentally forced a rethink on how businesses must be run.[17] As survival became the first order of business in the face of the growing severity of the pandemic, by the second half of the year, 'cash preservation'[18] quickly gave way to 'capital raising'[19] for most companies across the world. However, given the initial paralysis of the global private equity funds, which chose to wait and watch how the pandemic unfolded[20], companies turned to the global

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[16] Dimitri Batsev & Jason Katz, *How SPAC Skepticism Has Given PIPE Investors an Edge*, LAZARD ASSET MGMT. (May, 2021) https://www.lazardassetmanagement.com/research-insights/lazard-insights/spac-skepticism-pipe-edge.

[17] *See* Mark John, *Over half Europe's small firms fear for survival, survey finds,* REUTERS (Oct. 22, 2020) https://www.reuters.com/article/uk-europe-economy-smallbusiness-idUKKBN27709T.

[18] *See Cash preservation in response to COVID-19*, MCKINSEY & COMPANY (May 26, 2020) https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/cash-preservation-in-response-to-covid-19#.

[19] *See* Chris Bryant, *Companies Should Grab Cash Now Because a Grim Winter is Coming,* BLOOMBERG (Aug. 13, 2020) https://www.bloomberg.com/opinion/articles/2020-08-13/the-coronavirus-has-made-raising-equity-fashionable-again.

[20] Ewa Skornas & Larisa Whitmore, *The Impact of the COVID-19 Pandemic on the Private Equity Market,* S&P GLOBAL (Sep. 14, 2020) https://www.spglobal.com/marketintelligence/en/news-insights/research/the-impact-of-the-covid19-pandemic-on-the-private-equity-market.

stock markets which, after bottoming out in the first few months, had restarted their climb which was carefully orchestrated by most major central banks which announced rock bottom interest rates along with various forms of quantitative easing.[21] Even then, given the high volatility of the global stock markets in 2020, traditional IPOs, which heavily depend upon underpricing the stock to achieve an 'IPO pop'[22], were deemed too risky given the jittery sentiments of investors in the markets.[23]

Thus, IPOs via Special Purpose Acquisition Vehicles or SPACs, an alternative to the traditional IPOs, surged in popularity in the US due to the confluence of the following factors:

- Under the US regulatory system, the timeline for listing via a SPAC was shorter than that of a traditional IPO.[24]
- Given the nature of a SPAC listing process,[25] companies did not have to resort to an elaborate roadshow for interested investors, unlike the case of a traditional IPO, which saved costs.
- A debatable perception that a SPAC listing would be better immune to volatility when compared to a traditional IPO.[26]

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21 Press Release, US Federal Reserve, Federal Reserve announces extensive new measures to support the economy (Mar. 23, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm; Larry Elliot, *Bank of England pumps an extra £100bn into UK economy*, THE GUARDIAN (Jun. 18, 2020) https://www.theguardian.com/business/2020/jun/18/bank-of-england-uk-economy-quantitative-easing-coronavirus-crisis; *See* Silvia Amaro, *European Central Bank takes its pandemic bond buying to 1.35 trillion euros to try to prop up economy*, CNBC (June 4, 2020) https://www.cnbc.com/2020/06/04/european-central-bank-ramps-up-its-pandemic-bond-buying-to-1point35-trillion-euros.html.

22 *Breaking the bubble - Top risks to the SPAC surge,* BAKER MCKENZIE (Apr. 28, 2021) https://www.bakermckenzie.com/en/insight/publications/2021/04/breaking-the-bubble-spac-surge.

23 Deloitte Financial Reporting Alert, *supra* note 1.

24 *See* Investor Bulletin, US SEC, *supra* note 5.

25 *See* ECGI Working Paper, *supra* note 5; *Infra* note 32, at 6.

26 *See* ECGI Working Paper, *supra* note 5; *Infra* note 32, at 6.

- Private equity funds which were sitting on 'dry powder' till now, quickly jumped on this opening and poured in huge capital into these SPACs[27]

Thus, the allure of an apparently quicker, cheaper and a less volatile listing process quickly took over the US stock market with around 165 global SPAC IPO listings between January and October of 2020, nearly double the number of SPAC IPOs issued in 2019 and five times that of 2015.[28]

IV. PART – III: THE INDIAN TEMPTATION

The sudden spurt in US SPAC listings quickly caught global attention, forcing market regulators across the globe to relook their frameworks for such an alternative.[29] India too jumped on the bandwagon with SEBI forming an expert group under the Primary Market Advisory Committee to explore the potential of an Indian version of SPAC[30] and IFSCA even

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[27] *See* Adam Lewis, *Private equity plays a starring role in 2020's SPAC boom*, PITCHBOOK (Sep. 17, 2020) https://pitchbook.com/news/articles/private-equity-spacs-2020s.

[28] Nessa Anwar, *SPAC listings hit a record high in 2020 — but what are these 'shell companies'?*, CNBC (Nov. 22, 2020) https://www.cnbc.com/2020/11/23/what-are-spacs-2020-saw-record-number-of-shell-companies-listed.html.

[29] *See* FIN. CONDUCT AUTH., INVESTOR PROTECTION MEASURES FOR SPECIAL PURPOSE ACQUISITION COMPANIES: PROPOSED CHANGES TO THE LISTING RULES (CONSULTATION PAPER CP21/10) (Apr. 2021), https://www.fca.org.uk/publication/consultation/cp21-10.pdf [hereinafter FCA Consultation Paper]; *See* SGX, CONSULTATION PAPER ON PROPOSED LISTING FRAMEWORK FOR SPECIAL PURPOSE ACQUISITION COMPANIES, SING. EXCHANGE (Mar. 31, 2021), https://www.sgx.com/regulation/public-consultations/20210331-consultation-paper-proposed-listing-framework-special; *See* Look Gannon, *SPACs – Possible New Gateway to Fundraising in Hong Kong?*, DLA PIPER (May. 10, 2021) https://www.dlapiper.com/en/hongkong/insights/publications/2021/05/spacs-possible-new-gateway-to-fundraising-in-hong-kong/.

[30] TNN, *Sebi, IFSCA look at setup for 'blank cheque companies' in India*, TIMES OF IND. (Mar. 12, 2021) https://timesofindia.indiatimes.com/business/india-business/sebi-ifsca-look-at-setup-for-blank-cheque-cos-in-india/articleshow/81457082.cms.

coming out with a bare bones framework for SPACs meant exclusively for the IFSC GIFT City.[31]

Though the recent pace of SPAC IPOs in US has dramatically cooled down in 2021 as compared to 2020, partly due to the US stock market regulator throwing a monkey wrench in the growth engine of SPACs[32] (elaborated in **Part – IV** of this article), they are being recognized as a viable alternative fund-raising framework from the point of many regulators[33] and companies[34] across the globe.

In spite of the surging global acceptance of SPACs as a viable alternative source of capital, the question that this article seeks to raise and attempt to answer is – *whether SPACs and the Indian capital markets are a match made for each other?*

This question is even more pertinent to raise given the recent unprecedented boom in traditional IPOs that the Indian capital markets has witnessed in 2021,[35] partly led by technology companies such as Zomato, an entity that is yet to turn a profit.[36] This traditional IPO boom

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[31] INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY, CONSULTATION PAPER ON THE PROPOSED INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY (ISSUANCE AND LISTING OF SECURITIES) REGULATIONS, 2021 (Mar. 2021) https://ifsca.gov.in/Viewer/ReportandPublication/9.

[32] *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs"),* PUBLIC STATEMENT, US SEC (Apr. 12, 2021) https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs.

[33] *Supra* note 13, at 3.

[34] *See* Leah Hodgson, *As the US SPAC boom cools, Europe's is just heating up*, PITCHBOOK (May 17, 2021) https://pitchbook.com/news/articles/us-spac-boom-cools-europe-heats-up.

[35] *See* M. Sriram, *The coming Indian internet IPO rush—what's at stake, decoded,* MONEYCONTROL (Feb. 19, 2021) https://www.moneycontrol.com/news/business/ipo/decoding-the-upcoming-indian-internet-ipo-boom-6542341.html.

[36] Nupur Acharya & Baiju Kalesh, *Zomato, Paytm set to supercharge India's hot IPO market*, ECON. TIMES (July 14, 2021) https://economictimes.indiatimes.com/markets/ipos/fpos/zomato-paytm-set-to-supercharge-indias-hot-ipo-market/articleshow/84402405.cms.

by loss making companies would ideally threaten the perception around SPACs, which generally list to target and acquire these very companies in the technology, media and telecom, (*hereinafter* referred to as "**TMT industry**"), [37] leveraging the fact that they may not generate profits for years to come.

And yet, if, in a hypothetical scenario, these loss making Indian tech start-ups were given a choice between a traditional IPO and an Indian SPAC framework, as on the date of publication of this article, all of them would choose the hypothetical Indian SPAC framework in a heartbeat. This is clearly evidenced by the fact that many of these start-ups went so far as to check the viability of an IPO via a SPAC listing on the US stock exchanges,[38] until the SEC changed accounting policies surrounding SPACs in April, 2020 which ultimately cooled down the US interest in SPACs[39] (elaborated in **Part – IV** of this article).

Based on this Indian fascination to SPACs, one can draw two hypotheses:

- There exists demand for a potential framework for SPACs in India.
- Given the blind fascination surrounding SPACs in India which, when contrasted with the extent of apprehension and caution expressed by US market regulator on the SPAC boom in US,[40] the Indian market regulator would need to first address the chinks in the traditional US

[37] *See* Joseph Williams & Stefen Rasay, *Tech and SPACs: A dance of Wall Street darlings*, S&P GLOBAL (Mar. 16, 2021) https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/tech-and-spacs-a-dance-of-wall-street-darlings-63155224.
[38] *See* Harshit Rakheja, *After Grofers, Flipkart to Explore SPAC Route for Public Listing in US*, INC 42 (Mar. 05, 2021) https://inc42.com/buzz/after-grofers-flipkart-to-explore-spac-route-for-public-listing-in-us/.
[39] *See supra* note 32; *Supra* note 16, at 4.
[40] *See* Melanie Walker et al., *SEC focus on SPACs: Key takeaways from recent SEC statements and enforcement activity*, DLA PIPER (Apr. 28, 2021) https://www.dlapiper.com/en/us/insights/publications/2021/04/sec-focus-on-spacs-key-takeaways-from-recent-sec-statements-and-enforcement-activity/.

SPAC framework before making suitable changes in existing Indian laws for a smooth on-boarding of the Indian SPAC framework.

V. PART – IV: PERCEPTION AND REALITY OF A SPAC VIS-À-VIS A TRADITIONAL IPO

Even though the initial craze surrounding SPACs led many to believe this new alternative to be a superior fund-raising solution than a traditional IPO, new research has showed that there exist many previously unrecognized risks attached to SPACs including hidden costs of dilution due to redemptions and exercise of warrants,[41] which are subtle, opaque, and higher than has been previously understood.

A recent working paper Series by ECGI on SPACs (*hereinafter* referred to as '**the ECGI Paper**') has highlighted various flaws to the theory that SPACs are generally a better alternative to traditional IPOs. Generally, the advantages of SPACs over traditional IPOs discussed can be summed up as below:

- SPACs unlike traditional IPOs, do not under-price the public issue and hence offer better value for companies.[42]
- SPACs offer better certainty in relation to pricing the issue and are faster than traditional IPOs.[43]
- SPACs are essentially - a poor man's private equity,[44] i.e. anyone can bet on the skills of the sponsor/management in identifying attractive target companies and profit off of them.

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[41] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32.

[42] *See* Katie Roof, *What is an IPO pop and why do VCs hate it so much?*, TECHCRUNCH (Nov. 20, 2017) https://tcrn.ch/3mcPsir.

[43] *A Surge of SPACs in a Turbulent Economic Climate*, BAKER BOTTS (July 27, 2020) https://www.bakerbotts.com/thought-leadership/publications/2020/july/a-surge-of-spacs-in-a-turbulent-economic-climate.

[44] *See* Shuli Ren, *Why SPACs Are So Popular: They're the 'Poor Man's Private Equity Funds'*, BLOOMBERG (Mar. 02, 2021) https://www.bloomberg.com/news/articles/2021-03-02/why-spacs-are-so-popular-they-re-the-poor-man-s-private-equity-funds.

The ECGI Paper,[45] on studying 47 US SPAC mergers between January 2019 and June 2020, found that although the median SPACs raised $10 per share from investors in their IPOs, by the time the median SPAC merged with its target, it held just $6.67 in cash for each outstanding share, which means less working capital for the target company than anticipated, which would also mean underperformance of the stock in the market.

A. Equity Dilution to Invested IPO investors – Redemptions & Exercise of warrants

The study found that the degree of stock market under performance was directly proportional to the dilution in the SPAC equity caused by the redemptions by IPO investors as well as exercise of warrants.

The study even found that by allowing redemptions even for investors who voted for acquiring a target, the redeeming investors gained an edge over the ones that continued to stay invested in the SPAC. This was largely because the redeeming investors still had a right to exercise their share warrants even after redeeming their shares thereby putting the invested shareholders at a disadvantage as the continuing investors' equity would be diluted both by the PIPE investors filling in for redemption as well as the share warrants exercised by investors who redeemed their shares.

B. Sponsor's Promote & Investment – Potential Conflicts of Interest

The Sponsor promote creates a divergence of interests between the sponsor and the IPO investors as the sponsor still ends up winning if the terms of the merger are unfavourable to the SPAC investors. If the SPAC gets undervalued in a merger, the post-merger shares correspondingly

[45] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

decline in value, due to the presence of promote. As a result, if the sponsor has failed to secure a merger near the end of a two year SPAC term, the sponsor is more motivated to propose a weaker deal for SPAC investors if its alternative is to liquidate.[46]

Furthermore, sponsors acquire a certain chunk of units at the IPO, apart from their promoters. As the proceeds of the SPAC IPO are also used to cover various expenses such as underwriting fees. If the SPAC is unable to find a target then all investments which were used for covering various expenses may be lost and thus, propel the Sponsor to merge with a target at weaker terms.

C. UNDERWRITING FEES – THE HIDDEN COSTS

SPAC underwriting fees in US are typically between 5% and 5.5% of IPO proceeds, which is slightly less than typical fees in a traditional IPO of comparable size.[47] Of that amount, about 3.5% of proceeds is typically conditioned on the SPAC consummating a merger, and payment is deferred until the merger is consummated.[48] However, underwriting fee is rarely adjusted in tune with the amount of redemptions, at the time of the merger. Thus, if the redemptions are high and even with PIPE investors, the final pool is smaller than the original pool, then the underwriting fees in terms of percentage shoots up.

D. FORWARD LOOKING STATEMENTS – SAFE HARBOUR & ASYMMETRY OF INFORMATION

Though there exist some inherent advantages for US SPACs when compared to a traditional IPO such as SPACs can avail themselves safe harbour against forward looking statements made to PIPE investors,

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[46] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

[47] *Considering an IPO? First, understand the costs*, PRICEWATERHOUSECOOPERS, https://www.pwc.com/us/en/services/deals/library/cost-of-an-ipo.html#:~:text=Underwriting%20makes%20up%20the%20largest,directly%20attributable%20to%20the%20IPO (last visited Oct. 23, 2021).

[48] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

traditional IPOs do not enjoy such luxury. Thus, these SPACs are more suitable to new age technology companies that may not have turned profitable yet.

However, as PIPE investment is nothing but a private placement, for which SPACs issue a private placement memorandum to PIPE investors, PIPE investors have traditionally more information and data as compared to original IPO investors.[49]

E. MYTH – SPAC POOR MAN'S PRIVATE EQUITY. REALITY - SPAC MAFIA HAVE THE CAKE AND EAT IT TOO

With respect to SPAC being a poor man's private equity, the study found that SPACs were dominated by large institutional investors as compared to retail investors. Due to the opportunity afforded by redemptions, a SPACs' investors some times change from the moment of an IPO to the time it reaches a merger deal. Thus, a SPAC awards IPO investors generously to get the SPAC up and running as a public company so that later investors can later buy shares once a target has been selected to bring public.[50]

The fact that units of SPAC split and trade separate post IPO means that if one were to redeem one's shares post IPO but keep the warrants, then these are essentially risk free investments. Thus, theoretically, fixed income investors such as hedge funds could sell the warrants to generate coupon like payments and when required redeem their investment and also earn the interest reward.

Thus, later investors (such as PIPE investors) also bear the costs of such generous deal given to IPO-stage investors, and thus, arm twist the sponsor into giving them better terms for the deal, and the sponsors in

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[49] *See supra* note 16; *Supra* note 40, at 7.
[50] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

turn offer side payments in exchange for a commitment from PIPE investors to not redeem their shares.[51]

Thus, the retail investor is in fact the biggest loser out of this deal as the 'Redeemers' and the 'PIPErs' always getting the better deal.

F. US SPAC WARRANTS AS PER FASB ACCOUNTING STANDARDS - EQUITY INSTRUMENT OR A FINANCIAL LIABILITY?

Another issue with respect to SPAC specific to the US is the recent clarification by SEC[52] regarding the classification of SPAC warrants as liability instead of equity, owing to the unique features of US SPAC warrants.[53]

This sudden clarification resulted in a chilling effect for all SPACs looking to list in the US[54] as the reclassification of warrants as liability instead of equity meant that any change in the fair market values in these warrants at a later stage would be recorded as income/loss in the companies' Profit & Loss Statement, meaning their earnings would be affected by their stock volatility in the market.

In fact, many Indian start-ups which were looking to list in the US via a SPAC gave up on the idea post the SEC reclassification of warrants because for Indian start-ups which sought to justify their sky high valuations via a US listing, controlling market perception in a foreign jurisdiction all the while slaving to turn profitable would have been asking too much!

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[51] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

[52] *See supra* note 32; *Supra* note 16, at 4.

[53] *See* Matt Smith & Petar Tomov, *Providing Clarity Around SEC Statement on SPAC Warrant Accounting*, JDSUPRA (June 15, 2021) https://www.jdsupra.com/legalnews/providing-clarity-around-sec-statement-6697811/.

[54] *See* Pat Malo, *SPAC Deals Slow Dramatically After Move by SEC*, L.A. BUS. J. (June 21, 2021) https://labusinessjournal.com/news/2021/jun/21/spac-deals-slow-dramatically-sec-changes/.

VI. PART – V: AN INDIAN SPAC FRAMEWORK - REGULATORY AND GOVERNANCE CHALLENGES

This part will first highlight the existing legal and regulatory hurdles facing a potential Indian SPAC framework followed by identifying few governance challenges stemming from the nature of SPAC structures, including ones that would be unique to Indian capital markets and suggest workarounds for such issues.

A. REGULATORY HURDLES

The existing regulatory framework governing all Indian companies is the Companies Act, 2013 with SEBI regulating the process of listing on the stock exchanges by way of SEBI ICDR Regulations, 2018 as well as their continuous listing obligations by way of SEBI LODR Regulations, 2015. Apart from the above legislations, the other legislations most relevant when viewed from a potential Indian SPAC framework are the Income Tax Act, 1961 and Foreign Exchange regulations.

It is important to note that any change in the regulatory landscape concerning SPACs would require at least three regulatory/ nodal bodies, i.e. RBI, SEBI as well as the Ministry of Corporate Affairs to closely work together to amend the Foreign Exchange Regulations, the relevant SEBI regulations as well as the Companies Act, 2013 respectively. This tough ask, in itself, would be a big hurdle for any change in the regulatory landscape, as currently, SEBI is the only regulatory body that has taken an initiative to study a potential framework in this regard.

B. COMPANIES ACT & SEBI REGULATIONS

1. <u>SPAC: A Shell Company</u>

The first regulatory hurdle concerning SPACs in India is that the Registrar of Companies (RoC) is empowered to strike-off a company

which doesn't start operations within 1 year of being incorporated.[55] This is in stark contrast to the very nature of SPACs which list as shell companies and usually take upto 2 years to find a target to merge with.

Though the Companies (Removal of Name of Companies from the Register of Companies) Rules, 2016[56] precludes such listed entities from being removed, given the fact that SEBI ICDR regulations[57] require a company to have net tangible assets of at least ₹ 3 Cr., average operating profits of ₹ 15 Cr. and net worth of a minimum ₹ 1 Cr.; in each of the three preceding years, this leads to a catch-22 situation as the SEBI thresholds mandate a record of at least 3 years prior to listing on the Main Board of the IPO while, the Companies Act only exempts listed entities from the wrath of a potential strike off from the RoC.

The SEBI ICDR, however, provides a framework for listing of companies that cannot fulfil a minimum three-year history requirement, by mandating that a minimum 75% of the offer be issued to Qualified Institutional Buyers (*hereinafter* referred to as "**QIBs**").

2. Objects Clause of a SPAC

Furthermore, with respect to the Objects Clause, since the Companies Act[58] has done away with the provision of Other Objects, a SPAC would have to mandatorily specify its objects in its Memorandum of Association which could be cumbersome for SPACs.

The main object of a SPAC at its IPO stage is acquiring a target to merge with. However, post the merger, a SPAC adopts the objects of a target company. Furthermore, any amendment to the Memorandum or any change in name of the Company would require the approval of the

[55] Companies Act, No. 18 of 2013, §248(1) (Ind.).
[56] Companies (Removal of Name of Companies from the Register of Companies) Rules, 2016, Gazette of India, pt. II sec.3(i), Rule 3 (Dec. 26, 2016).
[57] Securities and Exchange Board of India (Issue of Capital & Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III sec. 4, Reg. 6 (Sep. 11, 2018).
[58] Companies Act, No. 18 of 2013, §4(1)(c) (Ind.).

shareholders as well as Central Government approval,[59] which would further lengthen the process of merger. This may not be ideal for a SPAC which would most likely have a narrow frame of time for any potential merger.

C. TAXATION & FOREIGN EXCHANGE REGULATIONS – APPROVALS GALORE!

While a cross border outbound merger with a Foreign SPAC (where the resultant Company is a foreign entity) would not only be not tax neutral (such capital gains tax would be levied at the hands of the Indian shareholders), the whole transaction would only proceed post the approval of the NCLT,[60] and also attract relevant Foreign Exchange laws and thus, require RBI approval as well, thereby lengthening the process as well as time taken for such approval.

In case of an acquisition of an Indian target company via transfer of shares instead of a scheme of merger, Indian shareholders holding the target's shares would be subject to RBI's Liberalized Remittance Scheme which only allows a remittance of upto $ 250,000 per financial year,[61] thus creating a potential bottleneck for any big ticket Indian shareholders.

In case of cross border mergers, the Company would need to meet the set RBI criteria with respect to operations through proper branch offices.[62]

Lastly, a typical NCLT approval for a scheme of merger usually takes a minimum of 6 months and can sometimes even extend to more than a year depending upon representations made by various stakeholders

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[59] *Id.,* §14.
[60] *Id.*, §234.
[61] RES. BANK IND., LIBERALISED REMITTANCE SCHEME, FREQUENTLY ASKED QUESTIONS (Feb. 13, 2019), https://m.rbi.org.in/scripts/FAQView.aspx?Id=115.
[62] Foreign Exchange Management (Cross Border Merger) Regulations, 2018, FEMA.389/2018-RB, Reg. 4(2) and Reg. 5 (3) (Mar. 20, 2018).

including Income tax authorities, Registrar of Companies, etc., i.e. almost half of the shelf life of a SPAC. This duration may increase substantially in case of cross border mergers. Thus, a fast track merger approval process specifically tailored for SPACs would also need to be created.

1. **SPACs under the International Financial Services Centre Framework**

The IFSCA (International Financial Services Centres Authority), a unified regulatory body with exclusive authority to regulate India's first and only IFSC, a special economic zone that largely caters to cross border transactions between international as well as domestic customers, has recently notified the IFSCA (Issuance and Listing of Securities) Regulations, 2021,[63] wherein a SPAC (a specified IFSC private company) would be eligible to raise capital through an IPO of specified securities worth a minimum $ 50 million on recognized stock exchanges in IFSC Gift City with the sponsor holding a minimum 20% of post issue paid up capital and which would be required to acquire a target for merger within 3 years of listing (extendable upto 1 year).

However, even with the unique nature of the IFSC (due to its *de jure* 'offshore status'), which boasts of applicability of foreign exchange control regulations to such listed entities on par with any other listed entity located in other foreign jurisdictions, restricted applicability of the Companies Act[64] and a securities law governed by IFSCA instead of SEBI,[65] the author is of the view that it will be a while before companies actually list a SPAC at IFSC as it is still new territory for all stakeholders. Even if SPAC listings do happen in the near term, they would be limited

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[63] International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021, Gazette of India, pt. III sec. 4 (July 19, 2021).

[64] MINISTRY OF CORP. AFFAIRS, NOTIFICATION G.S.R. 08(E), Gazette of India, pt. II sec. 3(i) (Jan. 4, 2017), https://www.mca.gov.in/bin/ebook/dms/getdocument?doc=NzY0OQ==&docCategory=Notifications&type=open.

[65] International Financial Services Centres Authority Act, No. 50 of 2019, § 13 (Ind.).

in number, as only those issuers who intend to seek out foreign investors or foreign entities for merger would prefer an IFSC listing.

Moreover, the author is of the opinion that mandating a 15 - 20% sponsor capital[66] in the abovementioned IFSC Regulations itself may not be in the best interests of all stakeholders (elaborated in Part – VI of the article). The Regulations also appear silent on any potential offer of share warrants along with shares at the time of IPOs and their subsequent treatment under the framework. Thus, the author is of the opinion that the major shortcomings of the IFSC Regulations appear similar to the US SPAC framework.

VII. PART – VI: THE WAY FORWARD - CORPORATE GOVERNANCE CHALLENGES & POTENTIAL WORKAROUNDS

While the author is quite confident that any draft framework for SPACs in India by SEBI would in any way seek to highlight and solve the above mentioned regulatory hurdles as many of the above hurdles are known issues in the capital markets sphere in India – it would be the governance challenges that would take centre stage as the common SPAC problems would metamorphose to issues unique to Indian markets, given that the Indian business environment is fundamentally different from other advanced economies.

A. THE MAIN CHALLENGE - AVOIDING A PROBLEM OF PLENTY

If the rapid US boom in SPACs followed by a sudden SEC mandated cool down – has taught us anything, the listing of too many SPACs at a time can lead to high pressure and competition to identify and acquire

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[66] *See* International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021, Gazette of India, pt. III sec. 4 (July 19, 2021), Reg. 75.

target companies[67], which may not always lead to the best results for SPAC shareholders. As per Wall Street Journal, there are about 260 SPAC companies with $87 billion on hand that face merger deadlines in the first three months of 2023.[68]

A solution to check the problem of plenty can be via two methods which both focus on one key player, i.e., the sponsor.

The first method would be to prescribe a minimum limit on the size of a SPAC IPO, as envisaged by the UK regulator, which mandated a minimum IPO size of 200 million pounds in its recently released consultation paper on SPACs, so that only quality SPAC sponsors set up IPOs.[69]

The second would be via mandating minimum sponsor related requirements.

B. SPONSOR CREDIBILITY REQUIREMENTS - ESPECIALLY IN A PROMOTER DRIVEN INDIAN ECONOMY

It has been observed that the success of SPAC IPOs boils down to the experience and expertise of sponsors[70]. Thus, stringent thresholds surrounding the credibility, experience, capability and track record[71] of sponsors ought to be put in place. This takes much more precedence in

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[67] *See* Richard Henderson, *Glut of Spac issuance makes hunt for deals more competitive*, FIN. TIMES (Oct. 17, 2020) https://www.ft.com/content/3258285a-00c2-445e-a318-3e760c298698.

[68] Amrith Ramkumar, *SPAC Pullback Pressures Creators to Find Quality Mergers,* WALL STREET J. (June 1, 2021) https://on.wsj.com/3pF28ko.

[69] *See* FCA Consultation Paper, *supra* note 29; *Supra* note 13, at 3.

[70] *See* Yun Li, *For SPACs, one factor seems to determine investing winners from losers*, CNBC (Jul 12, 2021) https://www.cnbc.com/2021/07/12/for-spacs-one-characteristic-seems-to-determine-the-investing-winners-from-losers.html.

[71] Rule 102.06, Minimum Numerical Standards - Acquisition Companies, NEW YORK STOCK EXCHANGE RULES, https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-10 (last visited Oct. 23, 2021).

the Indian scenario where most businesses are promoter driven, unlike in US where most businesses are professionally managed. The mere experience of being a promoter of a listed entity may not suffice as many promoter-driven listed entities in India have a poor track record when it comes to corporate governance practices.

C. SPONSOR'S PROMOTE – LINKED TO THE PERFORMANCE OF THE SPAC POST IPO

As stated earlier, the author is against the idea of a mandated minimum threshold of 20% promote for Sponsors as this may result in conflict-of-interest issues whereby Sponsors would be tempted to take weaker deals for mergers via SPAC as deadlines for SPAC acquisition near.

One way to incentivize Sponsors all the while protecting minority shareholder interest would be having conditional Promotes which would be locked in for a couple of years and can only be exercisable when their investments are 10-20% out of the money. A classic example to look upto in this regard would be the US SPAC deal surrounding the Pershing Square Tontine Holdings[72] which invested $ 65 Million in exchange for warrants that were 20% out of the money and without any sponsor promote. Thus, their investments would only receive a positive return only if the company would perform up to expectations.

D. DILUTION DUE TO REDEMPTION – LEVELLING THE PLAYING FIELD

Another concern would be the dilutive effect of redemption by shareholders post IPO but prior to the acquisition of the target. One possible workaround would be to reward the warrants of the redeeming

[72] *See* ECGI Working Paper, *supra* note 5; *Supra* note 32, at 6.

investors to non-redeeming investors, as envisaged by the Pershing Square Tontine Holdings SPAC,[73] thereby levelling the playing field.

Another option would be to cancel the warrants of redeeming shareholders, so as to safeguard dilution from such exercise later on.

E. RING-FENCING THE PROCEEDS FOR ACQUISITION AND REDEMPTION

In order to protect the interests of the minority shareholders, one can envisage a system wherein redemption would only be allowed post a successful shareholder approval for a prospective target and since, in a successful approval, the maximum percentage of dissenting shareholders would be 25%, such equity amounting to 25% of the overall equity can be ring fenced for the purposes of redemption and separate from the proceeds needed for the acquisition.

F. FORWARD LOOKING STATEMENTS - SAFE HARBOUR

While SEBI ICDR clearly states that there can be no forward-looking statements that cannot be substantiated (largely in line with US rules pertaining to IPOs), the very reason why most technology companies look to SPACs for an IPO is that in US, such SPACs that provide a forward-looking statement enjoy safe harbour, which becomes very vital for a technology company that is yet to turn profitable. This feature of the US SPAC framework is what made it popular for technology start-ups in the first place. Thus, the author is of the view that the regulator must take a view on this issue only post extensive consultation with the market participants and the industry at large as this issue may very well decide the degree of a potential success or failure of an Indian SPAC framework in the near term.

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[73] *Supra* note 32.

THE PRINCIPLE OF ALTER EGO & THE EVOLUTION OF CORPORATE CRIMINAL LIABILITY IN INDIA

Anubhav Chakravorty[*]

ABSTRACT

The principle of alter ego lays down that criminal liability may be attributed to a company for the acts of the individuals in control of the affairs of the company. The doctrine endeavours to view both the directors/shareholders and the company as a single entity—thereby lifting the corporate veil. This article attempts to sketch the course of the development of the principle of alter ego in India by dissecting various landmark judgements passed by Indian courts. The Supreme Court's decisions in Iridium India Telecom Ltd. v. Motorola Inc. and subsequently in Sunil Bharti v. CBI paved the way for a more nuanced approach towards corporate criminal liability. This article draws from that context and discusses the rapidly changing position of law, leading up to the recent amendments to the Companies Act, 2013, which furthers the Indian government's goal to find a balance between making the legal framework conducive for businesses and ensuring that reasonable measures continue to be in place for wrongful acts or omissions by companies. Newer hurdles that could potentially prop up in the wake of the newly amended Companies Act have also been deliberated and the legal position on corporate criminal liability in the United States of America and the United Kingdom have been studied to place the current framework in the broader context of how other jurisdictions treat corporate criminal liability. Although the recent reforms are a welcome change for turning India into a more business-friendly nation, this article reinforces the imminent need to overcome hurdles that are likely to be encountered with the imposition of the revised framework.

Keywords: Corporate Criminal Liability, Principle of Alter Ego.

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I. INTRODUCTION

Legal systems have long grappled with the association of criminal liability to corporations. Until corporations gained their omnipresence in the eighteenth century, the prevailing view was that they could not be held criminally liable.[1] Corporations were originally only seen to entangle in criminal litigation when there were claims of public nuisance. The systems in England and the United States first associated public nuisance to corporations when quasi-public corporations were found to have caused public nuisance as a result of their nonfeasance.[2] This precedent eventually developed into the more general understanding that an individual working as a corporation's agent could not be held guilty for an omission of the corporation, since it was only the corporation that was duty-bound to perform the specific act.[3]

This principle then set the ground for courts to hold private commercial entities criminally liable for public nuisances which were earlier only attributed to quasi-public corporations.[4] Eventually, it was

[1] Kathleen F. Brickey*, Corporate Criminal Accountability: A Brief History and an Observation*, 60 WASH. U. L. QUARTERLY. 393, 396 (1982).
[2] L.H. LEIGH, THE CRIMINAL LIABILITY OF CORPORATIONS IN ENGLISH LAW 16-18 (1969).
[3] JOHN C. COFFEE, JR., CORPORATE CRIMINAL RESPONSIBILITY, ENCYCLOPAEDIA OF CRIME AND JUSTICE 253-254 (Sanford H. Kadish ed., 1983).
[4] James R. Elkins, *Corporations and the Criminal Law: An Uneasy Alliance*, 65 KY. L. J. 73, 91-92 (1976).

held that corporations could also be held criminally liable for other positive acts and omissions. Once the precedent for holding corporations guilty of misfeasance for creating a nuisance was solidified, the courts were left free to apply the principle to other acts of misfeasance which did not require intent.[5]

This ambit was slower to encompass crimes that required intent,[6] until 1909 when the United States Supreme Court was the first to hold a corporation liable for a crime that required intent.[7] This move received great criticism at the time for being contrary to the objective of criminal law as a means to punish those who wronged morally, mainly because it relied on the vicarious guilt of corporations.

The apportionment of liability to corporations for crimes that require criminal intent has seen a rapid increase across the globe, ever since. In India, the Supreme Court on several instances restated that the legislative mandate for any criminal offence that prescribed a minimum punishment coupled with a fine prohibited the courts from only imposing the said fine in exclusion of the punishment.[8] The High Courts of several Indian states also went on to hold that companies could not be prosecuted for offences that necessarily required corporal punishment or imprisonment, given that companies could not possibly be sent to prison.[9] It was after the judgement of the Supreme Court in *A.K. Khosla v. T.S. Venkatesan*, that the judiciary began to tackle the other hurdle of not being able to associate *mens rea* to a company, which was a prerequisite unless specifically excluded by the statute.[10] The courts also began to acknowledge that

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[5] New York Central R. Co. v. United States, 212 U.S. 481 (1909).
[6] *Supra* note 4.
[7] New York Central R. Co. v. United States, 212 U.S. 481 (1909).
[8] Asst. Commr. v. Velliappa Textiles Ltd., (2003) 11 SCC 405 (Ind.); State of Maharashtra v. Jugmandar Lal, (1966) 3 SCR 1 (Ind.).
[9] State of Maharashtra v. Syndicate Transport Company Private Ltd., (1964) AIR Bom 195 (Ind.); Kusum Products Ltd. v. S.K. Sinha, I.T.O. Central Circle-X, Calcutta, (1980) 126 ITR 804 (Ind.).
[10] A.K. Khosla v. T.S. Venkatesan, (1992) Crl. L. J. 1448 (Ind.); Kalpanath Rai v. State, (1997) 8 SCC 732 (Ind.).

although a sentence exceeding what the statutes prescribed was always illegal, a sentence less than what was prescribed was not illegal in all cases.[11]

Ultimately, in *Standard Chartered Bank and Ors. v. Directorate of Enforcement and Ors.,*[12] the Supreme Court crystallized its stand on the matter, serving as a prominent precursor to the judgements and legislative changes that followed. The current legal regime in India culls out criminal liabilities for functionaries of companies, either generally through the Indian Penal Code, 1860 or more specifically through provisions like Section 27 of the Securities and Exchange Board of India Act, 1992 which lays down that an officer of the company would be found guilty of offences committed by companies if such an officer was in charge of and responsible for the business of the company, and Section 450 of the Companies Act, 2013—which prescribes a fine for the company and its responsible officers for any contravention for which no specific penalty/punishment has been laid down. Section 179 (1) of the Companies Act, 2013 authorizes the Board of Directors of a company to do the acts listed therein, and are hence liable for all the acts of the company.

However, this is not a concept that exists without a counterbalance, this article endeavours to dissect the concept of alter ego and the validity of its reverse application, by examining judgements leading up to recent statutory changes. It also examines the position in the United Kingdom and the United States as a contrast and seeks to place the current framework in the broader context of how other jurisdictions treat corporate criminal liability.

[11] Oswal Vanaspati & Allied Industries v. State of U.P., (1993) 1 Comp L. J. 172 (Ind.).
[12] Standard Chartered Bank v. Directorate of Enforcement, (2005) 4 SCC 530 (Ind.).

II. ERSTWHILE POSITION OF LAW

The theory that criminal liability could be attributed to a company because of actions of its directors i.e., the principle of alter ego, was earlier endorsed by a single judge bench of the Supreme Court in *Assistant Commissioner, Assessment-II, Bangalore v. Messers Velliappa Textiles Ltd.*[13] where the predominant procedural hurdle of the inability to arrest companies for crimes had been raised. The sections of the Income Tax Act, 1961, which the private company was alleged to have violated, required imprisonment to be coupled with a fine. This led to the verdict that the corporation could not be imprisoned because it lacked a physical form, and since the fine had to be coupled with imprisonment, one could not be imposed to the exclusion of the other. This took a very literal approach to attributing criminality to the corporation and the age-old issue for not being able to impose criminal sanctions to corporations for their lack of a physical form was seen to persist. Merriam Webster defines alter ego to mean "a second self or a different version of oneself. In jurisprudence spanning across legal systems, the Alter Ego Principle culls out an exception to the otherwise default position that a company is an entity that is separate from its shareholders/directors. The Alter Ego Doctrine lifts the corporate veil by viewing the directors/shareholders of the company and the company itself as a single entity.

Later, in *Standard Chartered Bank v. Directorate of Enforcement,*[14] a three-judge bench of the Supreme Court overruled the erstwhile position of the Supreme Court and held that the legislature could not have intended to penalize the corporations for minor offences while completely excusing them of the graver crimes, simply because the statute prescribed that a fine be coupled with imprisonment. Although the bench of the Supreme Court did not proceed to crystallize whether companies were indeed capable of having *mens rea,* it did lay down that companies could be prosecuted for criminal offences and punished with fines. This holding

[13] Asst. Commr. v. Velliappa Textiles Ltd., (2003) 11 SCC 405 (Ind.).
[14] Standard Chartered Bank v. Directorate of Enforcement, (2005) 4 SCC 530 (Ind.).

culminated in the Supreme Court's ruling in *Iridium India Telecom Ltd. v. Motorola Inc.*[15] and in *Sunil Bharti Mittal v. CBI,*[16] paving the way for a more nuanced approach to corporate criminal liability and holding companies more accountable for their actions, while finding ways to address procedural concerns inherent to criminal law. This was an implicit acknowledgement of the fact that criminal laws could not apply to corporations in the same way that it did to individuals and was therefore an essential milestone in paving the way for a more sophisticated approach to corporate criminal liability in India. Procedurally, it solved the conundrum of whether fines could be imposed on companies to the exclusion of any imprisonment when the offence specified that both were required.

The principle of alter ego gained more traction in the *Iridium* judgement where it was held that the acts of the individuals in control of the affairs of a company are attributed to the company and therefore the criminal accusations levelled against such individuals could be imputed onto the company too.[17] *Iridium* solidified the Supreme Court's stance on corporate criminal liability while addressing the issue of whether companies could be deemed to have criminal intention. For the apportionment of criminal liability, the Supreme Court had relied heavily on the doctrine of attribution to determine in whose hands the control of the company actually lay (to the extent that the company could be said to be acting through the person). In this manner, the *Iridium* judgement went a step ahead of the *Standard Chartered* judgement since in the former case, it was held that the person in-charge of the affairs of the company may be held liable for the wrongful actions of the company while in the latter, in extension of the Alter Ego Principle, it was observed that a person must be an authorized person acting in the course of his/her employment to be held liable for the actions of the company.

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[15] Iridium India Telecom Ltd. v. Motorola Inc., (2011) 1 SCC 74 (Ind.).
[16] Sunil Bharti Mittal v. CBI, (2015) 4 SCC 609 (Ind.).
[17] Iridium India Telecom Ltd. v. Motorola Inc., (2011) 1 SCC 74 (Ind.).

In the *Iridium* judgement, the Supreme Court also placed reliance on *Tesco Supermarket v. Nastrass,*[18] where it was held that the people who had the powers to steer the course of the company, derived from the Articles of Association, Memorandum of Association, approvals in meetings or specifically named by directors, would be liable for offences the company is deemed to have committed. The bench in *Iridium* went on to expand the scope of individuals that could be considered as instrumental to the functioning of the company to any natural person in charge of the company's affairs. However, this judgement left several questions unanswered: (a) what if no single officer was responsible for the affairs in question? (b) in a case where officers are held responsible, what would the liabilities of the company be? (c) what is the extent and nature of the liabilities that may be imposed on the company? And (d) how would the shareholders be recompensed for the erosion of their assets? Given the far-reaching nature of the questions left unanswered, the Iridium judgement set the foundation for the position of the judiciary on the issue of corporate criminal liability, and paved the way for the subsequent judgements and legislative changes that followed.

During the Supreme Court monitored CBI investigation relating to the grant of Unified Access Services Licenses (*hereinafter* referred to as "**UASL**"), the CBI had named the Deputy General Directors of three cellular companies. The main allegation was that the accused public servants entered into a criminal conspiracy with the accused beneficiary companies in taking a decision that caused an undue pecuniary advantage to them and a corresponding loss to the Exchequer.[19]

The learned Special Judge, apart from the accused persons in the charge-sheet, summoned the directors of M/s. Bharti Cellular Limited and M/s. Sterling Cellular Limited, Mr. Sunil Bharti and Mr. Raavi Ruia respectively. The reasoning provided for the same was that in their capacity as directors, these persons, *prima facie*, could be treated as

[18] Tesco Supermarket v. Nattrass, [1972] AC 153 (Ind.).
[19] Sunil Bharti Mittal v. CBI, (2015) 4 SCC 609 (Ind.).

controlling the affairs of the respective companies and represent the directing mind and will of each company. Thus, they were the "alter ego" of their respective companies and the acts of the companies could be attributed and imputed to them. Based on this premise, the Special Judge opined that there was enough material on record to proceed against the three directors as well.[20]

Subsequently, in *Sunil Bharti Mittal v. CBI,*[21] the bench of the Supreme Court dissected the principle of alter ego as laid down in *Iridium*, to look into other permutations that may invite its applicability; adding a few layers of complexity that, by then, had become central to the issue of corporate criminal liability. It dissected the impugned order and went on to give a detailed opinion of the issue that had been brought to the forefront: whether the liability of the companies could be attributed to the person(s) directing the affairs of the company by the invocation of the principle of alter ego.[22]

The appellants contended that the principle of alter ego had been applied in reverse—the liabilities of the company were being applied onto the individual(s) in control of its affairs. The respondents broadly rebutted this contention by claiming that the offences were necessarily required to be coupled with malicious intentions since they were not strict liability offences and since the companies would only act through their directors/officers, it was their *mens rea* that needed to be scrutinized.[23]

In analysing the aforesaid contentions, the Court placed heavy reliance on the precedent set by *Iridium* where it was laid down that where an offence requiring criminal intent is committed by the person(s) controlling the affairs of the company; the criminality that would be attributed to them would also go on to be imputed onto the company (since they were

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[20] *Id.*
[21] *Id.*
[22] Vishal Gera & Pierre Uppal, *Alter Ego: Judges and Punishes,* MONDAQ (Jan. 13, 2020) https://www.mondaq.com/india/shareholders/882646/alter-ego-judges-and-punishes.
[23] *Id.*

the "alter ego" of the company). In the present case, the *prima facie* reasons for summoning the directors were the control they exercised in the affairs of the companies and the likelihood that the will of the companies were represented through the directors owing to their controlling position.

The three-judge bench concluded that in instances where the company is the accused party, the directors may only be implicated in situations where ample incriminating evidence exists against the directors to adduce their role and criminal intention for the commission of the crime; or when the statute itself specifies the vicarious liability of directors for the acts of the company.

The bench further held that reliance had been placed erroneously on the principle of alter ego and set aside the order summoning the directors. In light of the criteria it solidified above, it found that in the impugned order, the Special Court had failed to record its satisfaction about the presence of material sufficient to incriminate the directors for the offences. The Supreme Court restated the crucial nature of the phrase "grounds for proceeding" in the statutes concerned and held that an order failing to delve into the reason(s) for the establishment of a *prima facie* case against the said controlling persons could be set aside. Although the Supreme Court made the position of law on this aspect clear, it restated the discretion of the Special Court to further dissect the material that had been placed on record to determine whether sufficient grounds were present to incriminate the Directors concerned.[24]

The court further restated the cardinal principle of criminal jurisprudence that vicarious liability necessarily needed to specifically arise out of the statute and that when a company was deemed an offender, vicarious liability could not be imputed automatically in the absence of any statutory provision stating so. The Court went on acknowledge that

[24] Satish Padhi et al., *Corporate Criminal Liability: Principles Of Attribution And Vicarious Liability Clarified,* MONDAQ (Feb. 05, 2015) https://www.mondaq.com/india/corporate-crime/372090/corporate-criminal-liability-principles-of-attribution-and-vicarious-liability-clarified.

although it was indeed true that *mens rea* could be attributed to a company by way of the principle of alter ego, a reverse application of that principle would require the fulfilment of either of the two conditions it listed above. Later, in *In Reference Amazan Capital Ltd*,[25] the Securities and Exchange Board of India held that unless directors could be held personally responsible for action criminal liability could not be imposed upon the erring directors

The transition from an era of absolute insulation to holding company criminally liable, as a result of the aforesaid judgements, took place without the courts going into the merits of corporate criminal liability. Questions such as whether this has resulted in any deterrence or retribution have not been deliberated upon. Further, the fact that criminal prosecution of a company leads to loss of assets and reputation of the company thereby, hampering the interests of stakeholders has not been considered; effectively leaving the questions left unanswered by the *Iridium* judgement untouched. Although the *Sunil Bharti Mittal* judgement did lay down that director could not vicariously be held liable for the criminal actions of the company, an in-depth analysis of why that was the case could have cleared some ambiguity in this regard. The legislative changes that followed, heralded mainly by the Report of the Committee to Review Offences under the Companies Act, 2013 did go on to address some of the said ambiguity.[26]

III. CHANGE IN LAW

The dissection of corporate criminal liability by the Indian courts has oscillated between finding new avenues and being met with hurdles similar to those in the eighteenth century. A future-proof solution to the issue of attributing liabilities to corporations, therefore, necessarily needed legislative backing. The Government of India (*hereinafter* referred to as

[25] In Re. Amazan Capital Ltd., (2017) SCCOnline SEBI 54 (Ind.).
[26] MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMMITTEE TO REVIEW OFFENCES UNDER THE COMPANIES ACT, 2013 (2018), https://www.mca.gov.in/Ministry/pdf/ReportCommittee_28082018.pdf.

"**Government**") has long endeavoured to balance its two crucial priorities of making the legal environment conducive for businesses and of ensuring that reasonable penalties are in place for wrongful acts or omissions by companies. Moves towards striking such a balance have been made to ensure that India fosters a business-friendly environment and the inflow of foreign investment increases.

With the enactment of the Companies (Amendment) Act, 2019 (*hereinafter* referred to as "**CAA 2019**") the Government classified several criminal offences in the earlier Companies Act, 2013 as civil defaults. The Government also proceeded to table the Companies Amendment Bill, 2020 (*hereinafter* referred to as "**CAB 2020**") which aimed to decriminalize another set of compoundable offences under the erstwhile Act.

Even prior to the passage of the CAB 2020, the motive of the Government to uphold the spirit of the CAB 2020 was evident from initiatives like the Companies Fresh Start Scheme, 2020 which pardoned delayed filings with the Registrar of Companies for some categories of companies,[27] and provided immunity to those companies in cases where the Registrar had proceeded to institute criminal proceedings against them.[28]

The CAA 2019 also put in place an In-House Adjudication Framework,[29] which instituted an online platform under the administration of the Ministry of Corporate Affairs (*hereinafter* referred to as "**Ministry**") to deal with various compoundable offences under the Act, replacing the prevailing process of adjudication before the National Company Law Tribunal. The In-House Adjudication Framework entails the settlement of certain offences by the imposition of penalties by an

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[27] MINISTRY CORP. AFFAIRS, GOV'T OF IND., COMPANIES FRESH START SCHEME 2020, GENERAL CIRCULAR NO. 12/2020 (Mar. 30, 2020), https://www.mca.gov.in/Ministry/pdf/Circular12_30032020.pdf.
[28] *Id.* at 6(vii).
[29] Companies Act, No. 18 of 2013, §454 (Ind.).

Adjudicating Officer[30] with the goal to clear the immense backlogs that most Indian courts are overwhelmed by and ensure the speedy redressal of matters. These orders may be appealed to the Regional Director of the Ministry. Deterrents put in place include the imposition of criminal sanctions for failure to comply with the orders and higher penalties for repeated offences.

The origin of most of the changes that the CAB 2020 encapsulates is a report published by the Company Law Committee in November 2019.[31] The issue of corporate criminal liability in the report was addressed to the extent of offences that were compoundable, leaving other, more grievous offences unaltered. The amendments in the Companies Amendment Act, 2020 (*hereinafter* referred to as "**CAA 2020**") steer the judicial attention away from wrongs that can objectively be determined and have no correlation with the public interest. The Report too paid specific attention to the fact that the said objective determination was only possible because the wrongful actions/omissions lacked the *mens rea* necessary for criminal prosecution and were thus best reclassified as civil offences which could be rectified upon the payment of penalties. This would also encourage the quick redressal of disputes since the threshold for civil liability i.e., 'preponderance of probability' would be relatively easier to establish.

The findings of the aforesaid report manifested in the CAA 2020, particularly with regard to the decriminalization of the offences in the earlier Act that were compoundable in their nature. In this domain, broadly, the CAA 2020 deleted criminal offences from the Act, excluded imprisonment for an array of compoundable offences and classified the fines as penalties, and decreased the amount of penalty for several other offences.

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30 MINISTRY CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMPANY LAW COMMITTEE, 102 (2019), https://www.mca.gov.in/Ministry/pdf/CLCReport_18112019.pdf.

31 *Id.*

These changes in the new CAA 2020 indicate a more nuanced understanding of the attribution of liabilities to corporations and simultaneously stand to create a stable framework for ease of business, penalize grievous crimes and reduce the load on the judicial machinery. However, this new model comes associated with its new set of risks and loopholes—ones that could be filled by drawing from prominent legal systems around the world.

IV. FLAWS IN THE PROPOSED MODEL & THE ROAD AHEAD

Although the minimized criminal sanctions on companies for technical and inadvertent errors in the CAA 2020 could be considered a welcome change, the civil penalties associated with the acts that were earlier classified as offences could simply be deemed regular business expenses by companies, and defeat the objective of the legislation.[32] A fixed set of penalties applying to companies of various sizes and risk-appetites could simultaneously skew the likelihood of deterrence to certain, specific classes of companies and have other classes of companies remain unaffected.

Earlier, penal consequences also came associated with a loss of goodwill for companies and led them to take steps to reduce the likelihood of criminal prosecution. This was more excessive for some acts (like technical errors) and less for others. The reclassification of criminal offences which, despite being short of grievous, still require a deterring effect for companies to adequately comply with, might now be seen with an air of nonchalance. One of the shortcomings of this method of imposition of fines is that companies could deliberately violate the law as the loss incurred due to the imposition of penalties may be much lesser than the advantages gained through such violations.

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[32] *Id.*

Further, the adjudication of penalties under the In-House Adjudication Framework has now been entrusted to a non-judicial body i.e., the Adjudicating Authority—which may be the Registrar of Companies or the Regional Director, both of whom are under the Central Government.

The relaxations in the CAA 2020 could potentially cause the executives of companies to act in a complacent manner, and remain shielded from liabilities for acts that would otherwise have been considered offences. A deeper understanding of the grapple to attribute criminal liability to corporations may be gained from an overview of what other jurisdictions have encountered.

The recent trajectory taken by the Indian government appears to be consistent with the criticism of the American scholars and the developments in the domain of attributing criminal liabilities to corporations and those who run them have been boosted by both the judiciary and the legislature.

Given that the imposition of criminal sanctions has substantial chances of reducing the likelihood of prosecution of companies,[33] the CAA 2019 and CAA 2020, along with the other allied schemes have been welcome changes for turning India more business-friendly. However, certain hurdles could likely still be met with, in the execution of these new changes. Although the reclassification of certain minor technical errors to civil wrongs would serve as an undisputed and welcome change, the reclassification of other graver offences could render them insufficient in acting as a deterrent for certain classes of companies. With this blueprint in place, these newer loopholes would be more subdued and could easily be rectified by creating different penalty brackets for different classes of companies. The inequity associated with penalizing all sorts of companies in a similar manner by identifying brackets for turnover, market

[33] John T. Byam, *The Economic Inefficiency of Corporate Criminal Liability*, 73(2) J. CRIM. L. & CRIMINOLOGY 582 (1982).

capitalization or whether the company is publicly traded or not would make way for a more layered approach to the apportionment of fines.

Practically, the disputes related to corporations could therefore be redressed sooner if the criminal offences in the Act continue to be classified as civil offences, given access to alternative recourses like mediation and arbitration, and the lower threshold for establishing liability in civil offences.

However, an array of offences that may be deemed to be committed by companies ought to still remain in place for malicious actions that cause damage to the public and the economy at large. The government would be required to adopt more sophisticated measures to conduct market studies and gain more clarity on the level of damage caused by such wrongful actions in order to devise approaches to abate the same and take a more sophisticated approach to apportion liabilities. The manner in which the company is constituted and its internal structure of governance should also be required to be scrutinized for instances where the guilt of the directors is being ascertained in line with the two principles laid down in *Sunil Bharti Mittal*: (a) ample incriminating evidence exists against the directors to adduce their role and criminal intention for the commission of the crime; or (b) when the statute itself specifies the vicarious liability of directors for the acts of the company.[34]

Further, the legislation would also be required to find newer ways to ensure larger companies, with decentralized powers, are not implicitly safeguarded from the likelihood of criminal penalties and that the controlling powers of the directors don't aid the shrewd dilution of their potential liabilities.

[34] *Supra* note 24.

V. POSITION IN THE UNITED KINGDOM AND THE UNITED STATES

A. CORPORATE CRIMINAL LIABILITY IN THE UNITED KINGDOM

In the United Kingdom, a corporation may be prosecuted for crimes committed by the individuals acting on behalf of the company when (a) the Parliament has enacted specific legislation to identify criminal offences for corporates; (b) vicarious liability is attracted for regulatory offences not requiring any proof of mental fault; and (c) offences are committed by individuals who can be "said to be the directing mind and will" of the corporation.[35]

The third scenario is referred to as the identification theory in the United Kingdom, which is similar in principle to the Doctrine of Alter Ego. This theory limits the ambit of a company's vicarious liability to individuals whose acts/omissions may result in the attribution of liability to the company.[36] Finding that the state of mind of the company was that of the individuals who represent the directing mind and will of the company, Lord Denning, J. in the case of *H L Boulton (Engineering) Co. Ltd v. T J Graham and Sons Ltd.*[37] held as under:

"A company in many ways may be likened to a human body. It has a brain and a nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such."

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[35] Ali Shalchi, *Corporate Criminal Liability*, HOUSE COMMONS LIBR. (May 5, 2021) https://researchbriefings.files.parliament.uk/documents/CBP-9027/CBP-9027.pdf.
[36] SMITH AND HOGAN, CRIMINAL LAW 178 (7th ed. 1992).
[37] H. L. Bolton (Engineering) Co. Ltd. v. T. J. Graham & Sons Ltd., [1957] 1 QB 159.

Further, in *Tesco Supermarket v. Nastrass,*[38] Lord Reid held that in order for liability to attach to the actions of a person, it must be the case that "*the person who acts is not speaking or acting for the company. He is acting as the company and his mind which directs his acts, is the mind of the company. If it is a guilty mind, then that guilt is the guilt of the company."* The identification principles laid down by Lord Reid in this judgement were later reaffirmed in *St Regis Paper Co. Ltd. v. R.*.[39]

The identification doctrine, in the manner enunciated above, is applicable to all criminal offences which could be said to have been committed by someone acting within their authority[40]. While the "directing mind" of a company is identified, prosecutors in the UK consider the manner in which the company is constituted, the delegation of authority within it and its internal structure of governance,[41] as opposed to simply associating seniority to a position of authority. However, in *The Serious Fraud Office v Barclays PLC & Anr.,*[42] the judge advocated for keeping the scope of the identification doctrine narrow and restated that the Parliament continued to have the flexibility to take specific instances and classify them as new corporate criminal offences.[43] The narrative that the legislature alone could act to remedy the shortcomings of the identification theory had begun to gain traction back in 2010, with the passing of the Bribery Act 2010 until recently, with the passing of the Criminal Finances Act 2017, which imposed liabilities on corporations for failing to prevent the facilitation of tax evasion by individuals that were associated to them. The judgement in *Barclays* made way for further Parliamentary deliberations about how larger companies

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[38] Tesco Supermarkets Ltd. v. Nattrass, [1972] AC 153.
[39] St. Regis Paper Co. Ltd. v. R. [2011] EWCA Crim 2527.
[40] *Supra* note 35 at page 6.
[41] *Corporate Prosecutions*, CROWN PROSECUTION SERV. (Oct. 12, 2021) https://www.cps.gov.uk/legal-guidance/corporate-prosecutions.
[42] The Serious Fraud Office v. Barclays PLC & Anr. [2018] EWHC 3055 (QB).
[43] S. Cogman et al., *No "Directing Mind and Will" Found in SFO Prosecution of Barclays*, HERBERT SMITH FREEHILLS (May 5, 2020) https://hsfnotes.com/fsrandcorpcrime/2020/05/05/no-directing-mind-and-will-found-in-sfo-prosecution-of-barclays/.

with decentralized powers could have lower exposure to criminal liability and how reforms needed to have a more layered approach to classifying governance structures.[44]

B. CORPORATE CRIMINAL LIABILITY IN THE UNITED STATES OF AMERICA

In the United States, as a general standard, federal criminal laws apply to corporations—some legislations refer to corporations specifically while others include corporations in their definitions.[45] In the landmark case of *New York Central R. Co. v. The United States,*[46] the US Supreme Court solidified its support for holding corporations liable for criminal acts and the *respondeat superior* test. The *respondeat superior* test holds an employer liable for the wrongful acts of its employee(s)—provided their actions are within the scope of their employment. This also applies to principal-agent relationships. When this doctrine is invoked, both the employer and the employee is likely to be held liable. This doctrine is applied to an employer irrespective of how closely it was supervising the conduct of its employee.[47]

On the federal level in the United States, it is also not uncommon for the collective action of many employees to result in liability for the corporation, even when no single employee has committed an offence.[48] The corporation is deemed to have knowledge of the commission of a certain act when *"one part of the corporation has half the information making up the item, and another part of the entity has the other half."*[49] In the *United States v.*

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[44] *Supra* note 41.
[45] *See* ALBERT W. ALSCHULER, LAW WITHOUT VALUES: THE LIFE, WORK AND LEGACY OF JUSTICE HOLMES 107 (1st ed., 2002)
[46] New York Central R. Co. v. United States, 212 U.S. 481 (1909).
[47] *Respondent Superior*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/respondeat_superior (last visited Oct. 20, 2021)
[48] United States v. Bank of New England, N.A., 821 F.2d 844, 856 (1st Cir. 1987), cert. denied 108 S. Ct. 328 (1987).
[49] In re WorldCom, Inc. Securities Litigation, 352 F. Supp. 2d 472, 497 (S.D.N.Y. 2005).

Bank of New England,[50] the bank failed to report transactions of over $10,000 to the U.S. Treasury for a customer that made separate withdrawals totalling to over $10,000 by presenting cheques to different tellers. The court made note of the practice of compartmentalization of information by corporations and held that the aggregate of those components ought to be treated as the knowledge of the corporation and highlighted that the onus to create a structure where each employee had a holistic view of the transactions was on the corporation.

Although the Supreme Court, in the *New York Central* judgement did lay down that there were certain offences organizations could not commit, no federal decisions identifying such offences followed. To further the objectivity in the domain of corporate criminal liability, the American Law Institute's Model Penal Code (*hereinafter* referred to as "**MPC**") went on to be adopted by several states. The MPC had a limited approach to the apportionment of liability to corporations and rejected the *respondeat superior.*[51] The MPC limited the liability of corporations to instances where *"the commission of the offense was authorized, requested, commanded, performed or recklessly tolerated by the board of directors or by a high managerial agent acting in behalf of the corporation within the scope of his office or employment."*[52]

Several American scholars have argued that corporate criminal liability should be abandoned altogether, asserting that moral wrongs require the possession of certain capabilities like rationality, autonomy and emotionality,[53] and that holding corporations vicariously liable for criminal

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[50] United States v. Bank of New England, N.A., 821 F.2d 844, 856 (1st Cir. 1987), cert. denied 108 S. Ct. 328 (1987).
[51] Sara Sun Beale, *The Development and Evolution of the U.S. Law of Corporate Criminal Liability*, 126 ZEITSHRIFT FÜR DIE GESAMTE STRAFRECHTSWISSENSCHAFT 27 (2014).
[52] MODEL PENAL CODE §2.07(1)(c) (1962).
[53] MICHAEL MOORE, PLACING BLAME: A GENERAL THEORY OF THE CRIMINAL LAW 596–617 (1997).

acts circumvents the principle in criminal jurisprudence that requires persons to be responsible for their own intentions and actions.[54]

VI. CONCLUSION

The development of corporate criminal liability in India has seen a great sea change from the original framework of the Companies Act, 1956. The courts originally tackled the hurdles of whether fines could be levied for criminal offences in exclusion to imprisonment (when the statutes required both), and whether companies were indeed capable of having the necessary *mens rea* to commit crimes. This led to the ultimate question of how the "alter ego" of the company in such instances was to be treated.

The development of the principle of alter ego greatly began with the *Iridium* judgement, where the Supreme Court held that criminal accusations levelled against individuals who are solely responsible for the functioning of the company could be imputed onto the company too. In *Sunil Bharti Mittal*, the Supreme Court invalidated the reverse application of this principle and held that the offences committed by the companies could not be imputed onto the directors or those who represent the mind and will of the company. The Law Committee's Report delved deeper into the issue of criminal liability being associated with companies and suggested the reclassification of many criminal offences to civil wrongs, taking a considerate view of how much of a deterrent criminal prosecution actually serves as and the already overwhelmed Courts and Tribunals.[55]

This Report and extensive parliamentary deliberations led to the passage of the CAA 2019 and CAA 2020, which put a rest to the dilemma many courts in India were put through and filled the gaps in many individual judgements. However, there is still space for reform in certain

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[54] John C. Coffee, Jr., *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 418 (1981).
[55] *Supra* note 30 at 14.

aspects like the detailing of the manner in which grave offences affecting the public at large would be identified (an aspect the Report of the Law Committee left unchanged) and the extent of that effect, the mechanism by way of which courts would dissect the internal governance structures of companies for the imposition of fines, and variation of fines based on the nature of the companies. While on one hand, India continues to follow the 'comply or else' approach—where there is no option but to follow the rules; on the other hand, it has also been recognized that there exists an over-criminalisation of corporate offences which has been toned down by decriminalising certain offences. Thus, somewhere we have accepted that the strict approach needs to be toned down. But still there is resistance towards adopting 'comply or explain' approach.

DO EDTECH COMPANIES FALL UNDER THE AMBIT OF E-COMMERCE ENTITIES UNDER THE CONSUMER PROTECTION (E-COMMERCE) RULES, 2020?

Aaryan Mohan[*]

ABSTRACT

The Consumer Protection Act, 2019, explicitly recognizes the need to afford specialized protection to the interests of consumers who avail services of e-commerce entities like EdTech companies, through a digital or electronic network. However, for EdTech companies to come under the purview of the Act, the education they impart would need to come under the ambit of "services" under the Act. On that backdrop, this article analyses the conflicting jurisprudence behind the exclusion of education from the ambit of "services" under the Act, and sheds light on exceptions to this exclusion: to formulate a uniform standard, which can be referred to while deciding on the inclusion of education rendered by EdTech companies under the ambit of services under the Act, generally, and the Consumer Protection (E-commerce) Rules, 2020, specially. The article recognizes two types of EdTech companies: K-12 EdTech companies, and other EdTech companies (based on their targeted consumer base), and tests the education they impart on the anvil of the uniform standard, to determine whether they fall under the ambit of the Consumer Protection (E-Commerce Rules), 2020. Further, for the purposes of conducting informed regulation, EdTech companies, which come under the ambit of the E-Commerce Rules, 2020, need further classification as a "marketplace e-commerce entity", an "inventory e-commerce entity", or a "seller"; so that duties and liabilities more suited to a particular company's modus operandi can be prescribed. The preceding analysis would also facilitate the formulation of an objective test to determine whether a particular EdTech company would fall under the ambit of the E-Commerce rules or not.

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Keywords: EdTech Company, Consumer Protection, E-Commerce.

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I. INTRODUCTION

The Consumer Protection Act, 2019 [*hereinafter* referred to as "**the Act**"] sports a purposive legislative intent, which intends to "provide for protection of the interests of consumers".[1] In furtherance of that intent, the Act confers a sweeping effect to the definition of who can be considered a "consumer",[2] [3] by the inclusion of "online transactions through electronic means",[4] to enable consumer-friendly oversight spanning even the virtual realm. Though the definition of consumer covers someone who "buys any goods"[5] or "hires or avails any services"[6] by effecting "online transactions through electronic means"[7], the phenomenon of "buying or selling of goods or services including digital products over digital or electronic network"[8] is separately termed as "e-

[1] Consumer Protection Act, No. 35 of 2019, Preamble (Ind.).
[2] *Id.*, §2(7).
[3] *See also*, L.D.A v. M.K Gupta (1994) 1 SCC 243 (Ind.) ¶ 2.
[4] Consumer Protection Act, No. 35 of 2019, §2(7), Explanation (b).
[5] *Id.*, §2(7)(i).
[6] *Id.*, §2(7)(ii).
[7] *Id.*, §2(7), Explanation (b).
[8] *Id.*, No. 35 of 2019, §2(16).

commerce".[9] The Act recognizes the need to afford specialized protection to the interests of consumers, and prevent unfair trade practices with relation to e-commerce,[10] as is evidenced by the entry into force of the Consumer Protection (E-commerce) Rules, 2020, (hereinafter "E-Commerce Rules").[11] The E-Commerce Rules aspire to the Act's intention to provide for protection of the interests of consumers, and exhaustively elaborate upon what activities can be considered: e-commerce or incidental thereto,[12] for the purposes of facilitating informed regulation under the rules.

The combination of education with technology (EdTech), has shown extraordinary financial growth,[13] owing to the reach of digital, and electronic networks utilised by EdTech companies to facilitate their business. The measure of EdTech's effectiveness can be gleaned through its inclusion in the recently enacted National Education Policy, 2020,[14] which intends to use the potency of digitisation, in its pursuit of fulfilling the mandate of Sustainable Development Goal 4: ensuring quality education for all.[15] However, amidst the favourable financial metrics, governmental recognition, and technological advancements, do EdTech companies come under the ambit of the E-Commerce Rules? The education imparted by an EdTech company would need to *first:* come

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[9] *Id.*, §2(16).
[10] *Id.*, §§94, 101(1)(zg).
[11] Consumer Protection (E-Commerce) Rules, 2020, Gazette of India G.S.R. 462(E), Rule 1 (2) (July 23, 2020).
[12] *Id.*, Rule 2.
[13] *See* REDSEER, EDTECH IN INDIA: AN OMIDYAR NETWORK INDIA – REDSEER REPORT 2019-20 5 (2019-2020), https://www.omidyarnetwork.in/wp-content/uploads/2020/06/20200527-EdTech-Report-Omidyar-V6.pdf.
[14] MINISTRY HUM. RESOURCES DEV., NATIONAL EDUCATION POLICY, PT. III, CH. 24: ONLINE AND DIGITAL EDUCATION: ENSURING EQUITABLE USE OF TECHNOLOGY (2020), https://www.education.gov.in/sites/upload_files/mhrd/files/NEP_Final_English_0.pdf
[15] *Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all,* UNITED NATIONS DEP'T ECON. & SOC. AFF. (Sept. 27, 2015), https://sdgs.un.org/goals/goal4

under the ambit of the services under the Act, [16] and *second*: utilize a "digital or electronic network"[17] to warrant the consideration of the E-Commerce Rules.[18]

On that backdrop, part II of this article would explore the interaction of education with India's consumer protection regime in judicial forums, and formulate a uniform standard which will be referred to determine whether education falls under the ambit of services in a given circumstance. Part III of this article would bifurcate EdTech companies into two broad categories and test whether the education they impart would fall under the ambit of services on the basis of the standard evolved in part II. On the basis of the exhaustive analysis conducted in part III, part IV would formulate an objective three-pronged standard to ascertain whether a particular EdTech company would come under the ambit of the Act generally, and the E-commerce Rules specially. Part V of the article would end with a gist of the observations made.

II. EDUCATION: "A MISSION/NOBLE VOCATION", OR A SERVICE?

The judiciary, and the consumer forums, have put education on a pedestal, insofar as, it is recognized as "a mission or a noble vocation",[19] and not a service. The reasoning behind the same, relying on the jurisprudence evolved on the topic, is two-pronged, as, *first:* any institution affiliated with a recognized board is discharging a statutory function, and therefore, the education that it imparts cannot be considered a service, and any deficiency cannot substantiate grounds for filing a complaint

[16] Consumer Protection Act, No. 35 of 2019, §2(42).
[17] Consumer Protection (E-Commerce) Rules, 2020, Gazette of India G.S.R. 462(E), Rule 1 (2) (July 23, 2020), Rule 2.
[18] *Id.*
[19] *See* A. Sundarambal v. Government of Goa, Daman & Diu & Ors. (1988) 4 SCC 42 (Ind.) ¶ 10; Smt. Taneja v. Calcutta Distt. Forum (1992) AIR Cal 95 (Ind.) ¶ 19.

under the Act;[20] *second:* there exists a set of comprehensive rules or regulations governing the conduct of an educational institution, which could facilitate the resolution of any grievance without referring the matter to an outside body.[21] Therefore, it can be reasonably assumed that core-educational functions stand outside the purview of the Act, and a student does not avail the services of an institution on paying consideration as understood contractually,[22] or under the Act,[23] but the charge that they pay is "for the privilege of participation in the examination"[24] in furtherance of securing a degree/diploma.

A. When can Education Come under the Ambit of Services?

In the case of *Bangalore Water Supply & Sewerage Board v. A. Rajappa,*[25] education was considered a service, but, the same cannot be relied upon for the purposes of the Act, as, the decision was rendered in 1978, before the entry into force of the Consumer Protection Act, 1986. Further, in *Maharshi Dayanand University* v. *Surjeet Kaur*,[26] the Supreme Court observed that the consumer forums have been swayed by the reasoning adopted by *Bangalore Water Supply (supra)* to satisfy them of their jurisdiction, and reliance on the same cannot be placed to direct an authority to act contrary to its own rules.[27]

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[20] *See* Bihar School Examination Board v. Suresh Prasad Sinha (2009) 8 SCC 483 (Ind.) ¶ 11-13; Maharshi Dayanand University v. Surjeet Kaur (2010) 11 SCC 159 (Ind.) ¶ 20; Anupama College of Engineering v. Gulshan Kumar & Ors. Civil appeal no. 17802 of 2017 (Supreme Court of India, Oct. 30, 2017).

[21] *See* Manu Solanki v. Vinayaka Mission University SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 18.

[22] *See* Smt. Taneja v. Calcutta Distt. Forum (1992) AIR Cal 95 (Ind.) ¶ 19.

[23] *Id.*

[24] Bihar School Examination Board v. Suresh Prasad Sinha, (2009) 8 SCC 483 (Ind.) ¶ 12.

[25] Bangalore Water Supply & Sewerage Board v. A. Rajappa, (1978) 2 SCC 213 (Ind.).

[26] Maharshi Dayanand University v. Surjeet Kaur, (2010) 11 SCC 159 (Ind.).

[27] Manu Solanki v. Vinayaka Mission University SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 18.

However, in the case of *Buddhist Mission Dental College v. Bhupesh Khurana,*[28] while placing reliance on *Bangalore Water Supply (supra),* the Supreme Court held that an educational institution is liable under the Act during the pre-admission phase. As, the factual matrix related to non-affiliation of a college offering a degree course, therefore, there existed neither a regulatory body, nor a set of rules,[29] which were susceptible to contravention.

B. CONSEQUENCES OF NON-AFFILIATION OF AN INSTITUTION IN THE POST-ADMISSION PHASE.

In *Manu Solanki v. Vinayaka Mission University,*[30] the National Consumer Forum clarified the position with respect to non-affiliation of a university post-admission and held that the same would be outside the purview of the act, as, it was during the "course of imparting education post-admission".[31] It further elaborated that "even if an Institution imparting education does not have a proper affiliation in imparting education, it is not rendering any service"[32]. Apart from the fact that the institution was imparting education post-admission, no supporting reasons were advanced to buttress the proposition in favour of ousting the jurisdiction of the consumer forums.

C. POST-ADMISSION TEST V. THE TEST OF EXAMINING STATUTORY REGULATION: TOWARDS A UNIFORM STANDARD.

The aforementioned shift from examining the existence of statutory regulation, and affiliation, to a broader post-admission test, to substantiate grounds for ousting the jurisdiction of consumer forums, would have been problematic if *Manu Solanki (supra)* did not explicitly render the

[28] Buddhist Mission Dental College v. Bhupesh Khurana (2009) 4 SCC 473 (Ind.).
[29] *Id.*, ¶ 31.
[30] Manu Solanki v. Vinayaka Mission University, SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 18.
[31] *Id.,* at ¶ 35
[32] *Id.,* at ¶ 38.

provisions of the Act applicable to coaching institutions.[33] *Manu Solanki (supra)* stated that coaching centres, and the like: "cannot be equated to regular schools or colleges which are regulated by a Regulatory Authority, and also confer a Degree/Diploma on the student who has passed in the examinations conducted as per the Rules and norms specified in the statute".[34] Rather inconsistently reverting from its unique post-admission test,[35] to the pre-established test of examining the existence of statutory regulation, demonstrating a shallow faith in the construction evolved.

Therefore, in examining the nature of the education imparted by EdTech companies as services, this article would concern itself with examining the existence of statutory regulation over the education that an EdTech company provides, and not the prescription of the post-admission test which relies on the timeline, which governs a student's admission into the programmes offered by EdTech companies.

III. DO EDTECH COMPANIES COME UNDER THE AMBIT OF THE E-COMMERCE RULES?

EdTech companies can be classified into two broad categories based on their target audience: K-12 EdTech companies[36] which focus on supplementing education imparted by affiliated educational institutions from kindergarten to the 12th grade, and EdTech companies, which concentrate their efforts beyond the confines of the traditional K-12 model,[37] including but not limited to: coaching related to entrance exams, and improving vocational skills for better employment prospects.

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[33] Fitjee Limited v. Minathi Rath, (2012) I CPJ 194 NC (Ind.).
[34] Manu Solanki v. Vinayaka Mission University, SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 45.
[35] *Id.,* at ¶ 35.
[36] *See generally*, *supra* note 13.
[37] *See generally*, *supra* note 13.

A. K-12 EDTECH COMPANIES AND THE E-COMMERCE RULES

If a K-12 EdTech company is not affiliated with any board, but supplements the education provided by traditional education institutions for a consideration;[38] the functions of the company would fall under the ambit of services as recognized under the Act, and the company would need to comply with the mandate of the Act. However, if a K-12 EdTech company is affiliated with a board, and the education it imparts is in furtherance of conferring a degree/diploma "on the student who has passed in the examinations conducted as per the Rules and norms specified in the statute",[39] the functions of the same would lie outside the ambit of the Act. Further, any K-12 EdTech company offering their services free of charge, would also not come under the ambit of the Act.[40]

The E-Commerce rules explicitly mention their scope and applicability to extend to "all goods and services bought or sold over digital or electronic network including digital products".[41] Therefore, a non-statutorily regulated K-12 EdTech company, which provides education for consideration over a digital or electronic network would need to comply with the mandate of the E-Commerce Rules, since the education it imparts does come under the ambit of the Act due to a lack of statutory regulation, and there exists an added consideration of a digital or electronic network. However, to conduct informed regulation: a more specific appellation fitting the model that the company adopts would need to be ascertained. The E-Commerce rules identify three distinct entities for the purposes of conducting informed regulation: "marketplace e-

[38] *Supra* note 13.
[39] Manu Solanki v. Vinayaka Mission University, SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 45.
[40] Consumer Protection Act, No. 35 of 2019, §2 (42).
[41] Consumer Protection (E-Commerce) Rules, 2020, Gazette of India G.S.R. 462(E), Rule 1 (2) (July 23, 2020), Rule 2(1)(a).

commerce entity",[42] "inventory e-commerce entity",[43] and "seller"[44] (as defined under section 2 (37) of the Act).

An "e-commerce entity"[45] is defined under the E-Commerce Rules as: "any person who owns, operates or manages digital or electronic facility or platform for electronic commerce, but does not include a seller offering his goods or services for sale on a marketplace e-commerce entity";[46] a person for the purposes of the Act, and the E-Commerce Rules does not mean a natural person as is evidenced by the explicit exclusion of any activities performed in a personal capacity,[47] and relates to a corporate entity.

Therefore, a K-12 EdTech company which "owns, operates or manages"[48] a digital or electronic platform to facilitate e-commerce on a systematic basis, can be considered an e-commerce entity for the purposes of the act and can be further classified into either a marketplace e-commerce entity or an inventory e-commerce entity: the former if it "provides an information technology platform on a digital or electronic network to facilitate transactions between buyers and sellers"[49], and the latter if it owns the products and services that it is selling directly to its consumers through a "digital or electronic facility"[50] that it "owns, operates or manages"[51]. If a K-12 EdTech company utilises a digital or electronic platform of a marketplace e-commerce entity to sell its own products or services, it would not be regarded as an e-commerce entity, but a seller for e-commerce related to that platform, as the E-Commerce Rules explicitly exclude from the ambit of who can be considered an e-

[42] *Id.*, Rule 3(g).
[43] *Id.*, Rule 3(f).
[44] *Id.*, Rule 3(k).
[45] *Id.*, Rule 3(b).
[46] *Id.*, Rule 3(b).
[47] *Id.*, Rule 2.
[48] *Id.*, Rule 3(b).
[49] *Id.*, Rule 3(g).
[50] *Id.*, Rule 3 (b).
[51] *Id.*

commerce entity: "a seller offering his goods or services for sale on a marketplace e-commerce entity"[52].

However, if a K-12 EdTech company sells a product, for example an electronic tablet, through a marketplace e-commerce entity, and the tablet enables the rendering of services as provided by the company, where the "furnishing of opinion, skill or services"[53] is the "essence"[54] of the services that they provide, the company could evade its responsibilities as a seller of the tablet under the E-Commerce Rules, as, seller is understood as per the meaning conferred to the term "product seller".[55] This explicitly excludes from the ambit of who can be considered as product sellers: "a provider of professional services in any transaction in which, the sale or use of a product is only incidental thereto, but furnishing of opinion, skill or services being the essence of such transaction*";*[56] though the duties that the E-Commerce Rules prescribe for a seller could be evaded,[57] the market place e-commerce entity whose digital platform would facilitate this transaction would still be liable under the Rules,[58] but the liability of the K-12 EdTech company selling the tablet, would arise only when the consumer starts availing their services as an inventory e-commerce entity,[59] and not as a seller as understood under the E-Commerce Rules.

B. OTHER EDTECH COMPANIES AND THE E-COMMERCE RULES

If an EdTech company, which does not employ the K-12 model: does not come under statutory regulation as a result of its non-affiliation, and the education it imparts is not in furtherance of conferment of a

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[52] *Id.*, Rule 3(g).
[53] Consumer Protection Act, No. 35 of 2019, §2(37)(b).
[54] *Id.*
[55] *Id.*, §2(37).
[56] *Id.*, §2 (37)(b).
[57] Consumer Protection (E-Commerce) Rules, 2020, Gazette of India G.S.R. 462(E), Rule 1 (2) (July 23, 2020), Rule 6.
[58] *Id.*, Rule 5.
[59] *Id.*, Rule 7.

degree/diploma;[60] the education imparted by such an EdTech company would be considered service under the Act. Additionally, if they conduct their business over a digital or electronic network, they would be liable to discharge the duties prescribed under the E-Commerce rules depending on their identification as a marketplace e-commerce entity/inventory e-commerce entity or a seller. EdTech companies, which prepare students for competitive exams, akin to tuition centers, do not impart education, which would lead to the conferment of a degree/diploma,[61] as they just aid the students in their preparation for competitive exams, and provide services as under the Act,[62] and therefore, are liable under the E-Commerce Rules. EdTech companies, which engage in imparting vocational education, however, are a different case.

1. What is Vocational Education?

Vocational education, according to the Supreme Court in *State of Punjab v. Senior Vocational Staff Masters Association,*[63] can be termed as "job-oriented education"[64], in which, "teaching is not on a regular basis"[65]. However, a more nuanced definition is provided by the notification,[66] which brought into existence: National Council for Vocational Education and Training (*hereinafter* referred to as "**NCVET**"). The notification, which details the functions of the NCVET, defines "vocational education and training"[67] to mean: "all skill related programs both long term and short term, apprenticeship training and recognition of prior learning, certified by the council but not covered by the All-India Council for

[60] *Supra* note 13.
[61] *See* Manu Solanki v. Vinayaka Mission University, SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 18.
[62] *Id.*
[63] State of Punjab v. Senior Vocational Staff Masters Association, 9 SCC 379 (2017).
[64] *Id.*, ¶ 13.
[65] *Id.*, ¶ 22.
[66] *See* MINISTRY SKILL DEV. & ENTREPRENEURSHIP, GOV'T OF IND., NOTIFICATION NO. SD-17/113/2017-E&PW (2018), https://ncvet.gov.in/sites/default/files/NCVET.pdf.
[67] *Id.*, §1(xxiv) 2

Technical Education Act, 1987(52 of 1987), the University Grants Commission Act, 1956 (3 of 1956), or by any other law for time being in force."[68]

2. Can the NCVET Oust the Jurisdiction of the Consumer Forums?

The NCVET is a non-statutory regulatory body,[69] which aims to "regulate the functioning of entities engaged in vocational education and training, both long-term and short-term, and establish minimum standards for the functioning of such entities"[70] and subsumes the pre-existing National Skill Development Agency and the National Council for Vocational Training.[71] Keeping in mind the existence of the NCVET, can an EdTech company, which has undergone requisite "affiliation",[72] and "accreditation"[73] to become a "recognized body"[74] under the notification: come under the purview of the Act, and more specifically the E-Commerce Rules?

The NCVET includes grievance redressal,[75] in the myriad of functions it is to perform in its pursuit of conducting "indirect regulation of vocational training institutes".[76] Therefore, if an EdTech company, is a recognized body performing functions related to imparting vocational education, and training: it would, on the request of the council, need to "redress grievances of their respective aggrieved persons, including

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[68] *Id.*
[69] *See* Press Release, Ministry of Skill Development and Entrepreneurship, Establishment of National Council for Vocational Education and Training, (June 28, 2019), https:/pib.gov.in/PressReleaseIframePage.aspx?PR*ID*=1576157.
[70] *Id.*
[71] *Id.*
[72] *Supra* note 66, §1(i)
[73] *Supra* note 66, §1(ii).
[74] *Supra* note 66, §1(xix).
[75] *Supra* note 66, §16(e)22.
[76] *Supra* note 69.

payment of monetary compensation"[77], and the NCVET may "provide redress to aggrieved persons by itself against certain type of grievances"[78] against a recognized body. Therefore, the pre-requisite of a grievance redressal mechanism is satisfied, as it being a consideration while examining the existence of statutory regulation could oust the jurisdiction of the consumer forums.[79] However, since the NCVET is not a statutory body, is its grievance redressal mechanism enough to oust the jurisdiction of the consumer forums?

The grievance redressal mechanism as envisaged by the notification is specifically tailored to matters revolving around vocational education and training, and it can be given preference over consumer forum (*generalia specialibus non derogant*)[80] only to the extent that the jurisdiction of the consumer forum over the dispute remains intact. As, the notification was notified in the official gazette "in pursuance of the decision of the cabinet in its meeting"[81], which makes it an executive notification, however, the E-Commerce Rules were enacted "In exercise of the powers conferred by sub-clause (zg) of sub-section (1) of section 101 of the Consumer Protection Act, 2019"[82], which is an act of the parliament, and no executive notification can oust the jurisdiction of the consumer forums bestowed upon them by an act of the parliament.[83] Further, the Supreme Court has time and again held, that as long as someone qualifies under the definition of consumer, the consumer forum would have the jurisdiction

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[77] *Supra* note 66, §22(1)(a).
[78] *Supra* note 66, §22(1)(b).
[79] *See* Smt. Taneja v. Calcutta Distt. Forum (1992) AIR Cal 95 (Ind.) ¶ 19.
[80] *See* CTO v. Binani Cement Ltd., (2014) 8 SCC 319 (Ind.) ¶ 37.
[81] *Supra* note 66.
[82] Consumer Protection Act, No. 35 of 2019, §101(1)(zg).
[83] Consumer Protection (E-Commerce) Rules, 2020, Gazette of India G.S.R. 462(E), Rule 1 (2) (July 23, 2020), Rule 8; *See* DDA & Ors. v. Joginder S. Monga, (2004) 2 SCC 297 (Ind.).

to entertain their complaints,[84] even if the functioning of statutorily mandated special mechanisms might overlap with that of the Act.[85]

Therefore, the existence of a non-statutory regulatory body like the NCVET, which recognizes grievance redressal as one of its functions, would not be enough to oust the jurisdiction of the consumer forums, and hence, any EdTech company, which is a recognized body under the notification would also have to comply with the E-Commerce Rules if they engage in functions related to imparting vocational education and training, and do so over a digital or electronic network.

IV. AN OBJECTIVE TEST TO ASCERTAIN WHETHER AN EDTECH COMPANY FALLS UNDER THE AMBIT OF THE E-COMMERCE RULES

The preceding analysis facilitates the formulation of an objective test, which can be used to ascertain whether an EdTech company would come under the ambit of the Act generally and the E-commerce Rules specially (not applicable if an EdTech company's services can be availed free of cost):

A. IS AN EDTECH COMPANY STATUTORILY REGULATED, OWING TO ITS AFFILIATION WITH A RECOGNIZED BOARD?

In case an EdTech company is statutorily regulated through its affiliation with a recognized board,[86] and the education it imparts leads to

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[84] *See* National Seeds Corporation Limited v. M. Madhusudhan Reddy and Anr., (2012) 2 SCC 506 (Ind.); Secretary, Thirumurugan Cooperative Agricultural Credit Society v. M. Lalitha (2004) 1 SCC 305 (Ind.).

[85] Imperial Structures Limited v. Surinder Anil Patni and Anr., Civil Appeal No. 3581-3590 of 2020 (Supreme Court of India).

[86] *See* Bihar School Examination Board v. Suresh Prasad Sinha, (2009) 8 SCC 483 (Ind.) ¶ 11-13; Maharshi Dayanand University v. Surjeet Kaur (2010) 11 SCC 159 (Ind.) ¶ 20; Anupama College of Engineering v. Gulshan Kumar & Ors. Civil appeal no. 17802 of 2017 (Supreme Court of India, Oct. 30, 2017).

the conferment of a degree/diploma on a student,[87] the company would not come under the scope of the Act, and the E-Commerce Rules.

B. IS THERE A STATUTORILY MANDATED GRIEVANCE REDRESSAL MECHANISM, WHICH CAN FACILITATE THE INSTITUTION OF COMPLAINTS AGAINST THE EDTECH COMPANY?

A tailored, and statutorily mandated grievance redressal mechanism can oust the jurisdiction of a consumer forum as, *first,* an authority cannot be forced to act contrary to its own rules,[88] and *second,* a special legislation would always be given preference over a general legislation in case of an overlap,[89] however, if a grievance redressal mechanism is not statutorily mandated, it cannot oust the jurisdiction of the consumer forums.[90]

C. WHETHER AN EDTECH COMPANY UTILIZES A DIGITAL OR ELECTRONIC NETWORK TO FACILITATE E-COMMERCE?

In case an EdTech company is not imparting education in furtherance of conferment of a degree/diploma on an individual, it would come under the ambit of the Act. Further, if it utilizes a digital or electronic network to facilitate e-commerce, it would come under the ambit of the E-Commerce Rules, more specifically:

- If an EdTech company directly sells to its consumers, through a digital or electronic facility or platform it owns operates or manages, it would be regarded as an inventory e-commerce entity;[91]
- If an EdTech company owns operates or manages a digital platform to facilitate transactions between seller EdTech companies and buyers it would be regarded as a marketplace e-commerce entity;[92]

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[87] Manu Solanki v. Vinayaka Mission University, SCC OnLine (2020) NCDRC 7 (Ind.) ¶ 18.
[88] *Id.*
[89] CTO v. Binani Cement Ltd., (2014) 8 SCC 319 (Ind.) ¶ 37.
[90] *Supra* note 66.
[91] Consumer Protection (E-Commerce) Rules, 2020, Gazette of India G.S.R. 462(E), Rule 1(2) (July 23, 2020), Rule 3(f).

- If an EdTech company sells a particular product through a marketplace e-commerce entity, the EdTech company would be regarded as a seller.[93]

V. CONCLUDING REMARKS

Classifying the nature of education imparted by an EdTech company as services under the Act can enable informed regulation of the types of EdTech companies, which could be brought under the ambit of the E-Commerce Rules. Additionally, the test furthered can help inform an E-Commerce company the compliance it needs to demonstrate under the E-Commerce Rules. The new consumer protection regime is a welcome step to alleviate the uncertainty plaguing a consumer who avails the services of an EdTech company digitally. However, creases still need ironing out on the privacy front,[94] as these companies engage in functions which involve the digital movement of a substantial amount of minor's data.

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[92] *Id.*, Rule 3(g).
[93] *Id.*, Rule 3 (k).
[94] MINISTRY ELECTRONICS & INFO. TECH., GOV'T OF INDIA, A FREE AND FAIR DIGITAL ECONOMY, PROTECTING PRIVACY, EMPOWERING INDIANS 42 (2018), https://www.meity.gov.in/writereaddata/files/Data_Protection_Committee_Report.pdf
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A RECURRENT QUEST FOR CORPORATE GOVERNANCE IN INDIA: REVISITING THE IMBALANCED SCALES OF SHAREHOLDERS' PROTECTION IN TATA- MISTRY CASE

Himanshu Kaswa & Shreya Pandey[*]

ABSTRACT

Corporate governance exists as a notional fragment in the overall mechanism of a company for which different set of standards, procedures and codes are adopted. The objective criterion set forth in the legislation and regulatory authorities' leaves scope for subjective enactment of procedures by the companies which raises concerns for unethical practices. Articles of Association (hereinafter referred to as "AoA") carries enormous significance in a corporate set-up as it contains rules and regulations for the entire management of a company. Extant loopholes and inadequate provisions in AoA cause a burgeoning effect on the poor governance system. The legal tangle involved between Tata and Mistry presented a set of procedural problems incorporated in AoA affecting substantive rights of the members of a company. National Company Law Appellate Tribunal comprehensively dealt with provisions of AoA, minority shareholders' right and removal of chairman, however, on appeal the Supreme Court delved into the matter with a different legal tangent recognizing the corporate governance norms. Through this paper, we discuss the decision rendered by Supreme Court in Tata-Mistry case by placing emphasis on the conundrum of clustered concentration of power among the directors, procedures involved in the removal of chairman and shareholders' transfer of shares exhibiting the derailment of minorities' protectionist regime. A critical analysis is drawn on the position of corporate governance in the epoch of majority shareholders' hegemony.

Keywords: Corporate Governance, Tata-Mistry case, Shareholders' Protection.

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I. INTRODUCTION

Corporate governance is a system providing a set of principles or norms which deploys the governance structure of a company. Sir Adrian Cadbury has defined corporate governance as *"the system by which companies are directed and controlled."*.[1] It essentially emphasizes the separation of ownership and control which also forms the bedrock for subsistence of trust between the shareholders and the company.[2] This whole mechanism is intended to ensure that horizons of management are conducted in a transparent manner and interests of all the stakeholders are protected which furthers the objectives of a company.

In the case of *Tata Consultancy Services Limited v. Cyrus Investments Pvt Ltd.,*[3] the Supreme Court dealt with validity of removal of Mr. Cyrus Mistry from the chairmanship of Tata Sons Limited through separate resolutions passed in the company. The legal battle between Tata and

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[1] *See* CADBURY, A., COMM. FIN. ASPECTS CORP. GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992), https://ecgi.global/sites/default/files/codes/documents/cadbury.pdf.
[2] Silvia Ayuso & Antonio Argandona, Responsible Corporate Governance Towards a Stakeholder Board of Directors, (IESE Bus. Sch. U. Navarra, Working Paper No. 701, 2007), http://www.iese.edu/research/pdfs/DI-0701-E.pdf.
[3] Tata Consultancy Services Limited v. Cyrus Investments Pvt Ltd, (2021) SCC OnLine SC 272.

Mistry presented a cloud of uncertainties with respect to perseverance of corporate governance principles. And casted serious aspersions on functioning of the board, dominance of majority shareholders, procedure involving removal of chairman, organizational culture and overall management of the company. Through placing emphasis on AoA in the case of *Tata Consultancy Services Limited v. Cyrus Investments Pvt Ltd,*[4] this article aims to explore the background of the case and focus on the issues pertaining to observance of due procedure, lack of corporate governance, power concentration, procedural irregularities, shareholders abuse etc. and lastly proffer suggestions along with concluding remarks.

II. BACKGROUND OF THE TATA-MISTRY CASE

Cyrus Mistry was appointed as the chairman of Tata Sons Group in 2012 through a selection procedure.[5] In the instant twist of corporate tales, Mr. Cyrus Mistry was sacked from the position of chairman by majority of the board of directors by invocation of the provisions of AoA. Subsequently, a suit was filed by Mr. Cyrus Mistry under Sections 241, 242 and 244 of the Companies Act, 2013 before National Company Law Tribunal Mumbai (*hereinafter* referred to as "**NCLT**") alleging oppression of minority shareholder rights and operational mismanagement. The core issues delved into by the Tribunal were exercise of control, procedure for removal of chairman, oppression and mismanagement by the company, rights of minority shareholders. NCLT in 2018 validated the procedure adopted by Tata sons to remove Cyrus Mistry from the post of chairman and lay aside all the charges against Tata Sons.[6] However, in 2019, the National Company Law Appellate Tribunal (*hereinafter* referred to as "**NCLAT**") overturned the NCLT judgment and determined the removal as 'illegal'. Further, NCLAT also ordered reinstatement of Mr. Cyrus

[4] *Id.*

[5] Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd. & Ors, (2019) SCC OnLine NCLAT 858 ¶ 79.

[6] Cyrus Investment Private Limited and Ors. v. Tata Consultancy Services Limited, (2018) SCC OnLine NCLT 24460.

Mistry as the chairman of Tata Sons.[7] The matter went to appeal before Supreme Court in 2020 wherein decision was rendered in favour of Tata Group and a stay was granted against NCLAT order to reinstate Cyrus Mistry.[8]

III. POWER ASYMMETRY WITHIN THE COMPANY

The pillar of a good governance structure nestles on transparency, accountability, efficiency, and equitable treatment of all stakeholders. The wheels of governance instrumentality of a company lie under the helm of board of directors which must adopt major policy decisions for the benefit of a company. The Companies Act, 2013 has extensively provided for duties of the directors which subsumes overseeing the operations, promoting the objectives of a company and acting as a shield against the interests of shareholders.[9] However, if AoA is crafted in a way which impedes the board of directors to perform its duties, then it should be considered antithetical to shareholders and the company as a whole. The question of adherence of corporate governance has been hit by a storm in the Tata-Mistry case wherein Article 121 of the AoA of the Tata Sons Ltd was challenged on its validity. Article 121 was added as a precursor to require Tata Sons to seek affirmative voting of majority of nominee directors on any matter associated with the company pursuant to which the matter shall be presented to board of directors.[10]

However, the right to appoint nominee directors vested with Tata Trusts was subject to aggregate paid up shareholding of 40% of the

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[7] Krishnadas Rajagopal, *Supreme Court backs Tata Sons, sets aside NCLAT order to reinstate Cyrus Mistry as chairman*, THE HINDU (Mar. 26, 2021) https://www.thehindu.com/news/national/sc-rules-in-favour-of-tata-sons-sets-aside-nclat-judgment-restoring-cyrus-mistry-as-chairman/article34167867.ece.

[8] *Id.*

[9] Companies Act, No.18 of 2013, §166 (Ind.).

[10] Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd. & Ors, (2019) SCC OnLine NCLAT 858 ¶ 26.

company.[11] Further, the only provision to change the shareholding of Tata Trusts as enshrined under Article 121A(g) was through the decision taken in Board meeting which again required affirmative vote of Nominee Directors to tread this matter before Board of Directors.[12] It shows the presence of cast iron rule engrafted in AoA wherein decisions of a company are absolutely dependent on affirmative vote of nominee directors and no majority decision can be taken by board of directors or in the general meeting of shareholders. Nowhere does the Companies Act, 2013 provide that affirmative vote of a particular person or group can be a pre-condition for passing a resolution. Conversely, the Act nowhere stipulates that a resolution shall fail when a person, having affirmative vote, fails to cast the vote.[13] However, in this case, Justice S.J Mukhopadhaya quoted *"The affirmative vote of the directors nominated by Tata Trusts has an overriding effect and renders the majority decision subservient to it"*.[14] The preeminent provisions manifest the concentration of power in the form of veto exercised by nominee directors over the rights of board of directors.

Board of directors is considered as the visionary light in the mainstay of an organization. The Corporate Governance Report issued by Cadbury Committee highlighted that corporate board plays a significant role in defining a company's purpose, subsequent alignment of strategies and formulation of plans to achieve that purpose.[15] In light of administration of such functions, a well-settled principle is that Board of Directors acts

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[11] *Id.,* ¶ 109.

[12] *Id.,* ¶ 111.

[13] Padmanabhan Iyer, *Veto Rights Relating to Quorum and Voting on Resolutions - Whether Enforceable Under the Indian Companies Act, 1956,* MONDAQ (July 25, 2003) https://www.mondaq.com/india/corporate-and-company law/22063/veto-rights-relating-to-quorum-and-voting-on-resolutions--whether-enforceable-under-the-indian-companies-act-1956.

[14] Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd. & Ors, (2019) SCC OnLine NCLAT 858 ¶ 154.

[15] *Supra* note 1 at ¶ 2.5 ("The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.").

as fiduciaries of shareholders' and other stakeholders' interest.[16] Board propels 'horizontal governance' in an organization wherein it acts as a median between dominant stockholders and management and prevents expropriation of other dispersed shareholders.[17] Though AoA may limit the power of the Board to regulate and oversee the affairs of an organization, however, any delegated power or constitution of an upper layer group among directors should not strip off the ultimate authority of board to ensure corporate oversight or governance.

The social psychological experiment by Stanley Milgram depicts that an individual is inclined to adopt inimical strategies and defy ethical standards to show his loyalty to the authority figure. Sense of loyalty often drives a 'reflexive obedience' among directors in an organisation towards the CEO which may guarantee unfettered support to the CEO's decision even at the cost of a director's fiduciary duty to the shareholders.[18] Drawing an analogy from Milgram's experiment, in the present case nominee directors owe their allegiance to Tata Trust by virtue of their appointment, hence, independent judgment and critical acumen would be seldom found even for the protection of minority shareholders and wellbeing of an organization.

Further, family-owned companies manage to have a dominant decision-making power with substantial ownership and controlling rights which raises concerns for expropriation of minor shareholders and self-

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16 Martin Lipton et al., *Stakeholder Governance and the Fiduciary Duties of Directors,* HARV. LAW SCH. F. CORP. GOVERNANCE (Aug. 24, 2019) https://corpgov.law.harvard.edu/2019/08/24/stakeholder-governance-and-the-fiduciary-duties-of-directors/.

17 Mark J Roe, *The Institutions of Corporate Governance* (Harv. John M. Olin Ctr. L., Econ., & Bus., Discussion Paper No. 488, 2004), http://www.law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf.

18 *See* Randall Morck, Behavioral Finance in Corporate Governance - Independent Directors, Non-Executive Chairs, and the Importance of the Devil's Advocate (Nat'l Bureau Econ. Res., Working Paper No. 10644, 2004), https://www.nber.org/papers/w10644.

serving tactics thereby leading to severe governance problems.[19] In order to eliminate such obstacles, independent directors were flung on board to keep a tab on the behaviour of controlling shareholders and have a perspective independent of inside management. Independent Directors are deemed to be 'watchful monitors' of management and treasury of strategic guidance to steer an organization towards its vision.[20] Section 149(4) of the Companies Act, 2013 provides that one third of the total number of directors should be appointed as independent directors in a listed public company[21] and it has further been substantiated under section 149(6) of the Companies Act, 2013 that nominee directors should not be considered as independent directors. However, nomination of upper echelons in a committee without the presence of independent directors evidently shows the concentration of power held by Tata Trusts indirectly. Presence of such provisions constitutes flagrant violation of corporate governance norms which has stirred serious questions on ethical standards followed in the company.

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[19] *See* Jayati Sarkar, *Board Independence & Corporate Governance in India: Recent Trends & Challenges Ahead,* 44 IND. J. INDUS. REL. 576-592, (2009) (Emphasis on the governance problem prevalent in continental Europe, Japan, East Asian economies including India, where family-owned corporations dominate and family members occupy superior positions with significant ownership and controlling rights with the intent to control the firm).

[20] *See* Vikramaditya S. Khanna & Shaun J. Mathew, *The Role of Independent Directors in Controlled Firms in India Preliminary Interview Evidence,* 22 NAT'L L. SCH. IND. REV. 35-66, (2010) ("Independent directors may be seen as watchful monitors of promoters and management on behalf of public shareholders or independent directors may be viewed as reservoirs of strategic advice intended to aid promoters and managers in maximizing overall firm value"), *See also* Jeffrey.N. Gordon, *The Rise of Independent Directors in the United States, 1950- 2005: Of Shareholder Value and Stock Market Prices,* 59 STAN. L. REV. 1465-1568, (2007).

[21] *See also,* Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 6(1), Clause 49 (Sept. 2, 2015).

IV. UNMASKING THE PROCESS OF REMOVAL OF CHAIRMAN

Cyrus Mistry was elected to the post of Executive Chairman by the selection committee on 29th December 2012.[22] NCLAT in its judgment held that appointment of Mr. Cyrus Pallonji Mistry as an Executive Chairman with substantial powers of management was akin to that of a Managing Director and will be considered as Key Managerial Personnel (*hereinafter* referred to as "**KMP**").[23] The KMP is entrusted with substantial power of management and the same powers were entrusted by Cyrus Mistry. The power to appoint or remove a KMP has been entrusted to the board as provided under Section 203(2) of the Companies Act, 2013 read with Rule 8 of the Companies (Meeting of the Board and its Powers) Rules, 2014. Since, the AoA of Tata Sons Limited under Article 118 provide for 'Constitution of a Selection Committee' for the purpose of selecting a new chairman of the board, it also specifies that the same process shall be followed for the removal of the chairman.[24] The Supreme Court observed that the sentence *"the same process shall be followed for the removal of incumbent Chairman"* is only applicable to the last limb of the article i.e., affirmative voting right under Article 121.[25] However, there has been no clarity on the meaning of 'same process' as the drafted Article 118 makes room for ambiguity and different interpretations.

It was also contended that advance notice of Mistry's removal was not given and an agenda item has also not been placed as required under Article 121B. The Supreme Court discarded the applicability of Article 121B by affirming that it is relevant only when the director decides to set

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22 Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd. & Ors., (2019) SCC OnLine NCLAT 858 ¶ 79.

23 *Id.*, at ¶ 88. (§2(51) of the Companies Act, 2013 provides key managerial personnel to include managing director).

24 *Id.*, at ¶ 74.

25 Tata Consultancy Services Limited v. Cyrus Investments Pvt Ltd, (2021) SCC OnLine SC 272 ¶ 16.34.

forth any matter or resolution before the Board. However, it fails to address that this substantial matter concerning the removal of Mistry was taken up by the board of directors of Tata Sons under the residuary "any other matters". In a company like Tata which has high repute and brand values, any major procedural irregularity or divergence from accepted practices will not only affect a single person but all the persons associated with the company. It is not merely a boardroom tussle between the two shareholders but in reality, it raises a big question mark on corporate governance norms in Indian companies which affect general investors at large. Though, corporate democracy also holds equal value but it should not be used to overrun corporate governance.

V. PROCEDURAL IRREGULARITIES IN TRANSFER OF SHARES

One of the primordial features of a company is the free transferability of shares and Section 44 of the Companies Act, 2013 provides that "*the shares, debentures or other interest of the member of a company are moveable property and hence are transferable in the manner as provided in the company's articles of association.*" However, the present case illustrates unreasonable fetters on the share transfer procedure as a draconian provision in the form of Article 75 of AoA empowered the 'Tata Sons Limited' at any time to transfer 'ordinary shares' of any of the shareholders by passing of special resolution with affirmative voting of nominee directors and without observance of due procedure of transfer.[26]

On the contrary, Article 121A(g) of AoA provides that the shareholding of Tata Trusts cannot be reduced without the resolution of 'Board of Directors'.[27] However, directors of 'Tata Trusts' by virtue of being nominee directors themselves exercises the right to affirmative voting. Implication of such a provision in AoA include tacitly non-

[26] Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd. & Ors., (2019) SCC OnLine NCLAT 858 ¶ 114.
[27] *Id.*, at ¶ 113.

enforcing such decision which affect the interests of Tata Trusts. As any collision course with Tata Trusts would reduce nominee directors' ordinary share capital below 40% aggregate and may result in their exit. This provision in AoA draws a corollary with the recognized principle of "no one can be a judge in his own cause." As per the majority rule, decisions of majority shareholders of a company are binding upon the minority shareholders.[28] However, dominant majority shareholders exert significant control and misuse their power to subdue the interests of minority. The principles of corporate governance envisage equal treatment of all shareholders wherein a proper balance of the rights of majority and minority shareholders must be drawn for smooth functioning of the company.[29] The exercise of power through majority rule must not act as prejudicial vice to minority rights or fulfilment of personal agendas.[30] The essence of shareholders democracy signifies that power of majority must be prevalent within reasonable bounds and should not impinge upon minority rights.

Though presence of Article 75 in AoA has not vitiated shareholders' protection in actuality, however, it raises a reasonable apprehension. Any action can be taken against them without conduct of fair play which may eventually lead to case of prejudice or oppression to any member or members or welfare of company. Non-controlling position of some shareholders causing dependency on the decisions of majority shareholders triggers the dominant shareholders' activism which may not be healthy for the welfare of minorities and the company. Board of directors cannot effectively exercise control over dominant shareholders as 'power cannot bite the source of power itself'. Thus, the powerless position of board of directors leads to glaring violations of corporate

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[28] Foss v. Harbottle, (1843) 67 Eng. Rep. 189.

[29] *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PRINCIPLES OF CORPORATE GOVERNANCE, G20/OECD (2015), https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf.

[30] Manjeet Kumar Sahu, *Rights of Minority Shareholders in India Under the Companies Act, 1956*, SOC. SCI. RES. NETWORK ELEC. J. (2013), https://ssrn.com/abstract=2564925.

governance which cannot be remedied inside the companies' management.

VI. TREADING TOWARDS A TRANSFORMATIONAL PATH

Corporate governance "*concerns the relationships between a company's owners, managers, board of directors* (*hereinafter* referred to as "**BOD**") *and other stakeholders*".[31] The system of enhancing the governance among these co-relators springs at the root of a sound governance mechanism.[32] Shareholders are considered the owners of company and owing to its status, a right-oriented principle must be deeply embedded in the structure of an effective corporate governance mechanism to ensure their protection. Endeavours include close scrutinisation of the management so that the functioning is concentrated towards maximization of shareholder's wealth.[33]

Law in corporate matters must aim at incorporating such norms wherein an effective in-house redressal mechanism consisting of non-interested or non-executive directors would ensure that the legality of decisions made by majority can be challenged without undue influence. Adequate number of non-executive directors who are independent of the company are required to be maintained for formulation of efficient company's strategy, risk management performance etc.[34] Non-executive directors should also be the members of board so that an independent judgment can be ascertained on key issues and their views also reflect on

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[31] EDMUND T. GOMEZ et al., THE GOVERNANCE OF EAST ASIAN CORPORATIONS: POST ASIAN FINANCIAL CRISIS (F. Gul & J. Tsui eds., 1st ed. 2004).
[32] Umakanth Varottil, *A Cautionary Tale of the Transplant Effect on Indian Corporate Governance* 21 NAT'L L. SCH. IND. REV. 1-41, (2009).
[33] Naveen Kumar & J.P Singh, *Corporate Governance in India: Case for Safeguarding Minority Shareholders Rights,* 2 INT'L J. MGMT. & BUS. STUD. 7-11, (2012).
[34] DEREK HIGGS COMM., DEPT. BUS., ENTERPRISE REG. REFORM U.K, REPORT ON INDEPENDENT REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (2003), http://www.ecgi.org/codes/documents/higgsreport.pdf.

overall board's decision.[35] Further, they can also act as parallel power centre in the board meetings to digress from considering any anti-governance practices in the company.[36]

Further, a reasonable process must be effectuated by the directors where shareholders have a right to say and such mechanism must be in accordance with Clause 49 of the Listing Agreement which mandates listed companies to have a "Shareholder Grievance Committee". Further, SEBI regulations must also place considerable emphasis on securing transparency as it has been clearly mandated under SEBI Listing Obligations and Disclosure Regulations, 2015 that equitable treatment must be ensured for all shareholders.[37] A company is an entity which follows the democratic process and the operations are implemented through the resolution passed by the majority shareholders.[38] It has been strengthened in the case of *Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishing Ltd,*[39] that any alteration which results in benefit of the majority shareholders and the company as a whole would be bad and must not attempt any discrimination between the majority and minority shareholders to give an undue edge over the latter.

Though an inherent dilemma exists with respect to protection of minority shareholders and principle of shareholders democracy, however,

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[35] *Supra* note 1 (The committee highlights significance of non-executive directors on a board so that their views influence the decisions of board).

[36] FIN. REPORTING COUNCIL, THE U.K. CORPORATE GOVERNANCE CODE (2003). (The code emphasizes on the need to include both executive and non-executive directors in the board so that "that no individual or small group of individuals can dominate the board's decision taking")

[37] *See* Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 6(1), Reg. 4(2)(c)(i) (Sept. 2, 2015).

[38] MINISTRY CORP. AFFAIRS IND., REPORT OF THE EXPERT COMMITTEE ON COMPANY LAW (2005), http://reports.mca.gov.in/Reports/23Irani%20committee%20report%20of%20the%20expert%20committee%20on%20Company%20law,2005.pdf.

[39] Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishing Ltd., (1991) SCC OnLine Ker 453.

a balance must be maintained between the two as it has also been established by Palmer *that a proper balance of rights of majority and minority shareholders is essential for the smooth functioning of the company.*[40] Incorporation of AoA must be in conformity with the Companies Act, 2013.[41] Further, amendments must also be made after passing of a special resolution.[42] However, the legislation only provides a mechanism to check oppression against minority while it has happened in the past or is continuing in nature and does not provide specific provisions that must be incorporated in AoA to ensure adequate safeguards against minority interests. The legislation is remediless in some areas where AoA itself lapses in ensuring corporate governance. Sound corporate governance principles involve enhancing the confidence of minority investors where a suitable mechanism is made viable to them in order to approach the appropriate forum not only when their rights are being violated or have been violated but also when a reasonable apprehension of violation exists in the future.

It must be ensured that AoA must not confer any weapon in the hands of board of directors or nominee directors to employ any means which might hinder shareholders' cause in future. The 'potential to exploit' the rights of shareholder must be considered to avert a substantial injury and the cannons of corporate law must expand its horizons to discourage incorporation of such article which might have an unfavourable effect on shareholders' protection in the long run. Any form of superior rights granted to only a group of shareholders to the exclusion of others must not be sustainable in law as it has been established in the case of *Needle Industries*[43] that "*oppression is a lack of probity and fair dealing in the affairs of the company to the prejudice of some portion of its members.*" In the instant case, Article 75 in its substance intends to present an example of 'lack of probity and fair dealing' which is prejudicial to some members.

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[40] *See* FRANCIS BEAUFORT PALMER, PALMER'S COMPANY LAW 492 (T.P.E Curry & Clive Macmillan Schmitthoff eds. 20th ed. 1959).
[41] Companies Act, No.18 of 2013, §6 (Ind.).
[42] *Id.*, §14.
[43] Needle Industries (India) Ltd. & Ors. v. Needle Industries Newey (India) Holding Ltd. & Ors., (1981) 3 SCC 333.

A company is an entity where a group of persons are entitled to work together and make mutual decisions which are beneficial to them as well as the company. However, the imposition of decisions made by majority shareholders leaves no scope for minority shareholders say in relevant matters. The introduction of entrenchment provision has eased down some hardships faced by the shareholders as it dictates that provisions of AoA are not subject to alteration by mere passing of special resolution and requires a cumbersome process.[44] However, introduction of this clause can only be made during a company's incorporation or an amendment brought about by special resolution.[45] In the pertinent case of Tata-Mistry, special resolution is itself controversial due to existence of affirmative voting of nominee directors and therefore, incorporation of such clause becomes redundant as the power to introduce it is still wielded under the helm of nominee directors. In such scenarios, protection of minority shareholders against the dominance of majority and prevention of corporate tyranny can only be assured when incorporation of entrenchment clause is not made voluntary. The discretionary power of a company weakens the regulatory mechanism and thereby affects the position of minorities. Therefore, there is a dire need to make entrenchment provision mandatory in AoA which would further create a room for privilege of minorities consent in critical matters.

AoA is considered a part of constitution of a company and their structuring plays an important role in ensuring shareholders' interests, corporate governance principles and overall effective functioning of a company.[46] Though various measures have been taken including appointment of independent directors, however, there is a need to create

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[44] Sandeep Nath Modi, *Entrenchment Provision: A boon for minority shareholders,* 6 INT'L J. SCI. TECH. & MGMT. (2017).
[45] Companies Act, No.18 of 2013, §5(4) (Ind.).
[46] *See* NEW YORK STOCK EXCHANGE RULES*,* §303A.04 (2019), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-66.

a committee which may form a second layer among all for the purpose of appointment of CEO, board member and management of companies etc. In order to ensure more transparency and protection of minorities, different committees may work independently to approve the appointments or resignation of various members. This requirement is closely synced with NYC listing requirements wherein there's a stipulation to have a Nomination Committee constituting entirely of independent directors for performing various functions including providing qualification to board members and regulating the management.

In order to achieve efficient corporate governance standards, there is a need to make the practice of Monarch (Raja) Model redundant as it focuses on precedence of self-interest over the interest of 'praja' i.e., another stakeholder. A drastic change is required to shift to the Custodian Model which empathizes on Gandhian principles wherein the promoters act as trustees and take such actions which behold the interest of minority shareholders.[47] Notwithstanding the existence of legislations, a concerted effort needs to be made to change the mindset and belief of stakeholders in a company towards adoption of corporate governance principle.

The concept of '*opinio juris sive necessitatis'* is one of the components to prove existence of custom under international law which emphasizes on the psychological belief that one is under a legal obligation to act in a certain way.[48] The same approach must be adopted to stir the conscience of stakeholders in a manner which makes them obligated to abide by the belief of fostering corporate governance in a company. In order to effectuate a better corporate governance mechanism, India should follow the example of Malaysia as it has established 'Minority Shareholders Watchdog Group' (*hereinafter* referred to as '**MSWG**') which monitors the corporate conduct and advises on issues pertaining to minority

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[47] *See* KOTAK COMM., SEBI, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (2017), https://www.sebi.gov.in/reports/reports/oct2017/report-of-the-committee-on-corporate-governance_36177.html.
[48] FRANÇOIS GENY, MÉTHODE D'INTERPRÉTATION ET SOURCES EN DROIT PRIVÉ POSITIF, ¶ 110 (2nd ed., 1899).

shareholders' rights.[49] MSWG has adopted an 'internal consultative' approach by engaging in deliberation to achieve a higher standard of corporate governance and thereby dispensing away with the need of approaching regulatory authorities or courts in the first place.[50] As India faces a huge backlog of cases, such approach must be welcomed to render speedy disposal of fundamental corporate issues. Embodiment of a corporate governance spirit requires an unyielding commitment towards preservation of shareholders' interest in the long run. As good corporate governance norms are indispensable for maintaining the integrity of a company, a bottom-down approach must be ensured to align the practices with the ethos and values of a corporate culture.

VII. CONCLUSION

Transparency, accountability and protection of the right of all shareholders are the stanchion of corporate governance.[51] The governance of a company must be viewed from the lens of stakeholder's perspective to maintain effective control over the board and ensure proper corporate governance.[52] Family dominated stakeholders act as the highest echelons of power establishing unwavering dominance in an organizational culture. The extent of control exerted by the dominant shareholders shrinks the concept of equality or level playing field to a mere abstract theory.[53] Further, the dominance also enables them to transfer assets or carry preferential allotments of shares to themselves. However, in the case of

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[49] *See* Varun Bhat, *Corporate Governance in India: Past, Present, and Suggestions for the Future*, 92 IOWA L. REV. 1429 (2007).
[50] *Id.*
[51] *Supra* note 29 at 3.
[52] *See* KUMAR MANGALAM BIRLA COMM., SEBI, REPORT OF THE KUMAR MANGALAM BIRLA COMMITTEE ON CORPORATE GOVERNANCE (1999), http://www.nfcg.in/UserFiles/kumarmbirla1999.pdf. See also, ALAN DIGNAM & JOHN LOWRY, COMPANY LAW, (5th ed., 2009).
[53] *See* Chee Keon Low, *A Road Map for Corporate Governance in East Asia,* 25 NW. J. INT'L L. BUS. 174 (2004).

Tata Consultancy Services Limited v. Cyrus Investments Pvt. Ltd.[54], the Supreme Court primarily centred its decision on Cyrus Mistry's removal and other factual matters. This case propelled a myriad of issues but the court failed to take a nuanced approach towards protection of minority shareholders. Without any independent assessment of oppression and mismanagement, the court reasoning was deficient on larger principles of corporate governance. Therefore, this case provides a new tangent to intricate corporate governance issues which must be worked upon to facilitate better functioning of the company in order to safeguard larger interests.

[54] Tata Consultancy Services Limited v. Cyrus Investments Pvt. Ltd, (2021) SCC OnLine SC 272.

COMPANY SECRETARIES AS CHIEF GOVERNANCE OFFICERS IN INDIAN COMPANIES

Nipun Ninad Naphade[*]

ABSTRACT

India has witnessed changing legal and financial structures inside its corporate entities over the past few decades. With an increase in financial irregularities in company records, the need for transparent and independent corporate governance is felt stronger than ever. The latest amendments to the Companies Act provide some regulatory mechanisms to make corporate administrations more accountable and accessible. However, mere external monitoring is not viable for the giant corporate nexus that accommodates companies of varying financial structures, sizes and technical setups. In such circumstances, the office of the Company Secretary often provides a convenient solution acceptable to both, the company management and the stakeholders. The CS is envisioned as a champion of stakeholder interests, and not as a mere employee of the management, as they have been traditionally stigmatized. This research article explores the foundation on which the office of Company Secretaries has been assimilated into Indian Company law, and whether it can be improved upon to empower them as governance officers. The researcher attempts to compare the position of company secretaries with that of the public office of an ombudsman. The paper involves analysis of committee reports, contemporaneous research, statute laws, case laws and opinio juris to understand the prevalent views on this concept. The research attempts to suggest a projected path for laws on company secretaries to elevate their responsibilities from being mere compliance officers to leaders in good governance enforcement.

Keywords: Company Secretary (CS), Corporate Governance, Independence, Accountability.

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I. INTRODUCTION

Corporate governance may be defined as the dynamic framework of laws that regulates commercial organizations and their relations with their stakeholders, by monitoring their transactions, managerial decisions and policy-making functions.[1] The advantage of such a framework is enjoyed by all stakeholders involved, and boosts the confidence of investors and government agencies in the stability and performance of the entity.[2] The consequent increase in economic value of the firm provides advantages to the employees of the firm, as it creates stability in employment and remuneration. In the long run, the presence of such benefits for stakeholders allows a company to fulfil its commercial goals, and helps it handle unforeseen situations with greater ease.[3] Corporate governance being such a crucial component of a company's survival strategy, it is handled by the company's top management. Although it began as a 'best business practice' approach, it has now become a mandated process in many jurisdictions for a variety of reasons.[4] To begin with, it helps the shareholders to implement their rights democratically, instead of restricting it to the books and reports of the company. Good corporate

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[1] Marco Becht, Corporate Governance and Control (Eur. Corp. Governance Inst., Working Paper No. 02, 2002), http://ius.bg.ac.rs/prof/Materijali/labmir/Corporate%20Governance%20&%20Control.pdf.

[2] Kose John & Lemma Senbet, *Corporate governance & board effectiveness*, 22 J. BANK. & FIN. 371, 372 (1998).

[3] Morrison-Paul & Donald S. Siegel, Corporate social responsibility & economic performance (Soc. Sci. Res. Network, Working Paper No. 01, 2006), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=900838.

[4] T. McNulty & Abigail Stewart, *Developing the Governance Space: A Study of the Role and Potential of the Company Secretary in and around the Board of Directors*, 36(4) ORG. ST. 513 (2015).

governance is a widely pursued commodity, and few entities are deemed worthy of accomplishing it. This concept was made a reality in India by the share market regulator SEBI, which issued certain corporate governance guidelines that were required to be incorporated into the company's listing agreement.[5] However, this only applies to the arrangement's exterior existence.

The ever-changing corporate and commercial operations around the world have necessitated the presence and active participation of a professional and statutorily empowered member of the management in ensuring that corporate governance requirements are upheld. In this context, this research delves into the origins and growth of the position of Company Secretary (*hereinafter* referred to as "**CS**") in India, as well as its role in enhancing transparency, accountability, and legal compliance in Indian corporations during the last few decades. This study is an incisive examination of how the presence of appropriate statutes, regulations, judicial declarations, and socio-economic events affected Indian corporate law and created a new area of leadership in company management. When the global financial crisis struck at the end of the last decade, financial stability became the primary concern of global regulators, ushering in a new age of unparalleled transparency standards. The CS must now verify that the company's ownership, structure, and operations comply with a slew of new rules designed at keeping global markets on track and stifling globalization's previously unbridled expansion.[6] A long awaited development in the evolution of the CS as member of management can be him accepting the role of the 'chief governance officer'. Such a step would enable him to monitor organisational statistics and support the management in understanding patterns in the market. The CS is considered to wield strategic influence over the Board of Directors, as he

[5] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 6(1), Reg.4 (Sept. 2, 2015).
[6] K. R. CHANDRATRE, COMPANY SECRETARY PRACTICE MANUAL 21 (4th ed., 2019).

forms a link between internal and external stakeholders of the company.[7] This position brings with itself the responsibility to facilitate transparent managerial actions from the Board, efficient responses to regulatory roadblocks and relay of information to stakeholders in a timely manner.[8]

Having set the context of the study, it is essential to highlight the focus of analysis in the form of a proposition. The main objective of the paper lies in determining whether the Indian corporate sector requires an upgraded approach towards good governance in current social, economic and legal circumstances. It is also pertinent to probe if the said upgrade in approach can be brought through better facilitation and empowerment of the CS in company management. Based on these questions, it is hypothesized that the statutory addition of the CS into company management has improved independence, accountability and transparency in Indian companies. It is also proposed that their empowerment into chief governance officers is the necessary step that India needs to take to ensure a stricter corporate governance regime. To test the hypothesis on these factors, the paper shall analyse the origin and evolution of international models of corporate governance.

II. HISTORICAL AND LEGAL CONTEXT

A. ORIGIN OF GOVERNANCE PERSONNEL IN COMPANIES

The Latin word 'secretarius' can be given credit of origin in the formation of the concept of 'secretaries', especially considering that a person working under such a title was historically meant to possess and manage commercial secrets on behalf of his master.[9] Its modern rise in usage began in post-industrialization England when in 1971, the British

[7] John Nowland et al., *The role of the company secretary in facilitating board effectiveness: reporting and compliance,* 61(1) ACC. & FIN. 1425, 1430 (2021).
[8] *Supra* note 4.
[9] C. C. Okolocha & E. I. Baba, *Assessment of extent of skills possessed by secretaries for effective electronic records management in polytechnics in north-central Nigeria*, 2(1) NAU. J. TECH. VOC. STU. 1, 3 (2017).

Institute of Secretaries and the Corporation of Secretaries combined[10] to form the Institute of Chartered Secretaries and Administrators (*hereinafter* referred to as "**ICSA**") in the UK. The Cadbury Committee, based on the submissions made by the representing group, consequently included secretaries as instruments of governance in their model, especially to fix the issue of irregular internal processes of companies and disorder in Board meetings.[11] The CS was envisioned to develop a relation of trust with the management and ownership of the company, thus cementing their position as a communication link.[12]

B. INFLUENCE OF SOCIO-ECONOMIC EVENTS

The acceptance of the CS as a link between stakeholders was founded on certain developments that were brought forward by regulatory authorities. The initiative was taken up by the Confederation of Indian Industries, which introduced the concept of corporate governance to numerous industries in India.[13] To begin with, they made recommendations with respect to rapid redressal of public concerns and investor queries by a company's executive officers, instilling transparency within management and shareholders across industries, and sharing of detailed information through disclosure processes with parallel corporate bodies as well as regulators.[14] The intention, by inference, was to slowly move towards a market without borders between investors, employees and the governing bodies involved. Subsequently, SEBI's Kumar Mangalam Birla Committee (2000) presented its report which proposed

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[10] Gerturd Erismann-Peyer et al., *The Evolution of Modern Corporate Governance* in THE INSIDER'S VIEW ON CORPORATE GOVERNANCE, 1-13 (2008).
[11] *Supra* note 7.
[12] Devendra Jarwal, *The Role of Company Secretary as Governance Officer*, NAT'L. CONVENTION COMPANY SECRETARIES, 84 (2013).
[13] Bhumesh Verma & Himani Singh, *Evolution of Corporate Governance in India,* SCC ONLINE (Nov. 13, 2019) https://www.scconline.com/blog/post/2019/11/13/evolution-of-corporate-governance-in-india/#_ftn2.
[14] *Id.*

insertion of Clause 49 in Listing Agreements, to implement stronger regulatory standards for corporate disclosures.[15]

The KM Birla Committee also recommended the appointment of independent directors on the Board in an attempt to distribute administrative power of the Board between executive and non-executive personnel in the management.[16] This recommendation was in line with the global trend of appointing independent directors as a monitoring mechanism inside the company to protect stakeholders' rights.[17] However, this mechanism did not produce the desired results in the Indian corporate sector, since there was no proper legislation to determine crucial aspects surrounding Independent Directors, such as minimum qualifications requirements, remuneration rules, distribution of authority, access to information and suitable training in financial, commercial or legal matters.[18] Additionally, the lack of formal education in matters of corporate governance and a socially ingrained propensity to avoid boardroom conflicts became the prime reasons for the failure of Independent directors as healthy monitoring mechanisms.

This outcome paved the way for accommodating a governance officer who was more qualified and was not bound by the complexities of being a board member. A consequent legislative solution was observed in the amendment to the Companies Act in 1974, which created a mandatory requirement that if a company possessed paid-up share capital of Rs. 25 Lakhs or more, it must appoint a whole-time secretary, and such secretary could not hold such position in more than one company.[19] The

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[15] KUMAR MANGALAM BIRLA COMM., SEBI, REPORT OF THE KUMAR MANGALAM BIRLA COMMITTEE ON CORPORATE GOVERNANCE ¶ 1 (1999).

[16] Sahoo Rani & Dr. Dwibedi Kumar, *An analytical study relating to the role of an Independent director in the globalised era: A detailed study,* 10(1) ASIA J. MGMT. 72, 74 (2019).

[17] María Gutiérrez & Maribel Sáez, *Deconstructing Independent Directors,* 13(1) J. CORP. L. STUD. 63, 64 (2013).

[18] Kamal Kishore & Srirang Jha, *Efficacy of Independent Directors in Corporate Governance: Indian Scenario*, 1(2) J. POL. & GOVERNANCE. 25, 29 (2012).

[19] Companies (Amendment) Act, No.41 of 1974, §30(1) (Ind.); *See* Companies Act, No.1 of 1956, §383A (Ind.).

amendment also made it mandatory for firms or body corporates working as company secretaries to resign from such employment within specified time.[20] An analysis of the objects and reasons of this amendment highlighted the government's aim to promote the secretarial profession as a qualified instrument of legal compliance, good governance and assistance in commercial decisions.[21] However, mere compulsion of appointment was not sufficient for promoting a profession, and the government needed to make ancillary provisions to ensure that the CS profession was able to display intended results.

The question of appropriate qualification and training of the CS was the biggest matter in consideration, as it became a hurdle for the successful functioning of Independent Directors.[22] Apart from pre-employment training, there was also the need to monitor the conduct and professional activities of the CS, since their role as governance personnel had considerable influence upon the legal compliance of their employing company.[23] By inference, the government would need to set up an institution that could certify that the CS personnel were trained and qualified to perform their duties of corporate governance, that their conduct was compliant with the laws and ethics of the profession, and that there would be immediate legal consequences if a CS was found violating such laws. Creating such a body would increase the acceptability of the CS as a corporate professional, because a qualifying institution would provide proof of credibility and qualification to such personnel.[24] In this pursuit, the Government of India provided statutory recognition to the Institute of Company Secretaries through the Company Secretaries

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[20] Companies (Amendment) Act, No.41 of 1974, §30(2) (Ind.).
[21] Poonam Rajharia & Bhawana Sharma, *Legal Aspects of Corporate Governance for IT Companies in India*, 2 (11) INT'L. J. RES. BUS. MGMT. 35, 39 (2014).
[22] *Supra* note 4.
[23] Sharifah Fuzi et al., *Comparative Analysis on the Requirement, Qualification and Responsibility of Company Secretaries in United Kingdom, Malaysia and India*, 16(1) J. ADMIN. SCI. 118, 120 (2019).
[24] Cary Coglianese et al., *The Role of Government in Corporate Governance*, 1 N.Y.U. J. L. & BUS. 219, 221 (2004).

Act 1980, and introduced regulatory provisions to cover the procedural aspects of the Institute's activities.[25] [26]

The slow process of accommodating qualified professionals as governance officers in the commercial sector gained momentum in the post 1990 era of liberalization & globalization.[27] The government introduced the Companies (Compliance Certificate) Rules, 2001 as a measure to increase the accountability of the company towards regulatory authorities.[28] This law brought forth the concept of secretarial audits and certification, whereby the CS was required to verify and state that a company was compliant in matters of share certificates, allotments, stakeholder grievance redressal, alteration of charter documents and other such activities as specified by the government.[29] This became the first observable instance in the corporate sector where entities were required to implement self-regulatory practices with the assistance and monitoring vision of a qualified professional. Although the concept of financial audits existed previously, the secretarial audit was the first to cover commercial, legal and industrial characteristics of an entity.[30]

Around this time, the world witnessed the discovery and investigation of massive securities frauds such as the Enron and Worldcom scams.[31] According to notable financial studies, the existence of whistle-blowers aided in the prompt detection and investigation financial irregularities, and governments could track accountability by mandating the appointment of

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[25] Company Secretaries Act, No.56 of 1980, §3(1), (Ind.).

[26] Company Secretaries Regulations, 1982, Gazette of India, pt. III sec. 1, Reg. 1, (Sept. 1, 1982).

[27] Ananyaa Jha & Aayush Kanojia, *Globalization and Corporate Governance in Indian Context*, 3(5) INT'L. J. L. MGMT. & HUMAN. 482, 486 (2020).

[28] Companies (Compliance Certificate) Rules, 2001, Gazette of India, pt. II, Rule 1 (Oct. 2001).

[29] Dr. V. Balachandran & A. Panjavarnam, *Secretarial Audit Compliance under Companies Act 2013 in India - A Study*, 6(10) INT'L. J. ADVANCED. RES. MGMT. & SOC. SCI. 82, 86 (2017).

[30] Rahul Joshi, Corporate Governance: Reforms to Promote Sustainability, 4(1) JAGRAN INT'L. J. CONTEMP. RES. 48, 50 (2017).

[31] Kathleen F. Brickey, *From Enron to Worldcom and Beyond: Life and Crime After Sarbanes-Oxley*, 81(2) WASH. U. L. QUARTERLY. 357, 358 (2003).

responsible individuals.[32] The United States introduced the Sarbanes – Oxley Act, signalling economies around the world that they needed to re-assess their monitoring mechanisms to protect their markets from serious frauds.[33] In India, the Naresh Chandra Committee was formed by the Ministry of Finance, and in its report, the committee raised doubts regarding the reliability of mechanisms monitoring relationships between companies, its auditors, and Independent Directors.[34] In pursuit of a solution, the SEBI then established the Narayan Murthy Committee, in order to fill up the lacunae in India's corporate governance model.[35] Having studied the contemporary financial frauds, and sensing a need to provide a better framework for forensic accounting in companies, the committee report recommended the empowerment of board committees such as the Audit committee, and proposed the appointment of the CS as a secretary to the audit committee.[36]

C. LEGISLATIVE DEVELOPMENTS

As defined in the Companies Act 1956, the CS was deemed to be an officer equivalent to director or manager, under whose directions the Board is accustomed to functioning.[37] This opened the possibility that the CS was not merely a clerical being, but an officer equivalent to a director in terms of its functions in the Company. The Act also allowed companies to appoint CS as representatives before a Tribunal or Appellate Tribunal

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[32] Robert M. Bowen et al., *Whistle-blowing: target firm characteristics and economic consequences*, 85(4) ACCT. REV. 1239 (2010).
[33] Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76(4) ST. JOHN'S L. REV. 671, 676 (2002).
[34] CONFEDERATION IND. INDUS., REPORT OF THE CII TASK FORCE ON CORPORATE GOVERNANCE CHAIRED BY MR. NARESH CHANDRA (Nov. 2002), https://www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.
[35] Dr. C. K. Gupta, *Corporate Governance Revisited-A Critical Study*, 2(1) INT'L. J. ADVANCED & INNOVATIVE. RES. 24, 26 (2015).
[36] COMM. CORP. GOVERNANCE, SEBI, THE REPORT OF SHRI N. R. NARAYANA MURTHY COMMITTEE ON CORPORATE GOVERNANCE (Mar. 2003), https://www.sebi.gov.in/reports/reports/mar-2003/the-report-of-shri-n-r-narayana-murthy-committee-on-corporate-governance-for-public-comments-_12986.html.
[37] Companies Act, No. 1 of 1956, §2(30) & §2(45) (Ind.).

under company law.[38] Furthermore, the Act permitted the authentication of company documents or proceedings by way of signature, obtained from a manager, director, or the CS.[39] Where the Act discussed prerequisites for the commencement of business by a company, one such requirement mentioned is submission of a declaration from either the director or CS that all other conditions enlisted therein have been complied with.[40] Section 215 of the Act required companies to get every balance sheet and profit & loss account signed by the manager or CS.[41] An overview of these provisions suggests that by legislative intent, the offices of directors, managers and CS have been placed at an equal level of authority, responsibility and accountability towards administrative processes.

Through the Companies (Amendment) Act, 1988, the CS was brought under the ambit of "officers in default" as discussed in S.5 of the Act.[42] This amendment created provisions for awarding punishment on secretaries found to be in default, and positioned them as common link between the management and stakeholders.[43] The amendment also inserted the provision that during the registration of the Memorandum of Articles, where the applicant needed to submit a declaration of compliance from an officer or representative of the company, such a declaration could be provided by a CS.[44] This increment in liability to the office of CS should have brought with it certain additional authority to ensure a balance. However, no such facilitation was supplied, and by inference, this imbalance can be observed as the cause for the stunted growth of CS in terms of voluntary governance regimes. The next step in evolution was the requirement set by the SEBI through Section 4, Listing

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38 *Id.*, §10GD.
39 *Id.*, §54.
40 *Id.*, §149.
41 *Id.*, §215.
42 *Id.*, §5(d).
43 Laurie Factor, *Company Secretary: administrator but not manager*, 46 CORP. MGMT. J. 388 (1994).
44 Companies Act, No. 1 of 1956, §33(2).

regulations (2003), mandating that the listing agreement must include disclosures in the areas of related party transactions, risk elimination processes, investor education and protection, etc. alongside compliance certificates for the same.[45] The provision required that these certificates would be provided by the authorised CS, casting a new responsibility on them. Similarly, a CS was also required to handle certification of the report on corporate governance presented by the company as per listing requirements. The guidance note provided by ICSI in 2010 provided for rights of practising CS (*hereinafter* referred to as "**PCS**") to gain access to various company records such as the company's registers, books of accounts, papers, documents, reports, and records, wherever they were maintained.[46] The PCS was authorised to obtain such information from the Company that he deemed necessary for certification purposes.

By 2011, it was a globally understood phenomenon that corporate disclosure requirements could not be mandatorily enforced unless an internal system of checks and balances could be set up.[47] Such a system would monitor the presence of fraudulent activity and eliminate areas of negligence that could cause financial and legal irregularities in day-to-day business. This visible change in policy is primarily observed in the introduction of the Companies Act 2013, which brought about a few major changes in the government's outlook towards public companies. The statement of objects and reasons of the new Act itself included an enhanced disclosure regime as its target. Apart from defining the CS as an officer[48] of the company, the new Act recognized the CS as an expert[49],

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[45] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2003, Gazette of India, pt. III sec. 4, Clause 47 & 49 (2003).
[46] INST. CO. SECRETARIES IND., GUIDANCE NOTE ON CORPORATE GOVERNANCE CERTIFICATE (Aug. 2010), https://www.icsi.edu/media/prb/pdf/GUIDANCE%20NOTE%20ON%20CG%20CERTIFICATE%20.pdf
[47] Madan Lal Bhasin, *Corporate Governance Disclosure Practices: The Portrait of a Developing Country,* 5(4) INT'L. J. BUS. & MGMT. 150, (2010).
[48] Companies Act, No.18 of 2013, §.2(59) (Ind.).
[49] *Id.*, §2(38).

and key managerial personnel (*hereinafter* referred to as "**KMP**")[50] in other provisions. This widening of ambit can be seen as a step towards the liberalisation of the CS from their stereotypical status as a clerical officer. The Act also mandated the CS to perform any prescribed functions such as reporting to the board on legal matters, ensuring company compliance with financial, industrial and regulatory standards, etc., essentially recognizing them as a compliance officer.[51]

Beginning from the incorporation of a company, the CS was allowed to provide the declaration of compliance, alongside other officers such as the manager, directors, or other authorised personnel.[52] The new Act mandated companies falling in prescribed categories to employ certain whole-time KMP, which included a Managing director, a Chief Financial Officer and a CS.[53] Here, the concept of 'Whole Time CS' (*hereinafter* referred to as "**WTCS**") was created. In increasing the ambit of responsibility of such a WTCS, the Act mandates a company's prospectus to state the name and address of its CS.[54] Apart from this, listed or specified companies are required to attach a secretarial audit report to the board report; such document needs to be obtained from a PCS, and the PCS is entitled to receive the cooperation and assistance of the company in verifying the data before certification.[55] The same provision also expects the board report to provide a directorial explanation on the qualifications provided by the PCS in his secretarial audit report.[56]

To enforce transparency & accountability, share certificates allotted to subscribers are required to be signed by the CS, and similar requirements govern the company's financial statements, board report, etc.[57] The Act also requires prescribed companies to get annual returns signed by a CS or

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50 *Id.*, §2(51).
51 *Id.*, §205.
52 *Id.*, §7(1)(b).
53 *Id.*, §203(1).
54 *Id.*, §26(a)(i).
55 *Id.*, §204 (1).
56 *Id.*, §204(2).
57 *Id.*, §134(1).

PCS wherever possible.[58] With regards to their regulatory knowledge & expertise, the Act allows a Company Liquidator to appoint one or more CS to assist with him with the performance of his duties.[59] These provisions create a context that the CS was intended to fulfil roles with varying levels of responsibility and authority, and in various situations of legal compliance. Reliance on the quasi-technical and quasi-judicial abilities of the CS has also been placed through S. 409 of the Act, which allows a person practising as CS for 15 years or more, and meeting other criteria set by the law, to be appointed as a technical member of the NCLT.[60] On the other hand, a CS may also act on behalf of the company before the NCLT, as an authorised pleader.[61] These couple of provisions equated the CS with Chartered Accountants and legal practitioners in terms of representative capacity. Thus, in the eyes of the legislature, a CS was deemed capable of defending the company's interests and communicating with the members of the NCLT in matters of legal compliance.

While the involvement of the CS grew in administrative processes of companies, the government of India found it necessary to harmonize and define the various specifications that needed to be observed by him, and in consequence, the idea of secretarial standards was created.[62] In such pursuit, the ICSI created the Secretarial Standards Board (*hereinafter* referred to as "**SSB**") in 2000, and the SSB in turn formulated standards SS-1 and SS-2, defining specifications around Board Meetings and General Meetings respectively.[63] These standards were given recognition by the Companies Act 2013 for the first time, then were formally accepted as applicable through government notification in 2015, and were finally

[58] *Id.*, §92.
[59] *Id.*, §291(1).
[60] *Id.*, §409(3)(d).
[61] *Id.*, §432.
[62] Milind Kasodekar, *Secretarial Standards – Tool for good Corporate Governance*, L. STREET IND. (Nov. 2, 2015) http://www.lawstreetindia.com/experts/column?sid=115.
[63] Meghna Thapar & Arjun Sharma, *Corporate Governance in India: An analysis*, 4(1) J. ECON. & SOC. DEV. 312, 314 (2017).

revised in 2017.[64] The SSB also introduced other standards, although they were deemed recommendatory in nature, and hence not mandated for compliance.[65] The Companies Act provides that it is the duty of the CS to ensure that a company is in compliance with all such secretarial standards as may be prescribed by the ICSI.[66] An analysis of the objects and reasons behind formulation of such standards suggests that the prime aim of standardizing secretarial conduct is to allow the profession to grow in terms of involvement, responsibility and authority in areas of governance leadership.[67]

Additionally, to contextualize the duties of a CS, the Ministry of Corporate Affairs added certain regulatory provisions through its appointment and remuneration rules.[68] The CS was thus required to provide advice to directors regarding their duties, facilitate meetings, maintain minutes of meetings and related records, obtain approvals from authorities, to assist the board in managing company affairs, to advise the board in matters of corporate governance and best practices, and other duties so imposed by the board or legislation.[69]. It can be observed that while the rules mention that the CS shall assist the board in other matters, when it comes to topics of good governance, best practices, compliances and board responsibilities, the terms 'advice' and 'guidance' are used.[70] A purposive interpretation of this construction suggests that the intention behind adding these terms is to elevate the status of CS, from a clerical

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[64] S. S. Rana, *Revised Secretarial Standards, SS-1 & SS-2 to be applicable from October 1, 2017*, MONDAQ (Aug. 30, 2017) https://www.mondaq.com/india/directors-and-officers/624706/revised-secretarial-standards-ss-1-and-ss-2-to-be-applicable-from-october-1-2017.

[65] Vartika Rawat, *Follow the Secretarial Standards in true letter and spirit': ICSI President*, CFO (Sept. 10, 2017) https://cfo.economictimes.indiatimes.com/news/follow-the-secretarial-standards-in-true-letter-and-spirit-icsi-president/60426543.

[66] Companies Act, No.18 of 2013, §§118(10), 205(b) (Ind.).

[67] Devendra Jarwal, *Opportunities for Company Secretaries to Serve Society and Economy in New Regime*, 42 NAT'L. CONF. COMPANY SECRETARIES 112, 113 (2014).

[68] Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, Gazette of India, pt. III, sec. 3(i).

[69] *Id.*, Rule 9.

[70] *Id.,* Rules 9(1) & 9(6).

position to an expert in governance, who can provide insight to the Board in certain matters.[71] These rules were later amended in 2020, whereby the requirement for companies to appoint whole time KMP if they had paid up share capital of 10 Crore rupees or more, was made a bit more specific.[72] The amended rules required that when a private company owned paid up share capital of or above 10 Crore rupees, such company would have to appoint a WTCS.[73]

The CS was first officially recognised as a compliance officer by SEBI through its Listing obligations & disclosure requirements in 2015, whereby listed entities were required to appoint a CS as compliance officer.[74] Such officer was required to monitor regulatory conformity, coordination between intermediaries and the company, information accuracy, and grievance redressal of investors. He was also positioned as secretary to the Audit committee, thereby cementing his role as an instrument of ensuring board accountability.[75] In 2018, an amendment to the regulations introduced the additional requirement that a listed company must, along with its own annual report, attach a secretarial audit report of its own as well as its material subsidiaries, and such audit must be conducted by a PCS.[76]

D. JUDICIAL APPROACH

The first focus of judicial scrutiny upon the office of the CS came as early as 1841, where the powers and duties of the CS were discussed. In *Pontifex v. Bignold*, the court observed that a secretary was a secretary of the

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[71] Julie Mclellan, *Applied Corporate Governance: New Challenges in Public Sector Governance,* 61(8) KEEPING GOOD COMPANIES 466, 468 (2009).

[72] Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, Gazette of India, pt. III, sec. 3 (i), Rule. 8.

[73] *Id.,* Rule 8A.

[74] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 6(1), (Sept. 2, 2015).

[75] *Id.,* Reg. 18(1)(e).

[76] *Id.,* Reg. 24A.

society; his allegiance must tilt towards the public benefit.[77] This cast a duty of pro-societal governance on the CS, making him a potential governance officer. Research suggests that over the years, secretarial functions have been explicitly specified in publicly traded firms, with an emphasis on interactions between the executive and supervisory boards, investors, public authorities and various stakeholders.[78] This position was revisited in the case of *Panorama Developments, Guildford, Ltd v. Fidelis Furnishing Fabrics Ltd.*[79] In this case, the court opined that the presence of a CS was necessary not for social causes, but for administrative ones, and such authority as an administrator was provided to him by the company to sign contracts and make public representations for the company.[80] The revolutionary verdict in the Enron case (*Skilling v. the United States*) shed light upon the conduct of the CS in employment during the years of the scandal.[81] The notes of the CS that were made during meetings of the audit committee were scrutinized during the trial, and it was discovered that the CS possessed evidence regarding fraud, and had recorded her suspicions in the matter. However the CS was prevented by the Board from taking action or informing authorities about it.[82] The Enron case became a prime example to show that while the Board of directors was authorised to take decisions for the company, it was necessary to empower the CS with greater independence and protection from ill consequences, and position them as potential whistle-blowers.[83] In terms of functions related to legal compliance, the Australian courts have explained that a company secretary could be equated to a general counsel,

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[77] Pontifex v. Bignold, [1841] 3 Scott. N. R. 390.
[78] *Supra* note 4.
[79] Panorama Developments, Guildford, Ltd v. Fidelis Furnishing Fabrics Ltd., [1971] 2 QB 711.
[80] Andrew Johnston, *Company secretaries: gatekeepers or doormen?* 18(1) WITHOUT PREJUDICE. 1, 4 (2017).
[81] Skilling v. the United States, 561 U.S. 358 (2010).
[82] Rezart Dibra, *Corporate Governance Failure: The Case of Enron and Parmalat*, 12(16) EUR. SCI. J. 283 (2016).
[83] Erica Beecher-Monas, *Enron, Epistemology, and Accountability: Regulating in a Global Economy*, 37(141) IND. L. REV. 141, 188 (2003).

and their responsibilities could be overlapping in many areas.[84] In such pursuit, the CS should not be dependent on Board approval in matters requiring regulatory scrutiny of the Board's actions.[85]

In India, the discussion on powers and duties of CS has followed the same route of evolution as other jurisdictions. One of the first decisions in the matter came in the case of *Lakshmirattan Cotton Mills Co. Ltd. & Behari Charan v. The Aluminium Corporation of India*, where the CS was labelled as a mere secretarial officer with no powers of administrative action, thus deeming him invalid to ratify debts on behalf of the company.[86] This judgment was based on previous common law judgments from English courts, whereby the CS was meant to play a static and limited role of assisting the board, unless a secondary power was granted to him through the memorandum of association of the company.[87] However, with the introduction of newer laws and socio-legal changes in the area of corporate governance, this stance changed. With more and more duties being statutorily imposed on the CS, the judiciary observed that the award of power and authority too needed to be raised considerably.[88] In the case of *Y. C. Bhavsar v. Vraj I.T.P. Ltd.*, the court explained that where a CS was carrying out a verification or audit, he must be allowed access to manpower, records and assistance, and that he should be treated akin to a financial expert like a chartered accountant.[89] It thus became an accepted position that audit of financial, legal, industrial or other records was a power bestowed to the CS or could be delegated to a firm of PCS.[90] While deciding on a case of mismanagement in *Sadbhav Infra Ltd. v. Montecarlo Ltd.*, the court observed that to enable corporate

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[84] Shafron v. Australian Securities and Investments Commission, (2012) HCA 18.

[85] Tim Hartin et al., *The Impact of the Global Financial Crisis continue to present an interesting challenge for company secretaries to navigate*, 7 INT'L. IN-HOUSE COUNSEL J. 1, 7 (2014).

[86] Lakshmirattan Cotton Mills Co. Ltd. & Behari Charan v. The Aluminium Corporation of India, (1971) 1 SCC 67.

[87] ROBERT PENNINGTON, PRINCIPLES OF COMPANY LAW 94 (2nd ed., 1967).

[88] *Supra* note 47.

[89] Y. C. Bhavsar v. Vraj I.T.P. Ltd., (2013) 116 CLA 75 (CLB).

[90] *Supra* note 67.

governance, CS must have powers to access and review company records.[91]

It can be inferred from the duties imposed upon CS that he is required to ensure that the conduct of the management does not adversely affect the interests of the stakeholders, and in such pursuit, he must intervene in activities such as malicious disposal of funds or assets.[92] However, the gravity of the role of CS in India can be understood only upon analysing the decision in *State of Gujarat v. Coromandal Investment Private Limited*.[93] Therein, the court discussed the ambit of S. 383 A of the Companies Act, suggesting that if a person was employed as WTCS in one company, he would have to relinquish his post as CS in other companies.[94] It is pertinent to note that no other KMP has been mandated to observe such restrictions on employment; this suggests that the law places the CS at a position of higher responsibility and expects a superior level of attention towards company affairs from such CS.[95] When not functioning under the direction of the board members, a company secretary's structural detachment is meant to strengthen the roles of the non-executive directors. Since neither the auditor nor the internal or external lawyers are required to attend board meetings and may not have direct access to the chairman or other non-executive directors, the CS can serve as a unique gatekeeper. This distinction between statutory duties and socio-legally projected functions of the CS mark a jurisprudential shift on the company secretary's position as a governance officer.

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[91] Sadbhav Infra Ltd. v. Montecarlo Ltd., (2014) 122 CLA 148 (CLB).
[92] *Supra* note 33.
[93] State of Gujarat v. Coromandal Investment Private Limited, (1991) 71 Comp. Cas. 470.
[94] Companies Act, No.1 of 1956, §383 A (Ind.).
[95] Chand Phool & Deb Taru, *Companies Act & Corporate Governance in India: Quo Vadis?*, 1(1) J. COM. & MGMT. 121, 125 (2018).

E. EXECUTIVE ENABLEMENT: COMPARING A CS TO AN OMBUDSMAN

The ombudsman can be described as an officer who has the ability to review the administrative acts of several government departments in light of citizen complaints. Various jurisdictions across the world have incorporated this Swedish concept into their public administration structures to ensure that the governing bodies do not cause unreasonable grievances to citizens. The ombudsman's duty is to facilitate grievance redressal, enforce accountability, and create a communication path between the pillars of public administration.[96] He is responsible for investigating occurrences of fraud, dishonesty and unauthenticated use of power by the executive wing of the government.[97] Hence, the ombudsman is an instrument of good governance in public administration and matters of the state.[98] It can be understood that such good governance is essentially meant to prevent corruption, nepotism, misuse of influence and protection of citizens' rights in the nation. By simple comparison, the public office of the ombudsman is comparable to that of governance personnel meant to handle regulatory compliance and corporate practice in corporate entities. In India, a listed company is expected to establish higher standards of disclosure and accountability by the appointment of a WTCS.[99] Such a permanent office in a corporate entity must thus be considered at a higher pedestal than an external PCS or a firm thereof.

In the previous section, we have discussed how the judiciary and legislative intent imposes greater responsibilities on a CS due to increasing occurrences and rising magnitudes of corporate embezzlement. It can be logically inferred that the CS is meant to be a sort of redressal officer for

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[96] Simone Caddedu, *The proceedings of the European Ombudsman*, 68(1) L. & CONTEMP. PROBS. 161, 162 (2004).
[97] V. S. Shukla, *The Ombudsman Hysteria,* 2 SUP. CT. J. 1, 86 (1967).
[98] Anita Stuhmcke, *Evaluating the effectiveness of an Ombudsman: a riddle, wrapped in a mystery inside an enigma*, 10 WELLINGTON CONF., INT'L. OMBUDSMAN. INST. 1, 4 (2012).
[99] Companies Act, No.1 of 1956, §203 (Ind.).

the stakeholders and that they shall abstain from being part of any stakeholder redressal committee.[100] Their independence is comparable to the ombudsman because although their activities are quasi-administrative in nature, neither of them are parts of executive bodies. The ombudsman is independent of the government, and similarly, the CS needs to be provided an independent position which is beyond the influence and interference of the Board of directors. Thus, the process of empowering a CS shall require his position to be given certain powers upon the administration of the Company, whereby he is not required to obtain board approvals in investigating or discussing matters of corporate governance with the employees, external stakeholders or regulatory authorities.

F. ANALYSING AND COMPARING INTERNATIONAL MODELS

The Anglo- American model of corporate governance can be observed as the fountain of origin from which subsequent divergent models arose[101] Its development was aided by the rapid boom in capitalist markets that created the need for private and public sector segregation in industries.[102] Its prime objective was to maintain management relations and cooperation with shareholders, owing to the fact that their adoption of a 'unitary tier board system' as elected by shareholders.[103] Optimized communications technology, lower business and financial barriers, and increased access to previously closed markets have given such businesses more freedom to choose where they want to manufacture. This created loopholes to enable getting around onerous regulations and finding low-cost labour/ materials. These two reasons, i.e. shareholder prominence

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[100] Rafael La Porta, *Investor Protection and Corporate Valuation*, 57(3) J. FIN. 1147, 1151 (2002).

[101] Thomas Clarke, *A critique of the Anglo-American Model of Corporate Governance*, 5(3) COMP. RES. L. & POL. ECON. 1, 2 (2009).

[102] Steve Toms & Mike Wright, *Divergence and convergence within Anglo-American corporate governance systems: Evidence from the US and UK, 1950–2000*, 47(2) BUS. HIST. 267, 269 (2005).

[103] Hassan Shirwa & Murat Onuk, *Corporate Governance Models & Possibility of Future Convergence,* 4(1) J. CORP. GOVERNANCE RES. 1 (2020).

and the rising probability of liability evasion have been tackled by setting up of governance officers.[104]Although the appointment of independent directors was the primary step towards better governance, cases like the Enron Fraud proved that company management needed a monitoring office with independence and accountability towards stakeholders.[105]

The second school of thought flourishes under the European model of corporate governance. As a means of improving good governance, some continental European countries, such as Germany, Austria, and the Netherlands, mandate a two-tiered board of directors,[106] As a result, the executive board, comprised of company executives, typically handles commercial operations, whereas the supervisory board, comprised wholly of non-executive directors, represents the investors and employees, employs and disqualifies executive board members, defines their remuneration, and reviews strategic changes. The German Codetermination Act of 1976 stipulates that worker be given seats on the board as stakeholders, in addition to the seats that accrue to shareholder representation.[107] This setup is materially similar to the appointment of an independent officer who is a link between employees, stakeholders and management, in the form of a CGO. Developing economies can be seen adopting a hybrid of the unitary and two-tier systems in corporate governance. Research in the Nigerian regime shows that ingrained institutionalism greatly influences stakeholders' expectations of financial, legal and regulatory administration, practises created or accepted, grievances & successes of legislative actions taken.[108] These conditions arise from a need for accountability, accessibility and transparency on

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[104] Jessica Djilani, *The British Importation of American Corporate Compliance*, 76 BROOK. L. REV. 303 (2010).

[105] *Supra* note 27.

[106] FELIX I. LESSAMBO, THE INTERNATIONAL CORPORATE GOVERNANCE SYSTEM 114 (1st ed. 2014).

[107] Hans Mertens & Erich Schanze, *The German Codetermination Act Of 1976,* 2 U. PA. J. INT'L L. 75, 77 (1979).

[108] Emmanuel Adegbite & Chizu Nakajima, *Institutions and Institutional Maintenance: Implications for Understanding and Theorizing Corporate Governance in Developing Economies*, 42(3) INT'L. STUD. MGMT. & ORG. 69, 73 (2012).

behalf of management tier officers. A similar picture is put up in the South East Asian economies such as Pakistan, which have adopted most of their legislative framework from the British colonial era principles of law.[109] Research suggests that board composition of companies has a positive effect on investor confidence, & firms with independent governance personnel have performed better statistically. [110]

The third school of governance is composed of the Chinese model, whereby three levels of Board members are employed to fulfil responsibilities of directorial, executive and supervisory nature respectively.[111] The third organ, which comprises of elected members working as monitors over the directors, is similar to a body of governance personnel.[112] It is primarily meant to increase accessibility, accountability and transparency of the board towards the stakeholders.[113] However, since no legal qualification is required, the amount of independence and scope of qualified corporate governance remains restricted to the director's discretion. Around the world, the CS has thus become more important than was initially intended, particularly in public companies, in order to mitigate legal and reputational risk. This added responsibility was not the result of any special law governing the CS.[114] Instead, laws requiring increased accountability, accurate governance, internal safeguards, separation of the chairman and CEO roles, a rise in the amount of non-

[109] Howard Leichter, *The patterns & origins of policy diffusion: The case of the commonwealth*, 15(2) COMP. POL. 223, 225 (1983).
[110] Attiya Y. Javed et al., *Corporate Governance and Firm Performance: Evidence from Karachi Stock Exchange*, 45(4) PAK. DEV. REV. 947, 956 (2006).
[111] On Kit Tam, *Models of corporate governance for Chinese companies*, 8(1) CORP. GOVERNANCE INT'L. REV. 52, 54 (2000).
[112] Andrew Keay & Jingchen Zhao, *Transforming corporate governance in Chinese corporations: A journey, not a destination,* 38 NW. J. INT'L L. & BUS. 187, 189 (2018).
[113] Yuan George Shan & David K. Round, *China's Corporate Governance: Emerging Issues and Problems*, 46(5) MODEL ASIAN STUD. 1316, 1324 (2012).
[114] SAMUEL IDOWU, CORPORATE SOCIAL RESPONSIBILITY FROM THE PERSPECTIVE OF CORPORATE SECRETARIES 52 (Walter Filho & Samuel O. Idowu eds., 1st ed. 2010).

executive board members, and mandatory CSR policies have fuelled the rise in the value of the CS.[115]

III. SUGGESTIONS

It is also visible through research that the position of a chief Governance Officer (CGO) lies at a higher pedestal, considering that it is no more a clerical position, but one of executive leadership. Thus, in order to promote the CS from mere compliance reporting to a director-level position, it is necessary to analyse how he may be given more authority. Although the CGO's duties differ by jurisdiction, the chairperson and board commonly rely on them for legal direction. As a result, his prime functions are focused on three basic areas:

- Instructing the board members, individually and as a team, in their duties and obligations;
- Ensuring that the firm complies with all legislation and regulations;
- Assisting with maintenance of stakeholder relationships.

This helps them ensure that the board and management are aware of the legitimate and reasonable demands, interests, and needs of the stakeholders. In a liberalised world where commercial equations spread across jurisdictions, the wide-ranging qualifications of the CS need to be incorporated into their authority to the point where it is improper to cover them in a clerical cloak with the word secretary.

Firstly, to be upgraded into a CGO, a CS must have governance experience and be familiar with how the company manages its turnover and its financial, social, and environmental consequences.[116] Hence, it is proposed that the CS must be involved in internal audits. Apart from the Secretarial Audit conducted under S.204 of the Companies Act, the CS

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[115] Joseph Lee, *the corporate governance officer as a transformed role of the company secretary: an international comparison,* 14 S.C. J. INT'L. L. & BUS. 109, 113 (2018).
[116] *Supra* note 47.

must be the monitoring authority on the report generated by an internal audit.[117] The internal audit is meant to ensure that a sturdy accounting system is in place, and that the company is able to identify risks, protect assets and analyse financial information.[118] Under company law, the monitoring powers of the management have been provided to the audit committee, but the CS is merely a secretary therein, and is thus denied the ability to opine freely and independently.[119] Hence, the under S. 138(2) of the Act, the clause should be amended to say that the internal audit shall be conducted and reported to the CGO. This step is crucial to facilitate his awareness of the company's overall operations, & change the perception that the CS only handles paperwork for financial and legal compliance.

Secondly, the CS is well-positioned to handle the function of strategic communication with stakeholders. Accordingly, a clause should be added under S.138 to mention that the CGO shall be responsible for presenting the internal audit report before the Annual General Meeting, and solving queries of stakeholders based on such report.[120] The CS must be available and accessible to stakeholders for active dialogue on issues of corporate governance, especially with respect to the internal audit. In such pursuit, the CGO should mandatorily be present for all company meetings including requisitioned meets, class meetings and short notice meetings, and must be authorised to work in conjunction with the chairperson to ensure that critical issues in modern corporations, such as IT governance and stakeholder relationships, are addressed. For such reasons, S. 205 of the Act should be amended to include the function of the CS to attend all company meetings, ensure that grievances of the stakeholders are

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[117] Companies Act, No.18 of 2013, §138 (Ind.).
[118] Premlal Joshi, *Which factors affect the internal audit effectiveness in India?*, 12(2) IND. J. COM. MGMT. STUD. 1, 3 (2021).
[119] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 6(1), (Sept. 2, 2015); *See supra* note 7.
[120] Companies Act, No.18 of 2013, §138 (Ind.).

addressed, and that financial/legal matters of critical importance are communicated to the requisite persons.[121]

Thirdly, the CS must be involved in managing the relations of the board of directors itself. The most rampant abuse of directorial power was observed in the *Enron case* (as was discussed above), and judicial opinion suggested that it was a lack of internal governance that allowed such a disaster. By inferences, the law needs to incorporate the CS into the process of appointment, remuneration and removal of directors in the company. There exist three areas of responsibility wherein the CS can be involved to monitor the employment of directors; background checks and analysis before appointment, analysis of findings in internal audits during employment, and investigations into allegations through investor grievances or vigil mechanism complaints.[122] The process of appointment of directors occurs through discussion in the general meeting, and during nomination or election of a director, the CS should be mandated to ensure that the requisite criteria of disclosures and checks are completed.[123] Secondly, if the findings of an internal audit suggest that a director in office has taken actions that are commercially, legally or financially detrimental to the interests of the company or its stakeholders, the CS should be empowered to analyse, investigate and present such data before the general meeting.[124] Thirdly, the CS should be involved in the process of removal of directors through S.169 of the Act, with the power to investigate into reasons of removal, and to analyse the claims of the director made in defence during the general meeting.[125]

This function should be removed from the ambit of the audit committee because the committee is itself comprised of directors, and

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[121] *Id.*, §205.
[122] Mohammad Tayseer Alshaboul & Mohammad Ahmad Abu Zraiq, *Investigating the Relationship Between Board of Directors and Corporate Financial in Jordan*, 8(2) J. FIN. & ACCT. 59, 64 (2020).
[123] Companies Act, No.18 of 2013, §152 (Ind.).
[124] Dr. S. K Gupta, *Leveraging Internal audit for good corporate governance*, L. STREET IND. (Dec. 02, 2020) http://www.lawstreetindia.com/experts/column?sid=502.
[125] Companies Act, No.18 of 2013, §169 (Ind.).

cannot be relied upon completely based on the occurrences of financial crimes involving directors in the recent years.[126] The reason for awarding the authority on the CS instead is twofold. Primarily, since the CS has access to company records and knowledge of the law, he is qualified to provide a professional opinion on such matters in an advisory capacity.[127] Secondarily, the CS is the only KMP defined by the Companies Act, who requires a legal qualification in order to occupy his post, and is strictly governed by rules, regulations and secretarial standards issued by the ICSI.[128] Thus, any mala fide advice or investigation made by the CS can be prevented or punished through the stringent framework on conduct by the ICSI.

Fourthly, and finally, various Indian laws allow the CS to represent the company before respective tribunals on legal matters.[129] This necessitates that the CS must be independent and protected from undue pressure from the Board of Directors in matters where a legal proceeding requires that the conduct of the board be discussed before a judicial authority. Hence, the process of removal of a CS should be made more difficult, to ensure that it is not used as a threat by the Board of directors.[130] Currently, the Companies Act does not specify any procedure for removal of the CS, and he is dismissed like any other employee of the company. The process must require the involvement of a hearing opportunity in a general meeting, wherein the causes of removal and the claims of the CS must be presented before the stakeholders. Such treatment is necessary, as the Act provides this mechanism to auditors for reasons of independence and protection from mala fide removal as well.[131] If all these changes are incorporated into the existing framework of Indian company law, the CS

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[126] Hernando Riski & W. Wiralestari, *Do Directors and Tax Aggressiveness Affect Fraudulent Financial Reporting*, 9(3) J. AKUNTANSI. 219, 222 (2019).
[127] Michael Hocken & Paul Latimer, *The Ostensible Authority of a Company Secretary - Does Size Matter?,* 20(2) COM. L. QUARTERLY. 35 (2006).
[128] Company Secretaries Act, No. 56 of 1980, §2(c) & §4 (Ind.).
[129] Companies Act, No.18 of 2013, §432 (Ind.).
[130] Kakabadse et al., *Company secretary: a role of breadth and majesty*, 11 SOC'Y. & BUS. REV. 333 (2016).
[131] Companies Act, No.18 of 2013, §140 (Ind.).

can be upgraded into a CGO and the economy can move towards a safer corporate sector in the years to come.

IV. CONCLUSION

Good governance is becoming increasingly crucial for all organisations, including those in the private, public, and charitable sectors. Due to rapid rate of regulatory change and public distrust of institutions, the role of company secretaries as caretakers and leaders of good governance has increased more than ever. A CS contributes significantly to board effectiveness, but due to the clerical nature of the job, they are an underestimated and underutilised resource. The CS should not be merely treated as an agent of compliance in regulatory spaces, but also as a leader of strategic importance. His presence should facilitate even the lowest tier of employees and the smallest group of shareholders to effectively voice their concerns and questions before the management. It is of great significance for the company secretary to thus be elevated to a higher pedestal of authority.

The presence of a chief governance officer is not only a sign of improved accountability but a step towards an organized approach to good corporate governance. Their independence, accountability and impartiality arise from the fact that they are beyond the sole control of the board of directors. They should be empowered to create a system of checks and balances between the management and ownership, so that they may act in good faith for the betterment of the company. For this reason, it is necessary that a legally qualified individual, who is governed by established professional codes of conduct, is selected for such a position. These reasons champion the case of the CS to be appointed in that office. India has observed a growing inclination of the legislature and judiciary towards company secretaries, and this fact further established its roots in the corporate sector. The author acknowledges that further research is required to determine whether such an appointment of chief governance officer can be statutorily mandated and whether such law can

apply to merely listed companies or unlisted public companies as well. However, this study conclusively accepts the hypothesis that India is a suitable jurisdiction for the evolution of company secretaries, and their elevation to become chief governance officers is the next logical step in corporate law.

INTEGRATION OF BLOCKCHAIN TECHNOLOGY IN CORPORATE GOVERNANCE: IMPLICATIONS AND APPLICATIONS

Chitransh Bhansali & Devansh Dev[*]

ABSTRACT

Blockchain is receiving a lot of attention in almost every industry, including the corporate world, and is attracting significant investments worldwide. Blockchain in its bare form is a sort of ledger which is in the public domain. It has garnered attention for huge returns on minimal investments in the cryptocurrency realm, however, there are multiple applications of the technology that will ease the overwhelming burden of data that they need to store and organize in every field, including corporate governance.

Blockchain technology can revolutionize the way companies are handled and how they work. It is a framework that provides stakeholders with greater decentralization and greater capacity for active and accurate decision-making and will be crucial to modern corporate governance. Stakeholders can be highly benefitted from the transparency, permanence, and efficiency that blockchain technology holds. Even organizing the data in a way that it is not easily altered, or easily accessible would significantly improve the efficiency by which any corporate would work. This paper aims to study the implications of the application of Blockchain technology in the corporate governance world. The paper will attempt to describe Blockchain in a non-technical language and will compare the implication with the three major theories of corporate governance. The authors will then delve into its potential application in the current corporate world; we will also highlight the potential challenges with its implementation in order to provide a holistic study. The paper will ultimately conclude with a short note on the future of Blockchain technology.

Keywords: Blockchain Technology, Corporate Governance, Cryptocurrency.

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I. INTRODUCTION

Cryptocurrency has been a much-debated issue in the past several years, and most of the time, it has been on the wrong side of the law. Even in India, the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021,[1] which may be presented before the parliament in the monsoon session, proposes restricting all private cryptocurrencies in India and providing a facilitative framework for Reserve Bank India's official digital cryptocurrency. However, within all the chaos around the legality of cryptocurrencies, it is high time to recognise the revolutionary potential of cryptocurrency's underlying technology, *i.e.,* **Blockchain technology**.

To reap the numerous benefits ranging from transparency to immunity of Blockchain Technology, the Ministry of Electronics and Information Technology of India (*hereinafter* referred to as "**MeitY**") has already released its draft on "Strategy for Level Blockchain Framework".[2] It acknowledges the fact that Blockchain technology will significantly change the governance models in the field of finance, healthcare, education, legal, and so on.

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1 PARLIAMENT OF IND., LOK SABHA BULLETIN PART – II, NO. 1989-2025 (2021), http://loksabhadocs.nic.in/bull2mk/2021/29012021.pdf.

2 MINISTRY ELECTRONICS & INFO. TECH., GOV'T OF IND., STRATEGY FOR LEVEL BLOCKCHAIN FRAMEWORK (2021), https://www.meity.gov.in/writereaddata/files/NationalStrategyBCT_%20Jan2021_final.pdf.

As seen in the last few decades, there has been an increase in corporate frauds and corporate governance failures. Whether the cause is inefficiency or distressful economic conditions in the country,[3] a better framework is always suggested in the corporate governance model. It is believed that these three combined forces: inadequacy of existing record-keeping systems, rampant corruption, and ineffective market regulators will lead to early adoption of Blockchain technology in developing countries.[4]

The inclusion of blockchain technology could revolutionise the way things are governed. It would eliminate the need of a third party to validate data and bring a system of a "peer-to-peer" network that can itself execute the protocol by consensus.[5] Even though, at this juncture, such self-executing agreements does not have the backing of a law, their functionality of tracking, monitoring, and implementing the data is equivalent to a legal contract which promise enforcement due to the backing of law.[6]

Seeing the self-executing nature of data, a new form of corporate governance structure has been developed, wherein a blockchain-based system is established in a decentralised model and it is governed by self-executing codes. This form of blockchain integrated corporate

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[3] Press Trust of India, *Improve Corporate Governance to Lift Economic Efficiency: RBI to India Inc*, BUS. STANDARD (Dec. 27, 2019) https://www.business-standard.com/article/pti-stories/das-asks-cos-banks-to-improve-corporate-governance-to-help-lift-efficiency-of-economy-119122701022_1.html.

[4] David Yermack, *Corporate Governance and Blockchains*, 21(1) REV. FIN. 7 (2017).

[5] Abdelkader Derbali et al., *How Will Blockchain Change Corporate Governance?*, 2(1) INT'L J. BUS. & RISK MGMT. 16, (2019).

[6] Florian Möslein, *Blockchain Applications and Company Law*, OXFORD BUS. L. BLOG (Feb. 23, 2021) https://www.law.ox.ac.uk/business-law-blog/blog/2021/02/blockchain-applications-and-company-law.

governance model is commonly known as "The Decentralized Autonomous Organization (*hereinafter* referred to as "**DAO**")".[7]

Globally, some corporations have already started experimenting with Blockchain technology in corporate governance, with the DAO form of framework based on Ethereum Blockchain,[8] which essentially provides shareholders or token holders with algorithm certainty of smart contracts which allows them to take a vote on proposals and automatically executes it with complete transparency.[9]

While Blockchain technology has countless applications, the objective of the article will be an attempt to analyse and explore its potential in the corporate governance world. Part I of the paper will provide a basic description of how blockchain technology works and attempt to compare its implication with the broadly categorised corporate governance theories. Part II of the paper will deal with the potential of application that Blockchain technology may have in corporate governance. Part III of the paper will study the potential challenges associated with the implication of blockchain technology.

II. BLOCKCHAIN TECHNOLOGY VIS-À-VIS CORPORATE GOVERNANCE

Blockchain, or it can be aptly said "a[n] [open] distributed ledger", is a decentralised database that can record various entries through linked blocks (as a chain). This chain of blocks operates on a peer-to-peer network, and each block stores all previous records in a public ledger (un-permissioned) or a private ledger (permissioned).

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[7] Samer Hassan, *Decentralized Autonomous Organization*, 10(2) INTERNET POL'Y REV. (2021).
[8] L. Liu et al., *From Technology to Society: An Overview of Blockchain-Based DAO*, 2(1) IEEE OPEN J. COMPUTER SOC'Y 204 (2021).
[9] Spencer J. Nord, *Blockchain Plumbing: A Potential Solution for Shareholder Voting?,* 21(3) U. PA. J. BUS. L. 706 (2019).

Instead of depending on intermediaries, it uses cryptography and hash function, which encrypts the input data by condensing them into secure output data in a block formed. Later, this block in a chain is verified through other computers on the networks as a collective chain unit. Thus, the most distinct feature is that it can track and validate entries with complete accuracy without any intermediary with almost to perfect immutability. Even if a hacker tries to modify any record, they will have every block on the chain to do so, which is impossible without a highly powerful computer. Therefore, while considering the applicability of Blockchain technology, the focus should be placed on its three key features, i.e., security, traceability, and transparency.

Another key application of Blockchain is "smart contracts" that could significantly affect how contracts and agreements are executed in the corporate world. Smart contracts are Blockchain protocols that run when predetermined conditions are met without any intermediary's involvement. Agency connections in smart contracts operate exactly as programmed, with no chance of the agent engaging in opportunistic conduct. All contractual conditions are available to the public and are completely transparent to check.

The Blockchain's potential to enhance corporate governance is quite indicative from its core features of de-centralisation, traceability, and transparency which will be beneficial for having strong corporate. Features of Blockchain will ensure the fulfilment of four pillars of corporate governance: "*Transparency, Accountability, Fairness, and Responsibility*".[10] Additionally, many international scholars have considered these core functions of Blockchain technology as a possible innovation that can significantly change the corporate governance landscape.[11] Even

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[10] DR. PRIYANKA KAUSHIK SHARMA, CORPORATE GOVERNANCE PRACTICES IN INDIA - A SYNTHESIS OF THEORIES, PRACTICES, AND CASES (2015).

[11] *Supra* note 4; Wulf A. Kaal, *Blockchain-Based Corporate Governance,* STAN. J. BLOCKCHAIN L. & POLI'Y. (2021) https://stanford-jblp.pubpub.org/pub/blockchain-corporate-governance/release/1. [hereinafter Kaal].

the state of Delaware, USA, has already amended its corporate code to replace the paper and electronic stock ledger with Blockchain technology for efficient record-keeping.[12]

While the primary objectives of good corporate governance are about promoting fairness, transparency, and accountability in a company,[13] the current models fail to ensure every factor to its fullest. To attain maximum level of cooperate governance, a "peer-to-peer" or "community-driven forms of corporate organisation and governance" could be adopted, wherein technology will allow authoritative decision making in the absence of a centrally defined authority that makes and enforces these decisions by the stakeholders of the company.[14] Such technological models will disrupt the existing traditional hierarchical model structure of the companies.

To further analyse the potential of Blockchain, it is pertinent to identify and compare the implications of the new Blockchain technology model with the three broadly categorised theories of corporate governance:

A. AGENCY THEORY

This theory is based on the notion of separation of ownership and authority; however, this delegation of authority given to the managers or board of directors (agents) by the shareholders (principal) leads to the fulfilment of self-interested goals of the agents.[15] Thus, in contrast, it is advocated that the key factor for good corporate governance is to protect

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[12] John C. Kelly & Maximilian J. Mescall, *Taking Stock of the Block: Blockchain, Corporate Stock Ledgers, and Delaware General Corporation Law: Part I,* 1(3) J. ROBOTICS, ARTIFICIAL INTELLIGENCE & L. 145 (2018).

[13] J. Wolfenshon, *Definition of corporate* governance, FIN. TIMES, June 21, 1999.

[14] Mark Fenwick & Erik P. M. Vermeulen, Technology and Corporate Governance: Blockchain, Crypto, and Artificial Intelligence (Eur. Corporate Governance Inst., Working Paper No. 424/2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3263222.

[15] ADOLF A. BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

and work towards stakeholders' interests.[16] The main aim is to enhance the conceptual structure that governs the relationship between the principal and the agents.

However, the existing corporate governance against unavoidable agency issues falls short of achieving the quality and stability required for good governance.[17] Even though the Indian Government has responded by implementing numerous compliances, one at times manages to slip under the radar.[18]

Blockchain holds numerous benefits for agency issues. Firstly, principals can examine all transactions by agents or the system itself and flag anomalies or inconsistencies. Secondly, by obviating the requirement for a central delegated authority, Blockchain technology has the potential to eliminate agency expenses in the business context. It substantially decreases agency expenses by providing decentralised artificial intelligence with the monitoring of agents. In addition, a smart contract allows for the public', a fully transparent, secure, and completely networked exchange between the principal and agents, disallowing any sort of alteration of data.[19]

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16 David E.M. Sappington, *Incentives in Principal-Agent Relationships*, 5 J. ECON. PERSP., 45 (1991).
17 Kaal, *supra* note 11.
18 Aarati Krishnan, *All you wanted to know about conflict of interest*, BUS. LINE (Apr. 16, 2018) https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about-conflict-of-interest/article23563094.ece.
19 Wulf A. Kaal, *Blockchain Solutions for Agency Problems in Corporate Governance*, COLUM. L. SCH. BLOG CORPORATIONS & CAP. MKT. (May 05, 2019) https://clsbluesky.law.columbia.edu/2019/05/23/Blockchain-solutions-for-agency-problems-in-corporate-governance.

B. STEWARDSHIP THEORY

According to this theory,[20] managers are trustworthy and unlikely to defraud investors of their cash. Managers place a high premium on their individual reputations. Stewardship theory asserts that when managers are left to their own devices, they will act responsibly as stewards of the assets under their supervision. This is in contrast to agency theory, which assumes managers operate in their own self-interest at the expense of shareholders. These stewards think that by working toward organisational, communal goals, they can meet personal needs and match their interests with those of the business and its owners. As a result, a steward is motivated to optimise organisational performance in order to fulfil shareholders' interests.

With the implementation of Blockchain technology, it would eliminate the knowledge disparity about the organisation, and shareholders will have the opportunity to become a value creator, thereby increasing the incentives and profit opportunities for stakeholders. Users with greater ownership/power have the opportunity to act as managers and promote platform innovation. Steem[21] is an example of a Blockchain network that rewards stewardship.[22]

C. STAKEHOLDER THEORY

Stakeholder theory advocates the enhancement of stakeholders' interests (rather than shareholders' interest) to achieve long-term sustainable development.[23] Apart from shareholders, stakeholders majorly include customers, board members, employees, and the community. Due

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[20] James H. Davis et al., *Towards a Stewardship Theory of Management,* 22(1) ACAD. MGMT. REV. 20 (1997).
[21] *See* Steem, https://steem.com/ (last visited Oct. 19, 2021).
[22] Giulio Caldarelli, *Exploiting Corporate Governance to Evaluate Blockchain Applications: A Comprehensive Framework*, 8(4) INT'L. J. ECON. & BUS. ADMIN. 166 (2020).
[23] James H. Davis et al., *Towards a Stewardship Theory of Management,* 22(1) ACAD. MGMT. REV. 20 (1997).

to the diverse set of interests among the stakeholders, it gets difficult to quantify and balance everyone's interests.

Countless corporate scams occurred in the past as due to alteration of the information by the managers, which has affected stakeholders at large.[24] However, with the implementation of Blockchain, such incidents could be avoided, as the transactional data and records would be available to everyone and can easily be scrutinised without the risk of any alteration. Thus, Blockchain technology would reflect as a source of trust, integrity, and auditability among the stakeholders.

To inculcate the interest of its stakeholders, two blockchain projects, EOS and TEZOS, provides its token holders the right to vote over various proposals. Initially, even the alleged founder(s) of the bitcoin had some discussion with the online community to discuss about the governance structure of the project.[25]

III. APPLICATION OF BLOCKCHAIN TECHNOLOGY IN CORPORATE GOVERNANCE

We will begin with an example to understand how structures that look over or manage some large-scale activity require blockchain technology to be implemented in the first place. Let us say there is a water board set up in any of the metropolitan cities of India, which provides water to the houses. This single-board overlooks different functions such as pumping water from the source itself and making it useable for household uses, estimates the cost, manage how the water is supplied to the houses, also

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[24] *Satyam scam: All you need to know about India's biggest accounting fraud*, HINDUSTAN TIMES (Apr. 09, 2015) https://www.hindustantimes.com/business/satyam-scam-all-you-need-to-know-about-india-s-biggest-accounting-fraud/story YTfHTZy9K6NvsW8PxIEEYL.html.

[25] Darcy W. E. Allen & Chris Berg, *Blockchain Governance: What can we Learn from the Economics of Corporate Governance?*, J. BRIT. BLOCKCHAIN ASS'N. (Mar. 30, 2020) https://jbba.scholasticahq.com/article/12455-blockchain-governance-what-we-can-learn-from-the-economics-of-corporate-governance.

takes precautions in case there is some failure in the chain, undertake repairing work and also manages the distribution of water during times of peak demand.

Now, add one more variable, that an individual can store water via rainwater harvesting, and use that for their households or even supply to other households, if it is excess. Blockchain technology can come into play to manage this for a whole city, wherein the information regarding metrics, requirements, and usage is stored securely and updated regularly. This system can be set up for the entire city by some other authority, for which an individual will incur a nominal fee. Since you have the authority over the water stored by you, you have a say on how it is managed and how you want it to be allotted to others. Some of the significant issues in the system include how the price for the water is calculated, how it is channelled in times when the supply is high or vice versa, who has the authority on up-gradation of such system, or who would be held liable by law in case there has been some wrongdoing. These are the issues that blockchain technology aims to respond to.

India does not have any law or set of regulations to govern Blockchain or Distributed Ledger Technology (*hereinafter* referred to as "**DLT"**), although it heavily discusses about implementation and application of blockchain technology in the recent MeitY's draft on "Strategy for Level Blockchain Framework".[26] Moreover, since the technology has been gaining attention in recent years, several houses of the Government Authorities have shown a positive stance towards implementing the same. We will be talking about some of the examples in more detail underneath.

In spite of the fact that many scholars have advocated for its application, there has not been any full-fledged application of global

[26] MINISTRY ELECTRONIC & INFO. TECH., GOV'T OF IND., STRATEGY FOR LEVEL BLOCKCHAIN FRAMEWORK (2021), https://www.meity.gov.in/writereaddata/files/NationalStrategyBCT_%20Jan2021_final.pdf.

regulations that have been adopted as such. According to Yermack (2017),[27] among other benefits, the adoption of Blockchain Technology in Corporate Governance would result in increased liquidity, lower costs, accurate recordkeeping, and transparent ownership, to name a few examples. Researchers such as Catalini and Gans (2016)[28] assert that the integration of multiple bank ledgers via Blockchain would speed up processes while also lowering expenses for the banks. In their paper, Abadi and Brunnermeier (2018)[29] express concerns about the ability of Blockchains to maintain cost-effectiveness, decentralization, and accuracy at the same time while also being decentralized. Jayasuriya and Sims (2019)[30] state that blockchain-based financial applications have a wide range of application in accounting, including triple-entry accounting, reduced earnings management, real-time auditing, and real-time settlement of accounts. Since the server is not owned by any particular entity, it also offers greater liquidity and accountability to the consumers.

To experiment with the benefits of blockchain technology, JP Morgan in 2020, developed an in-house system which was based on Blockchain named as "Onyx Blockchain Platform", to initiate and settle repurchase agreements between the United States Treasury Bonds and JP Morgan's own digital currency known as JPM Coin. It found that using Blockchain Technology helped them settle the transaction significantly faster than the conventional system.[31]

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[27] *Supra* note 4.

[28] Christian Catalini., Some Simple Economics of the Blockchain (Rotman Sch. Mgmt, Working Paper No. 2874598, MIT Sloan Research Paper No. 5191-16), https://ssrn.com/abstract=2874598.

[29] Joseph Abadi & Markus Brunnermeier, Blockchain Economics, (Nat'l Bureau Econ. Res., Working Paper no. 25407), https://www.nber.org/papers/w25407.

[30] Jayasuriya D. Dulani, & Alexandra Sims, *From the Abacus to Enterprise Resource Planning: Is Blockchain the Next Big Accounting Technology?*, INT'L. J. FIN. STUD. (2019) https://www.mdpi.com/2227-7072/8/2/36/pdf.

[31] Darren Sinden, *JP Morgan uses blockchain to create intraday liquidity,* FIN. FEEDS (Dec. 14, 2020) https://financefeeds.com/jp-morgan-uses-blockchain-create-intraday-liquidity/.

What the conventional method does in several days, the Blockchain Platform did it in a mere few hours and showed the enormous potential it holds. Thus, we will now look into the major applications and how implementing the technology can significantly ease the working of the corporate governance sector.

A. SHAREHOLDER VOTING

Even though the corporates employ countless people, cater to the mass via their products or services, and sometimes even influence the national environment, they are still answerable to their shareholders' votes. In today's world, shareholder voting has become a liability for corporate governance. Due to the fact that certain shareholders cast varied numbers of votes and that some clever investors take advantage of the traditional system of ownership, even the recordkeeping task of ownership is time-consuming.[32]

Blockchain technology, if implemented, has the potential to provide intelligent solutions for inefficiencies in traditional corporate governance, particularly in the interaction between shareholders and the corporation.

Organizations would benefit from blockchain-based shareholder voting as it will offer them a secure and immutable digital copy of the voting opinions expressed by shareholders during annual general meetings. It will ensure that voters may exercise their rights in a safe and transparent manner, as well as promoting cross-border investment opportunities. If regulators require access to voter data, they can do so using the private blockchain network. The voting instructions can be checked and traced because all records are accessible to every member, and they cannot be tampered with because all records are visible to everyone.

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[32] Alexander Daniels, *Blockchain & Shareholder voting: a hard fork for 21st-century corporate governance,* 21(2) J. BUS. L., 405 (2018).

Due to improvements in ownership identification, some voting behaviours, such as over voting and hedging, may be rendered obsolete as a result of these advancements. In the future, it is possible that vote counts will become more exact, precise, and verifiable. At the very least, the legitimacy of corporate governance would be partially restored.

Moreover, according to the present framework, the board of directors have a significant influence over the corporate's decision making, however, the advocates for shareholder empowerment have a better stand with the implementation of Blockchain technology as the products built on Blockchain technology shall allow shareholders to engage with firms in whole new ways if and when they are produced. Additionally, new tools of networking and engaging via the chain will help the shareholders participate more in the decision-making scenario by removing conventional structural hurdles.[33]

B. RECORD KEEPING

A records management system (*hereinafter* referred to as "**RMS**") is a system that allows an organisation to manage its records over a long tenure. It is the responsibility of this management to maintain systematic and efficient control over the creation, maintenance, and destruction of records, as well as over the business transactions that are related to those records. Record management is regarded as a critical component of operational efficiency since it increases the value of an organization's information assets.[34] Records have been defined by the International Records Management Standard (ISO 15489-1:2016) as "*information created,*

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[33] Christoph Van der Elst & Anne Lafarre, *Blockchain and Smart Contracting for the Shareholder Community*, 20 EUR. BUS. ORG. L. REV. 111 (2019) https://doi.org/10.1007/s40804-019-00136-0.

[34] *Records Management System (RMS),* TECHOPEDIA, https://www.techopedia.com/definition/30667/records-management-system-rms (last visited Oct. 10, 2021).

received and maintained as evidence and as an asset by an organization or person, in pursuance of legal obligations or in the transaction of business".[35]

In order to sign every transaction (for e.g., the transfer of assets from one person to another) with a unique digital signature belonging to the user who initiated the transaction, blockchain technology offers services under the realm of cryptography. These signatures are kept confidentially, but they are verifiable in the public domain, which enhances the credibility of the transaction, as well as, the accountability of the user.

We refer to our waterboard example stated earlier in this section. The DLT offers a system under which records are secure and easily accessible. Moreover, the system offers less involvement of bureaucracy as these transactions won't require the approval of multiple government agencies and offices in order to be ratified, validated, and approved multiple times, but instead require the approval of only one government agency and office.

In the 2019 report, released by Ministry of Finance, the Department of Economic Affairs talks positively about how DLT's applications reduce administrative or transaction costs as well as make the data more accountable, which helps in detecting fraud as well. The report talks about several sectors where this technology could revolutionize the whole system, such as the insurance sector, banking sector, payment systems, Know Your Customer (*hereinafter* referred to as "**KYC**"), Land Registries, Assets and Commodities management etc. [36]

[35] INT'L ORG. STANDARDIZATION, INFORMATION AND DOCUMENTATION - RECORDS MANAGEMENT 2 (2016), https://static1.squarespace.com/static/5a1c710fbce17620f861bf47/t/5a45d41353450a6f05e9b138/1514525716795/ISO%2B15489-1-2016.pdf.

[36] DEP'T ECON. AFFAIRS, GOV'T OF IND., REPORT OF THE COMMITTEE TO PROPOSE SPECIFIC ACTIONS TO BE TAKEN IN RELATION TO VIRTUAL CURRENCIES (2019), https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf.

Current records management solutions rely on a centralised collection of electronic records that have been captured and preserved within an organization's structures and systems to function properly. Some companies, for example, utilise content management systems to identify, classify, and administer collections of photographs, among other things. Blockchain transfers the duty and trust for keeping electronic records from the organization's structures and processes to a distributed network, thereby reducing the need for human intervention. A shift in the function of centralised records management systems and tools has occurred, with the blockchain itself taking on the role of validity and trust that had previously been fulfilled by records management systems and products.[37]

Recently, even the Central Board of Secondary Education issued a statement that it would be utilizing blockchain technology so that the board exam results are documented in a linked chain structure and cannot be altered. This system would not just help the passing batches of the current year but also from the previous years. The statement also mentioned that it would be making the signed certificates available for class 10th and 12th from 2019 to 2021 and will be uploading the certificates of previous years' batches as well.[38]

C. AUDITING

Referring back to our water board example, assume that the system is implemented for quite some time now. If all the data and transactions are listed in the public domain and doesn't have much involvement from the bureaucratic authorities, it streamlines the whole process for any auditor or rather, eases its job to a significant extent.

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[37] Victoria L. Lemieux, *A typology of blockchain recordkeeping solutions and some reflections on their implications for the future of archival preservation*, IEEE XPLORE (Jan. 15, 2018) https://ieeexplore.ieee.org/document/8258180.

[38] Mridusmita Deka, *CBSE To Use BlockChain Technology to Document Board Exam Results,* NDTV (Sept. 22, 2021) https://www.ndtv.com/education/cbse-use-blockchain-technology-document-board-exam-results.

When it comes to applications, blockchain opens up new opportunities for auditors, such as the review of certain transactions and the verification of the existence of digital assets, as well as attestation of consistency between information stored on a blockchain and information stored in the physical world. Furthermore, blockchain has the potential to radically alter the auditing process. Due to the fact that a comprehensive record of transactions is recorded on a blockchain, auditors will no longer be required to seek and then wait for data and documentation from trading partners. Furthermore, blockchain will outperform the existing audit sampling approach by enabling continuous audits for any "on-chain" transactions that occur during any given period of time.[39]

When blockchain technology is implemented, it will free up resources that were previously dedicated to evidence collection and verification. Since the whole system and its application is new, the new responsibilities might be difficult to complete, especially because there are no centralised authorities on the blockchain to guide the auditors. Auditors must draw on their knowledge of IT system audits in order to develop unique approaches of achieving strategic partners.

One of the vital factors to consider is data reliability. Since DLT acts as a new medium altogether, an auditor cannot just rely on the information but has to deal with how reliable is that data on the blockchain. One of the key factors then becomes the chances of the data on the blockchain to be altered somehow. The correctness of data on a blockchain is an extra factor to consider when evaluating the trustworthiness of data on a blockchain. According to the following statement made by a board member of the Public Company Accounting Oversight Board in response to this concern:

[39] Jay Schulman & Scott Wilson, *How blockchain technology will affect the audit,* RSM (Nov. 13, 2019) https://rsmus.com/what-we-do/services/assurance/how-blockchain-technology-will-affect-the-audit.html.

"*Blockchain does not magically make information contained within it inherently trustworthy. Events recorded in the chain are not necessarily accurate and complete. Recording a transaction on a blockchain does not alleviate the risk that the transaction is unauthorized, fraudulent or illegal. Blockchain also does not address threats that parties to a transaction are related, or that side agreements exist that are not reflected in the chain.*"[40]

Due to this, it is critical that the auditor understands the method by which data is submitted to a blockchain and the corresponding control processes that are involved with accurate input.

IV. SHORTCOMINGS

While implications of Blockchain technology in corporate governance looks alluring in theory, however, the technology is still at a nascent stage, and there are some shortcomings that need to be addressed before its actual applications.

A. STORAGE AND ENERGY CONSUMPTION OF BLOCKCHAIN TECHNOLOGY

Setting up a Blockchain technology requires a lot of storage space and energy consumption for running its systems and various other transaction fees,[41] all these costs will be borne by stakeholders only in the form of gas fee/transaction fee. Further, the high energy consumption will harm our environment as well.

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[40] Kathleen M. Hamm, *Mexican Mangos, Diamonds, Cargo Shipping Containers, Oh My! What Auditors Need to Know about Blockchain and Other Emerging Technologies: A Regulator's Perspective,* PUB. COMPANY ACCT. OVERSIGHT BOARD (Nov. 2, 2018) https://pcaobus.org/news-events/speeches/speech-detail/mexican-mangos-diamonds-cargo-shipping-containers-oh-my!-what-auditors-need-to-know-about-blockchain-and-other-emerging-technologies-a-regulator-s-perspective_684.

[41] Abdul Jabbar & Samir Dani, *Investigating the link between transaction and computational costs in a Blockchain environment*, 58 INT'L J. PRODUCTION RES. 1 (2020).

More the demand, more systems will be required; thereby, endangering the environment by increased energy consumption.[42] The energy consumed will be used to maintain the real-time ledger. Storage capacity is a major issue because the necessary computational power of a participating system (node) rises as every Blockchain develops;[43] and every time a new node is created, it has to communicate with all the previous nodes to ensure transparency and this process will keep on repeating to maintain transparency and security in the blockchain. However, these actions will increase the energy consumption unnecessarily and will hamper the future growth potential of a Blockchain.

However, there are different kind of blockchain, uses different amount of energy. For instance, Solana blockchain uses less energy than Bitcoin blockchain. Therefore, blockchain of different models must be explored.

B. FULL TRANSPARENCY VS PRIVACY

Privacy concerns also arise from the use of Blockchain. All records are easily accessible in a public or semi-public type of Blockchain. However, for any reason, certain stockholders or management may choose to remain anonymous as clearly stated in Nakamoto's original white paper: "*The necessity to announce all transactions publicly precludes this method, but privacy can still be maintained by breaking the flow of information in another place: by keeping public keys anonymous.*"[44].

Even in a purely permitted Blockchain with perfect anonymity, the history of active transactions gives some validators (those who verify the flow of data) and up to current information than any place else. Services

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[42] Eshani Ghosh & Baisakhi Das, *A Study on the Issue of Blockchain's Energy Consumption* in PROCEEDINGS OF INTERNATIONAL ETHICAL HACKING CONFERENCE 63 (2019).
[43] Zheng et al., *An Overview of Blockchain Technology: Architecture, Consensus, and Future Trends*, IEEE XPLORE (Sept. 11, 2017) https://ieeexplore.ieee.org/document/8029379
[44] Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN (2008) https://bitcoin.org/bitcoin.pdf.

that specialise in de-anonymising nodes may also be developed. Alternatively, too much privacy provides anonymity that enables illegal or unlawful activity.[45] Balancing privacy and transparency is probably an unresolved problem, and it needs to be addressed.

C. BLOCKCHAIN WALLETS

To give users the decentralised autonomy, each Blockchain wallet has a public-key (or asymmetric) cryptography to allow users to store Blockchain data. It is basically a digital wallet that holds the user's data, tokens, and other digital items, and each wallet's address has a private key for each Blockchain, this private key is solely provided to the user during the time of wallet creation and it should be kept secret and safe as if it gets lost there is no chance of recovery. They also need to make sure to not share this key to anyone, else their data and funds will be at risk. Not everyone is a tech expert to handle such information, thus there is a high chance that they might misplace or lose the private key.

Furthermore, even the chance of hacking or even modifying a single piece of information, which is called to be immutable as the attacker would have to go through very expensive and complicated process of changing every chain of data. However, as Huru Hasanova and his team has laid out in their paper that there are still various cyber vulnerabilities such as 51% hack, ransomware attacks, wallet security, private forks, double spending, DDos's attack and many others that could hack or interrupt the blockchain.[46] Therefore, proper safety measures are needed to be implemented to safeguard the blockchain from such attacks.

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[45] Alexander Daniels, *Blockchain & Shareholder Voting: A Hard Fork for 21st-Century Corporate Governance*, 21 J. BUS. L., 405 (2018).
[46] Huru Hasanova et al., *A Survey on Blockchain Cybersecurity Vulnerabilities and Possible Countermeasures*, 29 INT'L J. NETWORK MGMT. 219 (2019).

V. CONCLUSION

Through our research, we have found that the corporate governance issues that generally lead to massive shortcomings can be solved easily by Blockchain technology if implemented efficiently. Blockchain today can be compared to the Internet in the early 1990s in terms of functionality. Over the past two decades, we have witnessed how the "Internet of Information" has transformed our society. Now, we are entering a phase in which Blockchain has the potential to do the same by ushering in a new paradigm that includes the "Internet of Trust" and the "Internet of Value".[47]

As per the applications and examples stated, it is our conclusion that blockchain technology has the potential for a wide variety of applications which would help ameliorate the functioning of the corporate sector. However, there are some issues that exist which are yet to be decided upon, including the infamous debate if a permissioned blockchain server should be used or a public blockchain server should be used, the costs of maintenance, the vulnerability of the system, and the lack of deep research, which can only be countered by well thought legal framework behind its implementation

We have highlighted a few different potential applications, out of which the most significant implication of Blockchain technology for corporate governance is its decentralization which will immensely increase transparency in the corporate world. Corporations have been embroiled in scandals and financial crises. Specific forms of corporate governance are inefficient and ineffective. In turn, the current complexity of the investment chain may contribute to the current state of systems—the distance between two points.

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[47] *Blockchain technology in India Opportunities and challenges,* DELOITTE (Apr., 2017) https://www2.deloitte.com/content/dam/Deloitte/in/Documents/strategy/in-strategy-innovation-blockchain-technology-india-opportunities-challenges-noexp.pdf.

Moving ahead, we would like to highlight the fact that the number of households (money owners) and corporations (money users) have increased because of the complex financial system. There is a web of intermediaries (managers of money and providers of services). Since the invention of Blockchain technology, eliminating some forms of intermediation holds the most significant promise, as it presents a tremendous opportunity for better outcomes.

One of the first sectors to be impacted by the widespread adoption of Blockchain and its associated Distributed Ledger Technologies may be the financial services industries. The extent to which this technology will impact depends on how quickly industry players can capitalize on it and the nature of the support it receives from other stakeholders. Poor corporate governance can play a significant role in the failure of a company.

A transition from paper-based corporate records to Blockchain technology does not appear to conflict with the current regulatory framework in India, even though the Ministry of Corporate Affairs has made no official statements on the subject.

Therefore, this perspective on the potential of Blockchain technology with its various applications that could improve corporate governance would be worth exploring in greater depth.

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