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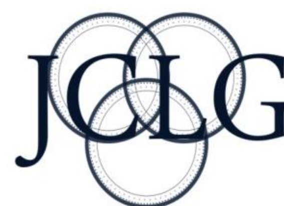

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FOREWORD

We are absolutely delighted to bring to you Volume 7, Issue 1 of the Journal on Governance. The generality of the theme of the current issue, '*Unravelling the New and Old Conundrums of Corporate Law – A Call for Harmonization',* has allowed us to explore a wide array of topics ranging from the newly notified Digital Data Protection Act to the unrealised potential of Limited Liability Partnerships ("LLPs") as a choice of investment vehicle for foreign investor.

The development of Indian corporate law has been dynamic these past few years. As the political climate continues to lean towards the far-right, the emphasis on facilitating ease of doing business and attracting foreign investments has been apparent and suitably reflected in the law. While India continues to navigate through murky waters, it becomes vital for the regulators to focus on corporate governance as a mechanism to maintain checks and balances.

In the first article, "Contemporary Fiscal Laws are Shaping the Board's Agenda: A Reflection," the author, Tarun Jain, delves into the developments in fiscal laws and the resulting implications for Key Managerial Personnel (KMPs) in body corporates. The evolving landscape of tax law has significantly extended beyond traditional boundaries. The author states that initially focused on holding corporate decision-makers accountable for tax consequences, now these laws encompass both anti-avoidance measures and substantive tax liability issues. Further, an intricate web of fiscal regulations now scrutinizes the roles of KMPs, often piercing the corporate veil and influencing corporate decision-making. The author highlights key developments in this evolving fiscal framework, emphasizing the increased responsibility of KMPs to address the growing demands of tax law.

In the second article, "An Overview of India's New Data Protection Law," the author, Dr. Deborshi Barat critiques the Digital Data Protection Act, 2023. The author states that the Act aims to safeguard the digital personal data of identifiable individuals, imposing obligations on "data fiduciaries" and additional duties on "significant data fiduciaries" (SDFs). However, compliance is critical, as non-compliance could result in substantial financial penalties. The author

suggests that organizations should use this interim period to prepare by conducting thorough data inventories and audits. This includes ensuring that third parties, such as data processors and vendors, also adhere to advanced data management practices. For this, the author has provided suggestions while concluding the article.

In the third article, "Exercise of Pre-Emptive Rights in Indian Limited Liability Partnerships: An Uneven Playing Field for the Non-Resident Investor," the authors Anshuman Mozumdar and Amogh Pareek delve into certain peculiarities in India's exchange control regulations that have created an uneven playing field between resident and non-resident investors in Indian LLPs. The authors briefly discuss the unrealized potential of LLPs as an investment vehicle for foreign investors. The article then focuses on specific causes of this untapped potential. It explains the effect of these regulatory gaps through an illustration, drawing parallels between an Indian LLP and an Indian company. Finally, the article concludes with recommendations and suggestions for amendments in the laws and procedures governing foreign investments in LLPs to address these concerns.

The fourth article is a case comment on the India Infrastructure Fund II v. Global Infrastructure Partners India Private Limited, by authors Avinash Subramanian, Parth Mishra and Simrann Venkkatesan where the author highlights that the SEBI Order has raised multiple concerns and confusions and may adversely impact the popularity of AIFs as an investment vehicle. The author goes on to explain the SEBI Order, explores its consequences in relation to market practices, and provides suggestions that may be taken into consideration to minimize the risks and resolve the concerns that SEBI has tried to address by passing the SEBI Order.

In the fifth article, "Resolution Applicants: Balancing Conflicting Interests and the Way Forward," the author, Nityesh Dadhich delves into the evolution of law concerning Resolution Applicants in India. For this purpose, the author conducts a comparative study with the United Kingdom and the United States. The authors argue that the Indian Government has adopted a much more stringent set of regulations compared to these two jurisdictions. Subsequently, the article identifies the leading grey areas and challenges, offering suggestions

on how these issues can be resolved. To provide a comprehensive understanding of the issue, the article examines a variety of suggestions and alternatives offered by the UNCITRAL's Legislative Guide on Insolvency and evaluates the extent to which those suggestions are relevant in the Indian context. Lastly, the authors highlights several recommendations regarding the provisions dealing with Resolution Applicants and regulations.

In the sixth article, "Corporate Governance in Indian Venture Capital Funds: Addressing Inefficiencies in Corporate Form and Dispute Resolution," the authors, Ryan Joseph & Sanjitha Ravi delve into the inefficiencies of Venture Capital Funds (VCFs) in India, which are mostly set up in the form of a trust. Venture Capital Funds play a significant role in boosting the capital account of India. Despite their substantial economic contribution, they have received very little scholarly attention. However, the authors identify two predominant lacunas for this: one in the corporate form of VCFs (agency cost) and the other in the dispute resolution mechanisms available to aggrieved stakeholders (non-arbitrability of a trust). As a remedy to this problem, the authors propose the use of Variable Capital Companies as an alternative to trusts when incorporating Venture Capital Funds, as this structure finds the right balance between governance standards and commercial flexibility.

In the last and seventh article, "Evolution of Corporate Governance: A Comparative Analysis of the Concept of CEO – Chairman Duality in the US, UK, and India," the authors, Atharva Aggarwal and Samruddhi Varma comment on the idea of separating the positions of Chairman of the Board and Chief Executive Officer (CEO). To strengthen the arguments, the authors carry on a comparative study between the United States, the United Kingdom, and India. The authors highlight the progress made in these countries and dissect the rationale put forth by regulators worldwide for maintaining a separation between these pivotal positions. The authors then highlight some of the impediments that led to the failure of SEBI's recent initiative to mandatorily separate power between the CEO and Chairman in the corporate governance structure of India. Lastly, the authors provide recommendations to strengthen the separation for better corporate governance standards.

All in all, we are sure that this issue should offer a wealth of information and insight to a reader, and some of the suggestions and observations may also assist in provoking a constructive discussion and deliberations on addressing these emerging issues in the field of corporate law.

As this issue marks the 15th year of the establishment of the Journal on Governance, we are filled with pride and gratitude. We express our heartfelt thanks to our patron and vice-chancellor, NLU-Jodhpur, Dr. Harpreet Kaur and the distinguished members of the Journal's Board of Advisors for their unwavering support. Our gratitude further extends to our Chief Editor, Dr. Manoj Kumar Singh who has remained a pillar of support for the journal for more than a decade.

Last but certainly not the least, we are extremely grateful to the stellar members of the Editorial Board of the Journal. The last year has been challenging in so many different ways, but our editors have continued to inspire us with their hard work and commitment. Their support has allowed us to manage the affairs of the journal in the most seamless way possible, and as we pass on the baton to future members, we remain excited to see what the future holds.

Deesha Reshmi & Ojasav Chitranshi

Editors-in-Chief, Journal on Governance

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CONTEMPORARY FISCAL LAWS ARE RESHAPING THE BOARD'S AGENDA: A REFLECTION

*Tarun Jain**

ABSTRACT

Though primarily seeking to attribute responsibilities to corporate decision-makers for the tax consequences of their decisions, there has been a fundamental expansion in the coverage and reach of tax laws. Not just for anti-avoidance inquiries but also for substantive tax-liability purposes, there is an expanding mesh of fiscal law framework which seeks to examine the role of individual Key Managerial Personnel ("KMP"), inter alia routinely piercing the corporate veil besides instilling various paradigms that increasingly influence corporate decision-making. In this background, this article attempts to sketch certain key developments in the fiscal law framework that attribute heightened responsibility upon the KMP so as to impress to them the need to address the increasing weight of fiscal law obligations.

Keywords: Corporate veil, Related party transactions, Directorship, Corporate taxpayer.

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* The Author is an advocate of Taxation Law.

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I. INTRODUCTION

The world has come a long way since the separation between corporate ownership and corporate management, resulting in the institution of professional management of corporate entities that would maximise the return to shareholders. In the wake of successive government reforms to the corporate law and high standards of corporate governance expected in the functioning of corporate entities, particularly listed companies, various statutory obligations and standard operating procedures that require deference from the corporate management have evolved. Modern legislations and regulatory frameworks, however, are continuously interlinked, and thus the scope of obligations is much wider than that prescribed under the corporate law framework. Notably, the fiscal law paradigm is one of the largest contributors, leading to expansion of the obligations to be met by corporate boards and key managerial personnel, besides the usual tax-compliances flowing from the tax law framework. In view of these and many other critical developments in the fiscal laws, the role and status of KMP are in a piquant situation requiring a revisit.

II. FOCUS ON INDIVIDUAL ROLES

The axiomatic corporate law proposition that a corporate entity is a distinct person having a separate legal entity from its shareholders is now

unexceptionally instituted even in tax laws.[1] Thus, as a logical conclusion, the consequences of non-compliance with tax laws, such as interest, penalties, etc. should befall only the non-compliant corporate entity without consequences for the corporate management. However, while addressing the consequences of the decision of the Supreme Court in *Standard Chartered Bank*[2]– which marked a watershed moment on the interface of criminal law with corporate law foundations and impressed upon the lawmakers their inability to incarcerate corporate personnel for offences of the company[3] – the tax laws have progressively advanced to specifically affix criminal liability on key managerial personnel[4] of the company.[5] The contemporary fiscal legislations, in fact, declare the KMP as individuals 'deemed to be guilty' of the offences committed by the company.[6]

Besides the legislative ascription of criminal conduct upon the KMP, a survey of contemporary tax laws in India reveals increased scrutiny (and corresponding liability) of individual affairs of the KMP, specifically directors, to attribute responsibility upon them even for civil infractions of the company in question in addition to the penal consequences.[7] Furthermore, there are special provisions in the fiscal laws which even affix the tax liability of the company on the KMP in certain specific situations.[8] Thus, the individual responsibilities and actions of the KMP attain crucial importance in determining their exposure to fiscal laws.

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[1] Income Tax Act, No.43 of 1961, §2(31) (Ind.); Central Goods and Services Tax Act, No. 12 of 2017, §2(84) (Ind.).
[2] Standard Chartered Bank v. Directorate of Enforcement, (2005) 4 SCC 530 (Ind.).
[3] Sunil Bharti Mittal v. Central Bureau of Investigation, (2015) 4 SCC 609 (Ind).
[4] Companies Act, No. 18 of 2013, §2(51) (Ind.); Income Tax Act, No.43 of 1961, §278B(2) (Ind.); Central Goods and Services Tax Act, No. 12 of 2017, §137(1) (Ind.).
[5] Income Tax Act, No.43 of 1961, §278B (3) (Ind.).
[6] Central Goods and Services Tax Act, No. 12 of 2017, §137(1) (Ind.).
[7] M.R. Pratap v. Income Tax Officer, (1992) 3 SCC 384 (Ind); *See* Carpenter Classic Exim Private Ltd. v. Commissioner of Customs, (2009) 11 SCC 293 (Ind.).
[8] Income Tax Act, No.43 of 1961, §179 (Ind.); Central Goods and Services Tax Act, No. 12 of 2017, §89 (Ind.).

III. ASCERTAINMENT OF 'INTENT' AND 'OBJECTIVE' OF THE CORPORATE TAXPAYER

The contemporary fiscal regulations, accentuated by their judicial interpretation,[9] place significant emphasis on the 'intent' and 'objective' of the taxpayer which implies examining the rationale for a particular tax position adopted by the company. This requirement translates into an appraisal of the internal corporate functioning by tax officers. Hence, internal corporate records, particularly board minutes, which evidence the key reasons for the company's decisions, are sought for by the Revenue authorities and often treated as evidence to cull or attribute allegations of contumacious conduct. The criticality of corporate records is particularly accentuated in anti-avoidance inquiries and instances of tax evasion where the fiscal law permits ascertainment of underlying intent[10] and affixation of criminal intent to the KMP, respectively. On a pragmatic level, this aspect has resulted in the corporate boards frequently seeking legal and expert opinions before the formalisation of decisions in order to delineate the tax consequences and also to record *bonafides* in the decision-making process, particularly in cases of complex fiscal regulations and contentious tax positions.

IV. LEGISLATIVE SANCTION FOR PIERCING OF CORPORATE VEIL

The separate entity principle, which forms the bedrock of corporate law, has traditionally been followed in the space of fiscal laws as well, except where judicial scrutiny has propelled the necessity for lifting the corporate veil.[11] However, while it was an exception earlier,[12] piercing of corporate veil is now

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[9] Commissioner of Customs v. Phoenix International Ltd., (2007) 10 SCC 114 (Ind.).
[10] Income Tax Act, No.43 of 1961, §95-102 (Ind.).
[11] *See generally*, Life Insurance Corporation v. Escorts Ltd., (1986) 1 SCC 264, paras 90-92 *inter alia* referring to Commissioner of Income Tax v. Sri Meenakshi Mills Ltd., (1967) 63 ITR 609 (SC); *See also*, Bennett Coleman & Co. v. Union of India, (1972) 2 SCC 788, para 11(Ind.); State of Rajasthan v. Gotan Lime Stone Khanji Udyog Pvt. Ltd., (2016) 4 SCC 469, para 24-27 (Ind.).
[12] *See* Juggilal v. Income Tax Officer, (1969) 73 ITR 702 (SC); Union of India v. Azadi Bachao Andolan, (2004) 10 SCC 1 para 115 (Ind.); Vodafone International Holdings BV v. Union of India, (2012) 6 SCC 613 para 79 (Ind.).

being increasingly sanctioned in fiscal legislation. Whether it be in a specific context (for illustration, in the wake of expansive scope of 'related persons'[13] in the fiscal laws) or on an omnibus basis (as an example, in the context of anti-avoidance rules[14]), the legislature seems to have recognised the growing chorus of the Revenue authorities citing the increasing tax-avoidance on account of sham corporate structures.[15] This trend is not confined to the anti-avoidance drive; to illustrate, the substantive changes to the income tax law to enact an indirect transfer tax[16] (which creates a tax charge in India even on account of offshore transactions) is a singular pivotal example that reflects the legislative seriousness to accord sanction to ignore corporate structures for tax purposes. Thus, tax considerations are now increasing and finding themselves in the agenda of offshore corporate boards.[17]

V. RELATED PARTY TRANSACTIONS: THE COMMON FULCRUM BETWEEN CORPORATE AND TAX LAW

There is also an interesting inter-linkage between corporate governance norms and tax laws; both place a special emphasis on scrutinising related party transactions ("**RPT**"). From an approach perspective, there is a conceptual distinction between the two laws. The corporate law prescribes a special framework for the regulation of RPTs[18] besides their specific review by the Audit Committee,[19]and additional reporting obligation,[20] the underlying objective

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[13] Central Excise Act, No. 1 of 1944, §4; *See* Union of India v. Bombay Tyre International, (1984) 1 SCC 467 (Ind.); Union of India v. Playworld Electronics (P) Ltd., (1989) 3 SCC 181(Ind.); Calcutta Chromotype Ltd. v. Commissioner of Central Excise, (1998) 3 SCC 681(Ind.); Commissioner of Central Excise v. Kwality Ice Cream Co., (2010) 13 SCC 722 (Ind.); Commissioner of Central Excise v. Detergents India Ltd., (2015) 7 SCC 198 (Ind.).

[14] Income Tax Act, No.43 of 1961, §98(1)(g) (Ind.).

[15] Vodafone International Holdings BV v. Union of India, (2012) 6 SCC 613(Ind.); Aditya Birla Nuvo Ltd. v. Deputy Director of Income Tax, (2012) 342 ITR 308 (Bom).

[16] Income Tax Act, No.43 of 1961, §9(1) Exp. 5 (Ind.).

[17] *See generally*, *Platform for Collaboration on Tax releases toolkit to help developing countries tackle the complex issues around taxing offshore indirect transfers of assets*, IMF (June 4, 2020) https://www.imf.org/en/News/Articles/2020/06/04/pr20235-platform-for-collaboration-on-tax-releases-toolkit-to-help-developing-countries.

[18] The Companies Act, No. 18 of 2013, §188 (Ind.).

[19] The Companies Act, No. 18 of 2013, §177(4)(iv) (Ind.).

being to ensure that the promoter dealings are not to the detriment of corporate stakeholders.[21] Tax laws also insist upon a review of the RPTs but towards ensuring that they are subjected to market-rate benchmarking.[22] Nonetheless, there is an interwoven interface between the two laws in so far as both generally follow the same arm's length standard as the basis to scrutinising RPTs.[23] Having said that, the company law does not elaborate on the nuances of the arm's length standards, which are expounded in the fiscal law paradigm, thereby resulting in the transmigration of the latter into the former's framework. In other words, the arm's length acts as a bridge that unifies the company law and tax law with respect of RPTs, meaning that the KMP are rather well advised to additionally examine corporate law compliance with the RPT framework in light of the fiscal stipulations as well.

VI. PLACE OF EFFECTIVE MANAGEMENT

As a thumb rule, most jurisdictions tax only locally sourced income of Non-Residents *vis-à-vis* the global income of resident taxpayers. Thus, in order to ascertain the extent of the tax charge, the ascertainment of residential status of the taxpayer becomes critical. For almost a decade now, the Indian income tax law has switched to a new basis for determining corporate tax residence. Earlier, the law employed the 'control and management' test, whereas now a company is considered to be a tax resident if its 'place of effective management' ("**POEM**") is in India.[24] The law itself clarifies that POEM "means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made."[25] Thus, the tax residence of the company has become ambulatory and trails the KMPs. Its

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[20] The Companies Act, No. 18 of 2013, §189 (Ind.).

[21] *See generally*, MINISTRY OF CORPORATE AFFAIRS, GOV'T OF IND., Related Party Transactions, https://www.mca.gov.in/content/mca/global/en/data-and-reports/reports/other-reports/report-company-law/related-party-transactions.html.

[22] Income Tax Act, No.43 of 1961, §92-94B (Ind.); Central Goods and Services Tax Rules, 2017, Gazette of India, pt. II, Rule 28.

[23] The Companies Act, No. 18 of 2013, §188(1), third proviso (Ind.); The Income Tax Act, No. 43 of 1961, § 92 (Ind.).

[24] Income Tax Act, No.43 of 1961, §6(3) (Ind.).

[25] Income Tax Act, No.43 of 1961, §6(3) Exp. (Ind.).

ascertainment also requires a close examination of their affairs in order to ascertain where the KMPs 'in substance' undertake the 'key management and commercial decisions' for the company. Besides the wide-ranging issues on the scope of POEM,[26] recent judicial exposition reveals minute and intense scrutiny of the location of KMP,[27] in addition to (and sometimes as a replacement to)[28] the place where the corporate decisions are taken in order to determine POEM and corporate residence. Thus, the location of board meetings and the presence of KMP need to be carefully planned, lest it lead to tax residence and concomitant consequences. The challenge becomes acute in the wake of technological advancements and corporate law relaxations that permit virtual meetings and thereby, *inter alia*, simultaneous presence of KMP across jurisdictions.

VII. NON-RECOGNITION OF DIFFERENT FORMS OF DIRECTORSHIP

As a critical departure from corporate laws, the provisions under the tax laws that impute liability upon the directors do not factor in the nuanced distinction between executive and non-executive ones or the other classes such as nominee directors, independent directors, etc. Resultantly, the burden is indiscriminately upon all directors (and KMPs) to establish the absence of neglect, misfeasance, breach of duty on their part in relation to the affairs of the company in order to avoid penal consequences.[29] Thus, it is expedient even for non-executive directors and other KMP to maintain distinct records that establish the extent of their knowledge and participation in the company's affairs, as if preparing in advance against the eventuality of corporate default.

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[26]*See generally*, Ashrita prasad Kotha, *Place of Effective Management Test in the Income Tax Act, 1961: Is it the Right Way Forward ?*, 8 NUJS L REV 13 (2015).

[27] *Tiger Global International II Holdings, Mauritius, In re* (2020) 429 ITR 288 (AAR).

[28] Mansarovar Commercial Pvt. Ltd. v. Commissioner of Income Tax, (2023) 453 ITR 661 (SC) (Ind.) [Review Petition Civil No. 727/2023 dismissed vide order dated 13.07.2023].

[29] The Income Tax Act, No. 43 of 1961, §179(1) (Ind.) §(1), The Income Tax Act, No. 43 of 1961, §278 (Ind.); Central Goods and Services Tax Act, No. 12 of 2017, §88(3) (Ind.); Central Goods and Services Tax Act, No. 12 of 2017, §89(1) (Ind.).

VIII. GLOBAL TAX COORDINATION

Besides the ongoing impetus towards globally aligned substantive tax rules to tax multinational enterprise ("**MNE**")[30] at an administrative level, especially in the last decade, there has been a significant thrust to enjoin the tax administrations across jurisdictions so as to undertake a coordinated action against taxpayers. Besides the mandatory tax reporting of the entire MNE group,[31] tax officers are now far better equipped to examine tax positions and address country-specific deviations in view of the international capacity-building programmes for tax officers[32] and wide network of 'exchange of information' forums between jurisdictions both at multilateral[33] and bilateral levels[34]. Additionally, in various cases the bilateral tax treaties themselves call upon the tax authorities to coordinate between jurisdictions, such as for determining taxpayers' entitlement to Tax Residency Certificate[35], beneficial ownership,[36] etc. The cross-sharing of information between different regulators and increased international collaboration, therefore, confirms the need for a coordinated approach towards tax compliances even within the overall corporate group at a global level.

IX. INCREASING INTERFACE BETWEEN ANTI-MONEY LAUNDERING AND FISCAL LEGISLATIONS

With the pursuit of 'black money' being a pioneering force shaping contemporary developments in fiscal laws, they have come to be forcefully intertwined with anti-money laundering ("**AML**") legislations. In fact, various

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30 *OECD BEPS*., https://www.oecd.org/tax/beps/.
31 Income Tax Act, No.43 of 1961, §286 (Ind.).
32 Tax Inspectors without Borders, https://www.tiwb.org/.
33 Global Forum on Transparency and Exchange of Information for Tax Purposes, https://www.oecd.org/tax/transparency/.
34 Automatic Exchange of Information and Exchange of Information on Request, https://incometaxindia.gov.in/Pages/eoi/exchange-of-information.aspx.
35 *See* Blackstone Capital Partners (Singapore) VI FDI Three PTE Ltd. v. Assistant Commissioner of Income Tax, (2023) 452 ITR 111 (Del).
36 *See* Director of Income Tax (International Taxation) v. Universal International Music B.V., [2013] 214 Taxman 19 (Bom).

offences under fiscal laws form predicate offences under the Indian AML law, thereby implying cascading AML consequences owing to defaults arising under the fiscal regulations.[37] Furthermore, pragmatically, simultaneous investigations under fiscal AML laws are the order of the day. These developments further call upon the corporate boards to assign accentuating priority to tax agenda and broader, rather than concurrent, oversight of the tax and corporate law compliance functions.

X. OTHER ASPECTS

There are a variety of other avenues where tax laws intersect with corporate functioning. Some of these aspects are listed below;

(1) In view of the overwhelming developments in the fiscal law paradigm, which affect, rather, redefine the scope of Merger and Acquisition ("**M&A**") transactions,[38] corporate boards require to tread a delicate path within this space with fiscal laws virtually reshaping the board agenda.[39]

(2) Indian fiscal laws are increasingly expanding to cover extra-territorial events. The indirect transfer tax, discussed earlier, is one such illustration. As another illustration, the scope of customs law has been expanded to "any offence or contravention thereunder committed outside India by any person",[40] thereby ascribing tax liabilities to non-residents involved in exportation of goods to India or, in view of another expansion,[41]*inter alia* affixing liability on non-residents engaged in importation of goods in India. Thus, the role of KMP, not just those stationed in India, but also within the global corporate group, needs to be revisited.

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[37] Prevention of Money Laundering Act, No. 15 of 2003, The Schedule.
[38] *See* Tarun Jain, *Steering influence of Tax laws over M&A transactions: Reflections on changing landscape in India*, 1 J. of Tax L. (HNLU, Shimla) 37-50 (2022).
[39] Income Tax Act, No.43 of 1961, §281 (Ind.); Central Goods and Services Tax Act, No. 12 of 2017, §81 (Ind.).
[40] The Customs Act, No. 52 of 1962, §1(2) (Ind.).
[41] The Customs Act, No. 52 1962, §2(3A), §2(20) and §2(26) (Ind).

(3) Contemporary global developments linking taxes with allied areas also pose a challenge for corporate boards. For illustration, the growing fade for ESG[42], EU carbon border adjustment,[43] etc. as such are not pivoted on tax laws and yet have an overwhelming linkage with them. Thus, these issues cannot be routinely relegated to mid-corporate executives, akin to tax compliance, and instead require extensive oversight by KMP.

(4) Addressing reputational issues that arise on account of tax investigations is also acritical challenge that directly faces corporate boards and KMP and is now increasingly getting the attention of the mainstream media. The fact that growing economic activity results in bulging tax demands compounds public perception issues, thereby landing them directly on the board agenda.

XI. CONCLUSION

The aforesaid aspects, which are only illustrative and not in any sense exhaustive, reflect an increasingly overwhelming bearing of fiscal law considerations, which are virtually dictating the affairs of corporate management in a variety of ways and in wide-ranging circumstances. It is therefore not surprising that corporate boards and other KMP are frequently seeking to directly interact with tax experts, perhaps in a bid to appreciate the finer nuances and the consequences of the fiscal laws. The scope of such interactions, which were earlier largely limited to M&A activity, has expanded, in view of large stakes and sizeable penal consequences for default, even in respect of intricate fiscal regulations the analysis of fine print of which was earlier routinely relegated to the corporate executives.

[42] *See generally*, Manoj Pardasani, *How ESG has given tax a new look*, Econ. Times (Apr. 05, 2023) https://economictimes.indiatimes.com/small-biz/sme-sector/how-esg-has-given-tax-a-new-look/articleshow/99256289.cms.

[43] *See generally*, European Commission, Carbon Border Adjustment Mechanism, https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en.

AN OVERVIEW OF INDIA'S NEW DATA PROTECTION LAW

*Dr. Deborshi Barat**

ABSTRACT

*The recently published Digital Personal Data Protection Act, 2023 ("**DPDP Act"/"Act**") aims to redefine India's legal framework governing personal data. Although the DPDP Act is not yet in force (as of the time of writing), it will become enforceable as soon as it gets notified by the Central Government (the "Government"). While different dates may be appointed for different provisions, several of the DPDP Act's provisions contemplate specific rules that are yet to be prescribed (as of the time of writing).*

Once the new framework takes effect, the existing data protection regime in India will be rendered obsolete. Accordingly, to the extent that the DPDP Act and its rules deviate from the existing regime, such differences need to be accounted for – including the ways in which all organizations need to handle each and every kind of personal data – whether such data is considered 'sensitive' or not. Based on recent reports, it appears that the Government may provide only a few months for entities to align their respective processes and business operations with statutory obligations under the new regime.[1]

*Broadly, the DPDP Act seeks to establish a framework to protect the digital personal data of, and/or related to, specifically identifiable individuals ("**data principals**"). In that respect, the law imposes obligations and limitations on the processing of such data by ("**data fiduciaries**"), i.e., those entities which determine the purpose and means of processing personal data, including in conjunction with other entities.*

Accordingly, entities that are likely to be considered data fiduciaries under the DPDP Act will need to start planning for, and designing, their compliance strategies with respect to such new obligations. In addition, the Government may assess an entity's status in terms of how onerous its obligations should be, based on the nature and scale of its data processing. Such

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[1] Rajat Sethi & Deborshi Barat, *All Aboard: Getting Ready for India's New Data Protection Journey,* S&R ASSOCIATES, (Aug. 08, 2023) https://www.snrlaw.in/all-aboard-getting-ready-for-indias-new-data-protection-journey/.

*entities, called 'significant data fiduciaries' ("**SDFs**"), will have additional obligations under the DPDP Act – i.e., in addition to those that all data fiduciaries need to comply with.*

Given the quantum of financial penalties involved, non-compliance and/or breaching specific obligations under the DPDP Act may prove prohibitively expensive for most organizations.[2] *While waiting for the Government to frame rules and notify provisions of the DPDP Act, organizations could use this transitional phase to prepare for future compliance requirements. Accordingly, data fiduciaries should draw up a compliance roadmap, the starting point of which ought to include a comprehensive data inventory – i.e., an internal data mapping exercise for ascertaining where and how personal information is lodged within their systems; in what form; for what purpose; and who the individuals related to such data are.*[3]

Importantly, while auditing a data trail through the entire lifecycle of personal data, organizations also need to check with third parties (e.g., other data fiduciaries with whom and/or to which such personal data has been shared and/or transferred), data processors, vendors and other parties in their supply chain to examine how personal information is stored and/or processed by such entities. These entities may also need to be brought on board in terms of adopting more sophisticated approaches to data management relative to past practices.

Keywords: Digital Data Protection, Personal Data, GDPR, Significant Data Fiduciary.

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[2] Deborshi Barat, *Yes Means Yes: Managing Consent Under India's New Data Protection Law,* S&R ASSOCIATES, (Sept. 20, 2023) https://www.snrlaw.in/yes-means-yes-managing-consent-under-indias-new-data-protection-law/.

[3] Deborshi Barat, *It's Personal: A Roadmap for Data Mapping in Digital India,* S&R ASSOCIATES, (Sept. 13, 2023) https://www.snrlaw.in/its-personal-a-roadmap-for-data-mapping-in-digital-india/.

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I. INTRODUCTION

The Act[4] was published in India's official gazette pursuant to a notification dated August 11, 2023,[5] after the approval of both houses of the Indian parliament and the President of India.[6] The DPDP Act is not effective as of the time of writing. It will become effective from the date(s) notified by the Government, and different dates may be notified for different provisions of the Act. Also, the Government may notify rules in the future, are not inconsistent with the provisions of the Act, to carry out the purposes of the new law. As of the time of writing, it appears that the Ministry of Electronics and Information Technology ("**MEIT**") has set a tentative deadline of January 31, 2024, for the purpose of notifying such rules pursuant to stakeholder consultations.[7]

II. BACKGROUND

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[4] Digital Personal Data Protection Act, No. 22 of 2023 (Ind.).
[5] Digital Personal Data Protection Act, No. 22 of 2023 (Ind.).
[6] Deborshi Barat, *'22/'23 Vision: Because India's 2022 Draft Data Protection Law is so Last Year,* S&R ASSOCIATES, (Aug. 07, 2023) https://www.snrlaw.in/22-23-vision-because-indias-2022-draft-data-protection-law-is-so-last-year/.
[7] Gulveen Aulakh & Shouvik Das, *Data Privacy Rules to be issued for consultation shortly: Rajeev Chandrasekhar,* LIVE MINT (Dec. 28, 2023) https://www.livemint.com/news/data-privacy-rules-to-be-issued-for-consultation-shortly-rajeev-chandrasekhar-11703772692563.html.

The DPDP Act seeks to overhaul the current legal framework[8] governing personal data,[9] which is based on Section 43A of the Information Technology Act, 2000,[10] along with rules framed under such provision ("**IT Rules**").[11] Rapid developments in digital technology,[12] the absence of a specific data privacy law, and the Supreme Court of India's judgement to classify privacy as a fundamental right under the Indian constitution[13] are among the factors that led to the adoption of the new legislation.

The DPDP Act defines data, personal data,[14] and digital personal data.[15] "Personal data" is defined broadly to mean any data about an individual who is identifiable by or in relation to such data, and "digital personal data" means personal data in digital form.

Unlike the IT Rules or the General Data Protection Regulation ("**GDPR**") of the European Union, the DPDP Act does *not* classify data into 'sensitive'[16] or 'special' categories. Instead, entities that process any digital personal data will be required to implement appropriate technical and organizational measures to

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[8] Deborshi Barat, *Personal and Non-Personal Data in Digital India: Before and After,* S&R ASSOCIATES, (May 17, 2023) https://www.snrlaw.in/personal-and-non-personal-data-in-digital-india-before-and-after/.
[9] Deborshi Barat, *Defining the Scope of 'Personal Data' in Digital India,* S&R ASSOCIATES, (July 12, 2023) https://www.snrlaw.in/defining-the-scope-of-personal-data-in-digital-india/; *See also:* Deborshi Barat, *What We Talk About When We Talk About Personal Data,* S&R ASSOCIATES, (June 14, 2023) https://www.snrlaw.in/what-we-talk-about-when-we-talk-about-personal-data/.
[10] Information Technology Act, No. 21 of 2000 (Ind.).
[11] Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011, Gazette of India, pt. II § 3(i) (Apr. 11, 2011).
[12] Deborshi Barat, *India's Proposed Digital Governance Framework: Past Developments and Present Status,* S&R ASSOCIATES, (May 24, 2023) https://www.snrlaw.in/indias-proposed-digital-governance-framework-past-developments-and-present-status/; *See also:* Deborshi Barat, *Back to the Future: India's Proposed Digital Governance Framework,* S&R ASSOCIATES (May 31, 2023) https://www.snrlaw.in/back-to-the-future-indias-proposed-digital-governance-framework/.
[13] Justice K.S. Puttaswamy v. Union of India, (2019) 1 SCC 1 (Ind.).
[14] Deborshi Barat, *What We Talk About When We Talk About Personal Data,* S&R ASSOCIATES (June 14, 2023) https://www.snrlaw.in/what-we-talk-about-when-we-talk-about-personal-data/.
[15] Barat*, supra* note 9.
[16] Deborshi Barat, *Sense and Sensitivity: 'Sensitive' Information Under India's New Data Regime,* S&R ASSOCIATES (July 27, 2023) https://www.snrlaw.in/sense-and-sensitivity-sensitive-information-under-indias-new-data-regime/.

ensure compliance with the new law. As long as such data remains in their possession or control, entities will remain responsible for protecting it, including with respect to separate processing tasks undertaken by data processors on their behalf.

The DPDP Act distinguishes between a data principal, data fiduciary, and data processor, as follows:

1. a **data principal** is an individual to whom the personal data relates and includes the parents or lawful guardian of such individual if the individual is a 'child' (*i.e.,* a person less than 18 years old) or a person with a disability.

2. a **data fiduciary** is any person who alone or in conjunction with another person determines the purpose and means of processing personal data.

3. a **data processor** is any person who processes personal data on behalf of a data fiduciary.[17]

Broadly, the DPDP Act seeks to establish a framework to protect the digital personal data of, and/or related to, specifically identifiable individuals (*i.e.*, data principals). In that respect, the law imposes obligations and limitations on the processing of such data-by-data fiduciaries. Accordingly, the DPDP Act seeks to set up an enforceable system that involves:

- securing explicit permission from each data principal before collecting and/or processing their personal information;

- giving data principals the right to specify a limited purpose with respect to which they approve the use of their data;

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[17] Sandip Bhagat & Deborshi Barat, *India's New Law: The Digital Personal Data Protection Act, 2023,* S&R Associates (Aug. 13, 2023) https://www.snrlaw.in/indias-new-law-the-digital-personal-data-protection-act-2023/.

- providing data principals with an option to withdraw their permission later, unless the purpose specified is rendered moot and/or no longer applies before such consent can be withdrawn; and
- requiring personal data to not be retained once the purpose of processing has been accomplished.[18]

Accordingly, entities that are likely to be considered data fiduciaries under the DPDP Act will need to start planning for, and design, their compliance strategies with respect to such new obligations. In addition, the Government may assess an entity's status in terms of how onerous its obligations should be, based on the nature and scale of its data processing. Such entities, called 'significant data fiduciaries' (discussed below), will have additional obligations under the DPDP Act – *i.e.*, in addition to those that all data fiduciaries need to comply with.[19]

Accordingly, all entities need to start thinking about these new compliance requirements, including in terms of the rules that are likely to instrumentalize various provisions of the DPDP Act, such as with respect to the following:

- templates and methods (*e.g.*, for providing notices and seeking consent)
- procedures (*e.g.*, with respect to data breach notifications, obtaining verifiable parental consent for processing children's data and establishing an effective grievance redressal mechanism)
- processes (*e.g.*, for conducting data protection impact assessments, where applicable), and
- various other details (*e.g.*, relevant periods for compliance, registration conditions, and accountability mechanisms)

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[18] Barat, *supra* note 2.
[19] Deborshi Barat, *The Importance of Being 'Significant': Significant Data Fiduciaries Under India's Proposed Data Protection Regime,* S&R ASSOCIATES (July 19, 2023) https://www.snrlaw.in/the-importance-of-being-significant-significant-data-fiduciaries-under-indias-proposed-data-protection-regime/.

Given the quantum of financial penalties involved, non-compliance and/or breaching specific obligations under the DPDP Act may prove prohibitively expensive for most organizations.[20]

III. APPLICABILITY[21]

The DPDP Act applies to:

- the processing of digital personal data within the territory of India, where the personal data is collected in (i) digital form; or (ii) non-digital form and digitized subsequently.
- the processing of digital personal data outside the territory of India, if such processing is in connection with any activity relating to the offering of goods and services to data principals within the territory of India.

The DPDP Act does *not* apply to:

- personal data processed by an individual for any personal or domestic purpose.
- personal data that is made or caused to be made publicly available by (i) the data principal to whom such personal data relates; or (ii) any other person who is under an obligation under any Indian law to make such personal data publicly available. As an example of the former, if an individual makes available their personal data while blogging their views, the provisions of the Act will not apply.
- the processing of personal data (i) by Government-notified state instrumentalities for reasons of national or public interest; or (ii) if it is necessary for research, archiving or statistical purposes as long as such data is not used to take any decision-specific to a data principal and such processing remains consistent with prescribed standards.

[20] Barat*,* *supra* note 1.
[21] *Id.*

The DPDP Act defines "processing" in relation to personal data to mean a wholly or partly automated operation (or set of operations) performed on digital personal data, and includes operations such as collection, storage, retrieval, use, sharing, disclosure by transmission, dissemination or otherwise making available, restriction, erasure or destruction.[22]

In summary, the DPDP Act establishes a legal framework to protect digital personal data, including by prohibiting the unauthorized use, alteration, or sharing of information in a way that compromises the confidentiality, integrity, and/or accuracy of such data.

IV. RIGHTS AND OBLIGATIONS

The Act provides rights for data principals and imposes obligations on data fiduciaries such as the following:

A. COLLECTION AND PROCESSING

- Personal data can be processed only under the provisions of the Act and for a lawful purpose (i) for which the data principal has provided free, specific, informed, unconditional, and unambiguous consent with clear affirmative action, thus signifying an agreement to such processing for a specified purpose (where processing is limited to the data necessary for such purpose); or (ii) for certain legitimate uses.[23]
- The Act sets out certain grounds or legitimate uses for the disclosure or processing of personal data without the data principal's consent. For example, personal data may be processed non-consensually for the purpose of employment, including to safeguard the employer from loss or liability, such as to: (i) prevent corporate espionage; (ii) maintain

[22] Barat, *supra* note 17.
[23] Deborshi Barat, *Daring to Deem? 'Deemed' Consents Under India's Proposed Data Protection Law,* S&R ASSOCIATES (June 28, 2023) https://www.snrlaw.in/daring-to-deem-deemed-consents-under-indias-proposed-data-protection-law/.

confidentiality, trade secrets, intellectual property, classified information; or (iii) provide any service or benefit sought by an employee. In addition, certain acts of processing related to state services and/or sovereign functions, public/national interest, mandatory legal disclosures or judicial obligations, and medical or public health emergencies may constitute legitimate use.

B. NOTICE AND CONSENT[24]

- Where consent is the basis of processing, the data principal will have the right to withdraw such consent at any time, and the data fiduciary must ensure that withdrawing is as easy to do as the giving of consent.
- Every request for consent is required to contain certain specified information and must be presented in clear and plain language, including by giving data principals the option to access it in English or any language specified in the Eighth Schedule to the Constitution of India.
- Each request for consent must be preceded or accompanied by a notice that sets out certain specified information in a manner to be prescribed through rules, including the way in which the data principal may make a complaint to the Data Protection Board of India ("**Board**").
- Where the data principal has given consent prior to the commencement of the DPDP Act, the above notice is required to be sent as soon as reasonably practicable, although the data fiduciary may continue processing such data until the corresponding consent is withdrawn.

C. DATA PRINCIPALS HAVE CERTAIN RIGHTS, INCLUDING:

- accessing information about their personal data;
- having their personal data corrected or erased;

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[24] Deborshi Barat, *Notice and Consent Requirements in India's New Digital Data Regime,* S&R ASSOCIATES (June 21, 2023) https://www.snrlaw.in/notice-and-consent-requirements-in-indias-new-digital-data-regime/.

- accessing a grievance redressal mechanism; and
- nominating another person to exercise their rights in the event of death or incapacity.

D. TRANSFER OF PERSONAL DATA OUTSIDE INDIA[25]

A transfer of personal data outside India is allowed except to countries/territories restricted by the Government through notification. However, the DPDP Act specifies that the provisions are in addition to, and not in derogation of, any other law in force. Therefore, other regulations may also apply to the transfer of data outside India. For instance:

- the Reserve Bank of India issued a directive in April 2018[26] with respect to the storage of payment system data, directing such data to be stored in a system located in India alone.[27]
- the Securities and Exchange Board of India issued a circular in March 2023 in connection with the framework for adopting cloud services by regulated entities, which requires data to reside and be processed within the legal boundaries of India, subject to certain conditions.[28]
- the Insurance Regulatory and Development Authority of India framed regulations in April 2017 related to the outsourcing of activities by Indian insurers, which require original policyholder records to be maintained in India.[29]

E. DATA FIDUCIARIES HAVE CERTAIN OBLIGATIONS INCLUDING:

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[25] Deborshi Barat, *How India holds up against EU, Brazil in data laws,* THE HINDU BUS. LINE (Aug. 01, 2023) https://www.thehindubusinessline.com/business-laws/how-data-protection-bill-compares-with-eu-brazil/article67138125.ece.

[26] Reserve Bank of India, Storage of Payment System Data, DPSS.CO.OD No.2785/06.08.005/2017-2018 (Apr. 06, 2018).

[27] *See* Reserve Bank of India, FAQs on Storage of Payment System Data (June 26, 2019).

[28] Securities and Exchange Board of India, Framework for Adoption of Cloud Services by SEBI Regulated Entities SEBI/HO/ITD/ITD_VAPT/P/CIR/2023/033 (Mar. 06, 2023).

[29] Insurance Regulatory and Development Authority of India (Outsourcing of Activities by Indian Insurers) Regulations, 2017, Gazette of India, pt. III § 4 (May 5, 2017).

- ensuring the completeness, accuracy, and consistency of personal data;
- undertaking reasonable security safeguards to prevent a data breach;
- informing the Board and the affected data principal in the event of a breach; and
- erasing personal data as soon as the specified purpose has been met and retention is not necessary for legal purposes.

F. EXEMPTIONS FROM MOST SUCH OBLIGATIONS MAY BE AVAILABLE IN CASES OF:

- enforcement of legal rights or claims;
- processing of personal data by a court, tribunal, or any other judicial or quasi-judicial body;
- prevention, detection, investigation, or prosecution of an offence;
- a court-approved scheme of merger or amalgamation or demerger; and
- for defaults in payment due on account of a loan from a financial institution.

G. DATA FIDUCIARY AND DATA PROCESSOR

- In general, a data processor may be engaged by a data fiduciary to process personal data on the latter's behalf for any activity relating to the offering of goods or services to data principals only under a valid contract.[30]
- In case of processing of personal data of individuals outside India pursuant to a contract between a person resident in India and a person resident outside India, the obligations of data fiduciaries, the rights of

[30] Deborshi Barat, *Contractual Arrangements Under India's New Data Protection Law: A Data Fiduciary's Guide to the Data Processing Universe,* S&R ASSOCIATES (Oct. 4, 2023) https://www.snrlaw.in/contractual-arrangements-under-indias-new-data-protection-law-a-data-fiduciarys-guide-to-the-data-processing-universe/.

data principals, and restrictions on cross-border transfers under the DPDP Act will generally not apply.

V. SIGNIFICANT DATA FIDUCIARY[31]

The Government has been empowered to notify any data fiduciary (or a class of data fiduciaries) as an SDF pursuant to an assessment of factors prescribed under the DPDP Act, along with other factors as deemed necessary by the Government.

Additional obligations apply to SDFs such as appointing a data protection officer ("**DPO**") and an independent data auditor and undertaking periodic data protection impact assessments and audits. The DPO is required to be an individual based in India who will be responsible to the board of directors or similar governing body of the SDF for the purpose of representing such SDF under the provisions of the Act. These additional obligations will apply to SDFS over and above the general obligations that are applicable to all data fiduciaries.

A. PROCESSING CHILDREN'S DATA[32]

While processing children's personal data, a data fiduciary is required to: (i) obtain verifiable parental consent (or consent of the lawful guardian, where applicable); (ii) not undertake tracking, behavioral monitoring, or targeted advertising; and (iii) not undertake processing of personal data which is likely to cause a detrimental effect on the well-being of a child. Under certain

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[31] Deborshi Barat, *How Much and How Bad? Significant Others in India's New Data Regime,* S&R Associates (Aug. 2, 2023) https://www.snrlaw.in/how-much-and-how-bad-significant-others-in-indias-new-data-regime/; *See also*: Deborshi Barat, *The Importance of Being 'Significant': Significant Data Fiduciaries Under India's Proposed Data Protection Regime,* S&R ASSOCIATES (July 19, 2023) https://www.snrlaw.in/the-importance-of-being-significant-significant-data-fiduciaries-under-indias-proposed-data-protection-regime/.

[32] Deborshi Barat, *Child's Play in Digital India: Handling Teen Data with Kid Gloves?* S&R ASSOCIATES (June 07, 2023) https://www.snrlaw.in/childs-play-in-digital-india-handling-teen-data-with-kid-gloves/; *See also:* Deborshi Barat, *No kidding with digital data protection,* THE HINDU BUS. LINE (June 18, 2023) https://www.thehindubusinessline.com/business-laws/no-kidding-with-digital-data-protection/article66980207.ece.

circumstances, the Government may lower the age limit for a particular data fiduciary.

VI. ADMINISTRATIVE FRAMEWORK[33]

In terms of the administrative framework, the Board will be established by the Government, comprising technical and subject-matter experts. The Board can be approached by aggrieved individuals once options under the mandated grievance redressal mechanism have been exhausted. Decisions of the Board will be appealable to the Telecom Disputes Settlement and Appellate Tribunal ("**TDSAT**"), with a final appeal to the Supreme Court of India. The Board and the TDSAT are proposed to be 'digital' in design, as far as practicable. Further, the DPDP Act contemplates an alternative dispute resolution process conducted by mediators chosen by the disputing parties pursuant to mutual agreement.

Upon being informed by a data fiduciary about a personal data breach, the Board may direct any urgent remedial or mitigation measure. In addition, it has the power to inquire into breaches and impose penalties. The Board's powers of inquiry (based on principles of natural justice) and imposition of penalty may get triggered pursuant to a complaint made by a data principal in respect of alleged instances of non-observance relating to a data fiduciary's obligations, a reference made by the Government, or the directions of a court. After giving the person concerned an opportunity to be heard and after recording their reasons in writing, the Board may issue such binding directions as it may consider necessary.

For the purposes of discharging its functions under this Act, the Board will have the powers of a civil court in respect of matters relating to (i) summoning and enforcing the attendance of any person and examining them on oath; (ii) receiving evidence of affidavit requiring the discovery and production of

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[33] Deborshi Barat, *Grievance Redressal and Dispute Resolution Under the DPDP Act,* S&R ASSOCIATES, (Sept. 25, 2023) https://www.snrlaw.in/grievance-redressal-and-dispute-resolution-under-the-dpdp-act/; *See also:* Deborshi Barat, *Data Protection. Decoding the grievance redressal process in DPDP Act*, THE HINDU BUS. LINE (Sept. 24, 2023) https://www.thehindubusinessline.com/business-laws/decoding-the-grievance-redressal-process-in-dpdp-act/article67340728.ece.

documents; (iii) inspecting any data, book, document, register, books of account or any other document; and (iv) such other matters as may be prescribed.

VII. GOVERNMENT POWERS

The Government has given itself wide powers under the DPDP Act, ranging from:

- rule-making and legal immunity (subject to a 'good faith' qualifier);
- granting exemptions to, and imposing additional obligations upon, certain entities via notification on the basis of prescribed factors;
- setting up, and overseeing the operations of the Board;
- calling upon entities to provide information as deemed necessary;
- taking strict measures such as blocking commercial online platforms from public access when they are owned and/or operated by repeat offenders.

VIII. CONSENT MANAGER[34]

In addition to data principals, data fiduciaries, and data processors, **consent managers** constitute another important entity category under the DPDP Act. Data principals will be allowed to give, manage, review, or withdraw their consent through a consent manager, which is required to be registered with the Board to act as a single point of contact for providing consent-related options to multiple individuals through an interoperable platform. Consent managers will remain accountable to data principals, including through technical, operational,

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[34] Barat, *supra* note 2. *See also:* Deborshi Barat, *India's Digital Public Infrastructure Could Have All the Answers to Questions Under the DPDP Act,* S&R ASSOCIATES (Oct. 23, 2023) https://www.snrlaw.in/indias-digital-public-infrastructure-could-have-all-the-answers-to-questions-under-the-dpdp-act/. *See also:* Deborshi Barat, *India's digital public infrastructure could have all the answers for the data privacy problem*, THE HINDU BUS. LINE (Oct. 22, 2023) https://www.thehindubusinessline.com/business-laws/indias-digital-public-infrastructure-could-have-all-the-answers-for-the-data-privacy-problem/article67448661.ece.

financial, and other eligibility conditions pursuant to which their registration and duties will oblige them to provide grievance redressal options.

IX. PENALTIES

Monetary penalties for non-compliance can range from INR 10,000 to INR 2.5 billion, depending upon the contravention. If the Board determines upon conclusion of an inquiry that non-compliance by a person is significant, it may, after giving the person a reasonable opportunity of being heard, impose a monetary penalty as specified in the DPDP Act according to the nature of offence having regard to certain factors such as (i) the nature, gravity, duration and repetitive nature of the breach; (ii) the type and nature of the personal data affected by the breach; (iii) realization of gain or avoidance of loss as a result of the breach; (v) mitigation actions undertaken in respect of the breach; and (vi) proportion, likely impact and effectiveness of the monetary penalty. If an SDF fails to fulfil its additional obligations under the DPDP Act, a monetary penalty of up to INR 1.5 billion may be imposed.

X. KEY TAKEAWAYS

The DPDP Act defines both 'personal data' and 'processing' in broad terms. As a result, various partially automated operations that companies routinely perform on (or with respect to) digitized data are likely to come under the ambit of India's new law – even if such data is only indirectly related to specific individuals.

Organizations need to check whether and to what extent the Act applies to them and their operations.[35] With respect to notice and consent[36] requirements, they should be prepared to go back to individuals once the Act becomes effective. Organizations that collect, process, and monetize personal data need to ascertain where, how, and whose personal information is lodged within their systems.[37] Although the provisions of the DPDP Act are not effective as yet,

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[35] Barat, *supra* note 1.
[36] Barat, *supra* note 2.
[37] Barat, *supra* note 3.

organizations also need to consider improving their information technology and cybersecurity systems to meet the new compliance requirements, including with respect to breaches. Relatedly, organizations will need to monitor entities in their supply chains, such as suppliers, about data processing obligations, and review existing contractual arrangements.[38]

While waiting for the Government to frame rules and notify provisions of the DPDP Act, organizations could use this transitional phase to prepare for future compliance requirements. Accordingly, data fiduciaries should draw up a compliance roadmap, the starting point of which ought to include a comprehensive data inventory – *i.e.*, an internal data mapping exercise for the purpose of ascertaining where and how personal information is lodged within their systems; in what form; for what purpose; and who the individuals related to such data are. [39]

This exercise, in turn, could involve the following steps:

Step 1: *Understanding the scope and definition of personal data under the DPDP Act*

Organizational databases are likely to contain vast volumes of information. Not all of such data may be considered 'personal'. The DPDP Act defines personal data as any data about an individual who is identifiable by or in relation to such data.

In most situations, a dataset is very likely to be 'mixed', *i.e.*, composed of both personal and non-personal data. Examples of mixed datasets include datasets in a bank where customer information is clubbed together with transaction details (including those involving payment services through credit and debit cards or loan agreements). In addition, some banks use customer relationship management ("**CRM**") services provided by third-party partners. Data held in a CRM environment may include personal information related to customers, such as their postal and email addresses, as well as information about the products

[38] Barat, *supra* note 30.
[39] Barat, *supra* note 3.

and services they purchase along with sales reports – including aggregated data. Such datasets can therefore include both personal and non-personal customer information.

Since 'Identifiability' is a central feature of personal data, entities could consider subjecting certain information to de-identification processes. Pseudonymization and anonymization are some such techniques. Pseudonymization refers to a process of disguising identities which reduces the risk of harm if and when a breach occurs. Anonymization relates to a process pursuant to which all identifying elements are eliminated from a personal dataset. Thus, when personal information is rendered anonymous in a way where the individual concerned is no longer identifiable, it may cease to remain personal. However, for data to be truly anonymized, the de-identification procedure involved must be truly irreversible.

The DPDP Act does not explicitly refer to, or exclude, anonymized data from its ambit. However, as long as it can be shown that the data in question does not identify a specific individual (whether on its own or in conjunction with other information) – such data is likely to remain exempt from the application of the DPDP Act. Since anonymization is a standard practice in data aggregation processes, data fiduciaries could consider the employment of such techniques if their business and commercial aims are limited to obtaining aggregated insights only (*e.g.*, to examine a general trend or demographic).

Step 2: *Determining what personal data is collected and/or used by the organization*

This step should also include ascertaining the different *types* and/or *categories* of personal data which are being – or have already been – collected, processed and stored by each department or division within the organization, including through questionnaires distributed among business heads, managers and departmental supervisors.

Step 3: *Finding out where the data is stored and processed – including which third-party systems or cloud service providers house such data, and where those servers are located*

Step 4: *Mapping where the data goes from the point of collection, receipt or transfer, across the organization, including (i) internally through one or several business departments; and (ii) externally to vendors, processors or other third parties*

Step 5: *Determining (i) the identities of the individuals related to such personal data; and (ii) how long such data is retained by the organization, and in what formats.*

Step 5 could include ascertaining if the data is structured or not. Each individual whose personal data is being – or has already been – processed by the organization needs to be specifically identified from organizational databases. Once the DPDP Act takes effect, such individuals need to be contacted for the purpose of giving statutory notices in the prescribed form. However, in the case of proprietary processes or systems that store unstructured data, certain manual interventions and discovery modes may also be necessary.

Importantly, while auditing a data trail through the entire lifecycle of such personal data, organizations also need to check with third parties (*e.g.*, other data fiduciaries with whom, and/or to which, such personal data has been shared and/or transferred; data processors; vendors; and other parties in their supply chain) to examine how personal information is stored and/or processed by such entities. These entities may also need to be brought on board in terms of adopting more sophisticated approaches to data management relative to past practices.[40]

A. DATA GOVERNANCE POLICIES AND TRAINING

All organizations may need to organize internal sensitization workshops, including across marketing and sales departments, about data handling and consent management practices. Further, organizations may specifically have to conduct data privacy training and awareness programs for employees and contractors who handle personal information and monitor consent. A chief information security officer ("**CISO**") could ensure compliance with standard operating procedures that contain easy-to-understand consent tracking

[40] Barat, *supra* note 2.

protocols. Such procedures should stem from, and complement, an internal data governance policy related to information protection, including through the adoption of appropriate technical safeguards and organizational measures – *e.g.*, by widely disseminating knowledge within the organization about reasonable security procedures and protocols. An organization's data governance policy could also include fundamental principles with respect to (i) notice and consent management, (ii) data retention and erasure, (ii) confidentiality, and (iii) data integrity.

B. NOTICE AND CONSENT

Next, entities need to start planning for their legacy databases – even if consent had been obtained in the past. Accordingly, organizations could invest in appropriate technological expertise such that these legacy databases can be ingested into platforms (including outsourced ones) – which, in turn, may need to be secured through appropriate agreements with information technology ("**IT**") infrastructure providers.

Once the DPDP Act enters into force, those individuals who may have consented to the processing of their personal data before the DPDP Act took effect need to be provided with notices afresh – and within a reasonable time – such that each notice contains specific informational categories in a templated form and is served in a specific manner, details of which will be notified through separate rules prescribed by the Government. Further, these notices need to be made available in over twenty languages if specific individuals so required. Accordingly, developing multiple language capabilities could be a priority focus area for now.

C. CONSENT MANAGEMENT

The process of identifying and contacting specific individuals for the purpose of giving notice under the DPDP Act can be automated. However, in the case of proprietary processes or systems that store unstructured data, certain manual interventions and discovery modes may be necessary.

The contacting of individuals should be done in a form that can produce an auditable log – including for the purpose of identifying those individuals who

wish to withdraw or do not provide consent. Upon consent withdrawal, data processing with respect to such individuals may need to stop within a reasonable period (absent a legal requirement or authorization in this regard). Importantly, the DPDP Act requires the consent withdrawal process to be made as easy as it was to provide consent in the first place (*e.g.*, if the consent could be provided with a single click, such consent should be similarly retractable). Further, organizations need to ensure that when consent is withdrawn, all other entities processing the corresponding data – including contracted data processors – also stop processing such data, failing which the primary entity may be held liable for a data breach. Since the cessation of processing must be followed up with data erasure, organizations also need to check their deletion capabilities.

D. CONSENT MANAGEMENT PLATFORMS

In addition, a consent management platform ("**CMP**") could be used by data fiduciaries as a tool to collect and manage individual consent. Although 'consent managers' under the DPDP Act will remain accountable to individual data principals – including through technical, operational, financial, and other eligibility conditions – data fiduciaries could also enter into customized arrangements with CMP providers. Accordingly, organizations could create and maintain a central repository of compliant consent responses for use across all internal departments. Conversely, rules can be set to automatically purge non-responders from a company's legacy database.

Since 'right to access' provisions under the DPDP Act enable individual users to request for, and to find out, *what* an organization knows about them and *how* it uses such information, data fiduciaries will be obliged to respond to such requests, which can lead to considerable compliance burdens – especially if these requests are not stored properly (*e.g.*, in a consolidated dashboard). In that regard, companies may need to automate their workflows to manage such new requirements.

Finally, since an organization's data landscape is likely to keep changing over time, data mapping tools – whether in-house or third-party run/owned – may need to scan for data stores on a regular basis.

EXERCISE OF PRE-EMPTIVE RIGHTS IN INDIAN LIMITED LIABILITY PARTNERSHIPS– AN UNEVEN PLAYING FIELD FOR NON-RESIDENTINVESTORS

Anshuman Mozumdar & Amogh Pareek[*]

ABSTRACT

This article delves into certain peculiarities in India's exchange control regulations that have given rise to an uneven playing field between resident and non-resident investors in Indian Limited Liability Partnerships ("LLP's"). Such an uneven playing field gets exacerbated in the event of further funding/ exercise of pre-emptive rights by resident and non-resident investors, in LLPs.

The authors briefly discuss the unrealised potential of LLPs as a choice of investment vehicle for foreign investors. The authors then focus on specific causes of such untapped potential (being lacunae in pricing guidelines for foreign investments in LLPs and lacunae in the statutory forms for reporting such foreign investments). The article explains the effect of the above lacuna through an illustration, while drawing parallels between an Indian LLP and an Indian company (where the law does not suffer from such lacunae). Finally, the article concludes with recommendations and suggestions on certain amendments in law and procedure governing foreign investments in LLPs, to solve for the aforesaid concern.

Keywords: Limited Liability Partnerships, pre-emptive rights, Foreign Direct Investment, Pricing guidelines.

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DISCLAIMER - *These are personal views of the authors and do not necessarily reflect the views of Khaitan & Co.*

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I. INTRODUCTION

Limited Liability Partnerships gained popularity in India as a choice of investment vehicle, primarily because of greater flexibility in their management and governance, and the ability to distribute profits in a more tax efficient manner (as compared to Indian companies). LLPs found greater appeal with foreign investors post 2015, when the Indian government diluted entity specific foreign direct investment ("**FDI**") restrictions on LLPs.[1]

Despite these advantages, LLPs have barely achieved their potential as a choice of investment vehicle in India, especially amongst non-resident investors. This article analyses certain nuances in India's exchange control regulations that could be one such cause of this problem. These nuances get discovered only in instances where LLPs have a mix of resident and non-resident investors and are not prominent in LLPs that are entirely owned by non-residents.

II. PRICING GUIDELINES UNDER FEMA FOR COMPANIES AND LLPs

When non-residents subscribe to shares in unlisted Indian companies, the pricing guidelines ("**Pricing Guidelines**") stipulated under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 issued under the Foreign Exchange and Management Act, 1999 ("**NDI Rules**") require the "*price of equity instruments of the Indian company*"[2] issued to such non-residents, to be equal to or more than the fair market valuation ("**FMV**") of such equity instruments, determined as per any internationally accepted pricing methodology and at arm's length.

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[1] Department for Promotion of Industry and Internal Trade, Consolidated FDI Policy 16 (2020) https://www.meity.gov.in/writereaddata/files/FDI-PolicyCircular-2020-29October2020_0.pdf.

[2] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, The Gazette of India: Extraordinary, pt. II § 3(ii), Rule 21(2)(a)(ii) (Oct. 17, 2019).

Since the *price per share* of a company is a function of the FMV of the entire company and the total outstanding equity shares of the company, non-resident investors have the ability to subscribe to a specific number of shares in a company, to acquire a commercially agreed percentage stake in the company for a contracted price (which is at or above such per-share FMV). This flexibility is also available to non-resident investors in follow-on funding rounds while exercising their pre-emptive rights, thus providing them an opportunity with a reasonable level playing field, to prevent their shareholding from getting diluted. Separately, when companies issue shares to its existing shareholders (including non-resident shareholders) under a rights issue, the shares can be offered to non-resident shareholders at the same price as offered to resident shareholders (even if such price is lower than the FMV).

However, Pricing Guidelines work differently for foreign investments in LLPs due to certain lacunae in the NDI Rules and the format of *Form FDI-LLP(I)* (a form prescribed by the Reserve Bank of India for reporting foreign investments in LLPs).[3]

NDI Rules contemplate that foreign investments in LLPs by way of capital contribution or acquisition of profit shares must be made at a price that is equal to or more than the fair market value as per any internationally accepted valuation norms.[4] A combined reading of the NDI Rules with the information fields in *Form FDI-LLP(I)* suggests that when non-residents make capital contributions into Indian LLPs, such contribution should be made at or above the *prorated* FMV of the LLP(i.e. FMV of the LLP, prorated for the percentage of contribution made by the non-resident investor against the total past and present contributions in the LLP from all investors/ partners).

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[3] Reserve Bank of India, Foreign Investment Reporting and Management System (FIRMS) User Manual for Business Users 48 (2023) https://firms.rbi.org.in/firms/faces/pages/login.xhtml#.
[4] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, The Gazette of India: Extraordinary, pt. II § 3(ii), Rule 6(b) (Oct. 17, 2019).

III. LACUNAE IN NDI RULES AND FORM FDI-LLP(I) AND ITS IMPACT ON PRE-EMPTIVE RIGHTS

While the Limited Liability Partnership Act, 2008 ("**LLP Act**") is silent on this aspect, LLPs have the flexibility to denote contributions/ profit shares in the LLP as notional units/ shares (the same needs to be recognised under the LLP agreement executed among the partners of the LLP). However, such an enabling provision has not been built into the NDI Rules and the *Form FDI-LLP(I)*.

The objective of pre-emptive rights is to ensure that the investor's shareholding does not get diluted without an equal opportunity to fund the LLP, pro rata to its existing shareholding. A critical component of a pre-emptive right is that the valuation/ price offered to all investors for a further fund raise, should be uniform, to ensure a level playing field amongst investors.

The nuance of the NDI Rules and *Form FDI-LLP(I),* not recognizing a per instrument/unit FMV, though seemingly innocuous, has a significant, unintended consequence, at the time of exercise of pre-emptive rights by the non-resident partner of the LLP, where the LLP has an existing mix of resident and non-resident partners.

This can be explained through the following illustration:

- "**NR**" is a non-resident investor and "**R**" is a resident investor in an LLP, "**ABC LLP**".

- NR and R contribute INR 1 million each at the time of incorporation of ABC LLP, and own 50% interest/ profit share each, in ABC LLP. The total contribution in ABC LLP after its incorporation, stands at INR 2 million.

- After a year of its incorporation ABC LLP has a valuation of INR 4.5 million and a total capital of INR 2 million, and now requires another INR 2 million for expanding its operations. NR and R decide to make further contributions of INR 1 million each into ABC LLP.

- It would be fair that such further contributions by NR and R, made in equal proportions should result in both NR and R retaining their 50% interest/

profit share in ABC LLP. However, this is where the lacunae in the NDI Rules and *Form FDI-LLP(I)* create an uneven playing field for NR (a non-resident investor), that would not have been the case if the investment vehicle was an Indian company and not an LLP.

- The following table plays out the above fact scenario in context of a foreign investment by NR and R in an LLP and compares the same with a foreign investment by NR and R in a company:

Subject	LLP	Company
A: Initial contribution/ Capital (at the time of incorporation)		
Initial capital infusion	NR: INR 1 million R: INR 1 million	NR: INR 1 million R: INR 1 million
FMV	Nominal - no valuation report needed.	
Issue price per share/ unit	Not applicable (since NDI Rules and Form FDI-LLI (I) do not recognise the ability of LLPs to issue units).	INR 10 per share 1.1.1
Number of shares/ units issued	Not applicable (for the above reason).	NR: 100,000 shares R: 100,000 shares Total: 200,000 shares
Percentage shareholding/ interest	NR: 50% R: 50%	NR: 50% R: 50%
Total capital (NR +R)	INR 2 million	INR 2 million
B: Further capital infusion after 1 year		

Subject	**LLP**	**Company**
Fresh capital infusion	NR: INR 1 million R: INR 1 million	NR: INR 1 million R: INR 1 million
FMV of entity as per the valuer (*assumption*)	FMV of the LLP is INR 4.5 million	FMV of the company is INR 4.5 million. FMV of each share is INR 22.5 (4.5 million divided by 200,000 shares)
Entries to be made in prescribed forms to report FDI	In form FDI-LLP-1, the following key entries have to be entered: • Total capital contribution by NR– INR 1 million • Total capital contribution by all investors – INR4 million *(which includes the prior contributions of NR and R)* • FMV of LLP – INR 4.5 million • Pro-rated FMV for 50% shareholding - INR 2.25	In form FC-GPR, the following key entries have to be entered: • Total amount of remittance by NR—INR 1 million • Issue price per share —INR 25 • Number of shares issued — 40,000 (Total remittance = 40,000 shares multiplied by INR 25 = INR 1 million) • FMV of each share - INR 22.5

Subject	LLP	Company
	million (50% of FMV).	
Percentage shareholding/ interest	Since Form FDI-LLP(I) calculates pro-rated FMV of NR and does not contemplate a per instrument/ per unit FMV, NR (being a non-resident) has to invest at least INR 1.25 million to retain a 50% shareholding in the LLP (since the prorated FMV for a 50% profit share is INR 2.25 million and NR had previously invested INR 1 million in the LLP). However, R has the flexibility to only pay INR 1 million to retain its profit share at 50%.	Since form FC GPR records FMV of each share at the time of the subsequent issuance, NR will be compliant with Pricing Guidelines since issue price will be INR 25 and FMV of each share will be INR 22.5. Since 40,000 shares are being issued at the same issue price of INR 25 to both NR and R, shareholding of NR remains at 50% for a subsequent capital infusion of INR 1 million.

In other words, due to the peculiarities of the Form FDI LLP(I), if a non-resident investor invests INR 1 million in the LLP in a subsequent funding round, NR shall get a post investment profit share/ interest of only44.44% on a cumulative basis in the LLP (total contribution of INR 2 million, on a total valuation of INR 4.5 million).

However, for the same amount of subsequent investment (INR 1 million) and the same FMV of the entity (INR 4.5 million) during a further capital raise, the NR investor in a company retains a shareholding of 50% and complies with the Pricing Guidelines.

IV. RECOMMENDATIONS AND CONCLUSION

A possible solution to the issue described above, could have been to allow LLPs to offer disproportionate profit share to non-resident investors as compared to the capital/ contributions made by them. Taking the above example, this would have ensured that a non-resident investor continues to have a profit share of 50% in the LLP while its aggregate contribution in the LLP drops to 44.44%. However, we understand from our previous experiences that the Reserve Bank of India does not permit such disproportionate profit sharing in favour of NR investors (such disproportionate profit share is permissible if the same favours the resident investors).

In light of the above, the solution to the concerns discussed in this article can be found within the NDI Rules. NDI Rules allow foreign investors to purchase units of entities/pooled investment vehicles such as mutual funds, Alternate Investment Funds, Real Estate Investment Trusts or Infrastructure Investment Trusts. These entities are often constituted as trusts under the Indian Trusts Act, 1882.[5]Hence, recognition of 'units' issued by investment vehicles, is not a novel concept under the NDI Rules.

NDI Rules and Form FDI-LLP(I) should be amended to recognise the ability of Indian LLPs to issue units.[6] Consequential changes should be made to ensure that investors can subscribe to units of an LLP at or above the FMV of such unit. This will solve the concerns highlighted in this article and create a level playing field for foreign investors.

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[5] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, The Gazette of India: Extraordinary, pt. II § 3(ii), Sch. II, Sch. III, & Sch. IV (Oct. 17, 2019).
[6] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, The Gazette of India: Extraordinary, pt. II § 3(ii), Rule 2(aq) (Oct. 17, 2019).

As a supplement to the above, the LLP Act, NDI Rules and Form FDI-LLP(I) may also be amended to permit a rights issue by LLPs (similar to companies), since there is no such fundamental difference between companies and LLPs that warrants such flexibility to exist for companies but not for LLPs.

These measures should help increase the popularity of LLPs as a choice of investment vehicle and contribute to the government's vision of increasing the ease of doing business in India.

CASE COMMENT: INDIA INFRASTRUCTURE FUND II V. GLOBAL INFRASTRUCTURE PARTNERS INDIA PRIVATE LIMITED: ARE AIFS CROSSING LIMITS BY PLEDGING SECURITIES OF PORTFOLIO COMPANIES?

*Avinash Subramanian, Parth Mishra & Simrann Venkkatesan**

ABSTRACT

An Alternative Investment Fund ("AIF") set up under the provisions of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III sec.4 (May 21, 2012) is a fund established or incorporated in India as a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors.[1] *In ordinary course of business sophisticated investors (qualified and non – retail investors) pool funds in an investment vehicle i.e. AIF and create a corpus. These funds are invested by AIF into investee companies.*

It has been a common market practice for AIFs to pledge securities in their investee companies in order to secure credit facilities availed by the investee companies for raising finances.

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Note: this case comment is updated till April 02, 2024 and may not capture subsequent developments in applicable law.

[1] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III sec. 4, Reg. 2 (May 21, 2012).

However, SEBI vide an order dated May 31, 2023[2] in the case of India Infrastructure Fund II v Global Infrastructure Partners India Private Limited and Anr., ("SEBI Order") inter alia held that pledging of securities of portfolio companies by a Category I AIF for borrowing of funds or leverage by portfolio companies would be violative of Regulation 16(1)(c) of the AIF Regulations.

The SEBI Order has raised multiple concerns and confusions, as it may adversely impact the popularity of AIFs as an investment vehicle, including by limiting the borrowing limits of the portfolio companies. This case analysis explains the SEBI Order, explores its consequences in relation to the market practices and provides suggestions that may be taken into consideration to minimise the risks and resolve the concerns that SEBI has tried to address by passing of the SEBI Order.

Keywords: Alternative Investment Fund, Pledge, Portfolio Companies.

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I. THE BUSINESS

As per the last published ease of doing business index by the World Bank Group, India had improved its ranking to 63 in the overall ease of doing

[2] Securities and Exchange Board of India, Final Order in respect of India Infrastructure Fund II, Global Infrastructure Partners India Private Limited and IDBI Trusteeship Services Limited, QJA/KS/AFD-1/AFD-1-SEC/27020/2023-24 (May 31, 2023).

business indicator. However, it continued to rank low in the enforcement of contracts indicator as of 2020.[3] Needless to mention, while efforts are being undertaken to improve the judicial process and quicken the enforcement process, much is left desired in the said process.

However, an exception to this process has been the pledge enforcement process. Pursuant to the enactment of the Depositories Act 1996[4] and introduction of dematerialized shares in 1992, India has progressively adopted electronic transfer of shares. While it was initially made mandatory for listed public companies, this has slowly been expanded to all securities issued by unlisted public companies and now private companies as well.

Given the ease of enforcement process associated with pledge of securities, pledges have increasingly become the most preferred form of security interest taken by lenders and financial institutions. It is in this context that this case analysis seeks to analyse the implications of the actions taken by Securities and Exchange Board of India ("**SEBI**") in relation to such pledges.

As part of SEBI's initiative to create a platform for setting up of pooling vehicles in India which are managed by investment managers in accordance with global practices, SEBI introduced the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, ("**AIF Regulations**")[5] in order to facilitate the creation and regulation of alternative investment funds in India.

An Alternative Investment Fund ("**AIF**") set up under the provisions of the AIF Regulations is a fund (which is not a mutual fund regulated by SEBI) established or incorporated in India as a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it

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[3] Embassy of India, The Hague, *Ease of doing Business*, https://indianembassynetherlands.gov.in/page/ease-of-doing-business-in-india/#:~:text=INDIA%20%E2%80%93%20EASE%20OF%20DOING%20BUSINESS,to%20do%20business%20in%20India.
[4] The Depositories Act, No. 22 of 1996 (Ind.).
[5] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III §4 (May 21, 2012).

in accordance with a defined investment policy for the benefit of its investors.[6] In ordinary course of business sophisticated investors (qualified and non – retail investors) pool funds in an investment vehicle i.e. AIF and create a corpus. A person or entity who is appointed by the AIF to manage its investments by whatever name called is a manager of the AIF and in certain cases it may also be same as the sponsor of the AIF ("**Manager**"). These funds are invested by AIF into investee companies.

AIFs are registered in one of the 3 categories as mentioned below:

A. "Category I AIF" which invests in start-up or early-stage ventures or social ventures or small and medium sized enterprises ("**SME**") or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME funds, social impact funds, infrastructure funds, special situation funds and such other AIFs as may be specified.[7]

B. "Category III AIF" which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. AIFs such as hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended and for which no specific incentives or concessions are given by the government or any other regulator are included within the definition of Category III AIFs.[8]

C. "Category II AIF" are the residuary category of AIF that do not fall in Category I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements. For the purpose of Category III AIFs, AIFs such as private equity funds or debt funds

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[6] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III §4, Reg. 2 (May 21, 2012).

[7] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III §4, Reg. 4 (May 21, 2012).

[8] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III §4, Reg. 3(4)(c) (May 21, 2012).

for which no specific incentives or concessions are given by the government or any other regulator are included.[9]

AIFs have increasingly become the favored form for committing investments by investors in India. The attraction of AIFs is due to ease of creation and deployment as well as the light touch manner of regulation that has been practiced by SEBI. Given the said reasons, India has seen a five-fold increase in commitments raised by AIFs from ~ INR 2,00,000 crores to ~ INR 10,00,000 crores.[10] It is therefore necessary that the attractiveness of this investment vehicle is not tarnished by confusion created in the market.

Having introduced the concepts of AIFs, it is trite to provide a brief introduction on the relevance of pledge as a form of security. Creation of pledge is governed by the provisions of the Indian Contract Act No. 9, 1872 ("**Indian Contract Act, 1872**"). Indian Contract Act, 1872, sec. 172 defines pledge to mean "the bailment of goods as security for payment of a debt or performance of a promise". As noted, the nature of a pledge is intrinsically for satisfying a debt or a promise. The modalities for creation of pledge were governed by the provisions of the Indian Contract Act, 1872. However, post the enactment of the Depositories Act, 1996, the modalities for creation of pledge over dematerialised securities are now enshrined within the provisions of the Depositories Act, 1996 and the regulations made thereunder.

While the Depositories Act, 1996 governs the provisions of the procedure in relation to the creation and enforcement of pledge, the substantive provisions in relation to the rights and remedies in relation to the creation and enforcement of pledge continue to be governed by the provisions of the Indian Contract Act, 1872.[11]

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[9] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III §4, Reg. 3(4)(b) (May 21, 2012).
[10] Securities and Exchange Board of India, Data relating to activities of AIFs (2023) https://www.sebi.gov.in/statistics/1392982252002.html.
[11] PTC India Financial Services Limited v. Venkateswarlu Kari and Another, (2022) 9 SCC 704 (Ind.).

II. SEBI SETTING BOUNDARIES

It has been a common market practice for holding entities to pledge securities in their investee companies in order to secure credit facilities availed by the investee companies for raising finances. This is particularly prevalent in sectors where operating companies are set up as special purpose vehicles ("**SPV**") (such as projects, infrastructure and real estate) undertaking greenfield projects and therefore the pledge over the shareholding of such SPVs forms an intrinsic part of any security structure for loans sanctioned by lenders and financial institutions. The requirement of pledge is necessitated by the ground reality that such SPVs to whom loans are sanctioned do not have any assets at the time of disbursement of loans and the pledge provided by the holding company secures the lenders in taking control of the investee companies upon occurrence of default.

However, SEBI vide an order dated May 31, 2023 in the case of India Infrastructure Fund II v Global Infrastructure Partners India Private Limited and Anr., ("**SEBI Order**") *inter alia* held that pledging of securities of portfolio companies by a Category I AIF for borrowing of funds or leverage by portfolio companies would be violative of Regulation 16(1)(c) of the AIF Regulations.[12]

A. BRIEF FACTS:

a) India Infrastructure Fund II ("**Fund**") is registered with SEBI as a Category I AIF under the provisions of the AIF Regulations.[13]

b) The Fund is managed by Global Infrastructure Partners India Private Limited ("**Manager**"). IDBI Trusteeship Services Limited is the trustee of the Fund ("**Trustee**"). SEBI had conducted an on-site inspection of the

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[12] Securities and Exchange Board of India, Final Order in respect of India Infrastructure Fund II, Global Infrastructure Partners India Private Limited and IDBI Trusteeship Services Limited, QJA/KS/AFD-1/AFD-1-SEC/27020/2023-24 (May 31, 2023).
[13] *Id* at 1.

Fund to look into compliance with respect to the AIF Regulations and circulars issued thereunder.[14]

c) In its quarterly report dated June 30, 2021, the Fund disclosed to its investors the pledges granted by the Fund on securities amounting to approx. INR 1,383 crores (approx. USD 160 million) of various portfolio companies held by the Fund, with lenders as a collateral for loan taken by the portfolio companies.

d) On the basis of findings of the inspection, common show cause notice dated March 29, 2023 was issued, *inter alia*, alleging that:[15]

   (i) due to the pledging of the securities held by the Fund, the investee companies were able to secure larger size loans, i.e. get increased leverage in an indirect manner. The Fund had engaged in leverage by pledging fund assets for loans taken by portfolio companies. This act of the Fund was observed to be in violation of the AIF Regulations which prevented AIFs to undertake/engage in leverage.

   (ii) the aforesaid act of the notices had the effect of jeopardizing the investments of the investors in the Fund, thus, the same was not in the best interest of the investors in the Fund.

e) The submissions made in response to the show cause notice included, *inter alia,* as follows:[16]

   (i) the trust deed set out the investment mandate of the Fund i.e. to carry on activity as an AIF for the purpose of raising resources to make funds available for portfolio companies so as to achieve long-term capital appreciation and to earn current income for its beneficiaries i.e. the investors.

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[14] *Id* at 3.
[15] *Id* 4 at 4.
[16] *Id* 6 at 6.

(ii) the trust deed also sets out certain powers of the Trustee, including the power to pledge or create an encumbrance over any securities held by the Fund, including as collateral to enable any portfolio company to avail of financial assistance; and

(iii) every investor of the Fund was aware of the investment mandate, the private placement memorandum and the terms of the trust deed.

(iv) the applicability of AIF Regulations is limited to borrowings (whether direct or indirect) or leverage availed of by the Fund. There is no evidence on record and not even an allegation in the show cause notice that the borrowings for which the Fund has pledged or created other charge over its securities is any kind of structure, artifice or device for the Fund to have indirectly borrowed or taken leverage over its investments.

(v) as per the noticees' understanding of Regulations 16(1)(c) of the AIF Regulations, pledging of securities of portfolio companies to enable such companies to undertake borrowing/leverage would not amount to borrowing (whether direct or indirect) or leverage on part of the Fund, as the portfolio companies and the Fund are distinct and separate entities. The noticees' have acted on the basis of such understanding.

(vi) the Fund was set up with the objective of investing in Indian infrastructure projects with the strategy of ensuring meaningful stakes for participation in the management of the underlying asset/business. In pursuance of the said declared portfolio strategy/investment mandate, the Fund acquires meaningful stake in portfolio companies and acts as promoter/majority shareholder of such companies. The pledging of securities of portfolio companies by the Fund to enable such companies to obtain loans for their business requirements was in normal course of business and undertaken with prior knowledge of all investors.

(vii) regulation 3(4)(c) of the AIF Regulations permits Category III AIF to employ leverage. SEBI vide circulars dated July 29, 2013,

September 29, 2017 and April, 2021 has prescribed a reporting format for Category III AIFs that undertake leverage. The prescribed format for reporting leverage does not include disclosures in respect of pledge of securities for borrowings by the investee companies. The pledging of securities does not amount to undertaking leverage.

(viii) the Fund had pledged/created other charges over the securities of portfolio companies to enable such portfolio companies to borrow funds for their business requirements keeping in the mind the best interest of the portfolio companies and in turn, the best interest of investors of the Fund. The investors in turn benefited from the performance of the portfolio companies in which the Fund had a meaningful stake.

B. SEBI'S CONCERNS AND RULING:

a) All SEBI observed that Category I and II AIFs are not permitted to borrow funds either directly or indirectly or engage in leverage against assets of AIF.

b) The pledges undertaken by the Fund were in relation to substantial loans of portfolio companies in comparison to the assets under management ("**AUM**") i.e., approx. 24% (twenty four percent) of the AUM of the Fund.

c) SEBI reasoned that the Fund had engaged in leveraging by pledging fund assets for loans taken by portfolio companies.

d) This act of the Fund was observed to be in violation of the AIF Regulations. According to SEBI, this had the effect of exposing the investors to additional risk of possible default by the portfolio companies, jeopardizing the investments of the investors in the Fund, concluding that this was not in the best interest of the investors in the Fund.

e) SEBI ruled that use of expression "any leverage" under AIF Regulations is not confined to leverage availed of by the Category I AIF itself. It prohibits Category I AIF from being party to any leverage availed of

either by Category I AIF or by any other entity. In the present case, portfolio companies availed of significant loans against pledge of securities by the Fund which enabled the portfolio companies to leverage.

f) SEBI ruled that the Fund, by pledging securities held by it in portfolio companies for loans availed of by portfolio companies, engaged in leverage, thereby, violated Regulation 16(1)(c) of the AIF Regulations.

III. SCOPE OF THE SEBI ORDER: SETTING BOUNDARIES OR HOPPING FENCES?

As per the AIF Regulations, Regulation 16 prescribes the investment conditions for Category I AIF which states that the Category I AIF shall not borrow funds directly or indirectly or engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the investable funds. Category II AIF's do not have any such restrictions under the AIF Regulations as has been determined in the SEBI Order.

While this ruling was in the context of pledge of securities by a Category I AIF, SEBI has taken this opportunity and also made similar observations with respect to Category II AIFs, thereby observing that even Category II AIFs are not permitted to pledge securities of portfolio companies for the borrowing of such portfolio company.

It is a common practice for promoters or the holders of equity shares to offer their shareholding to lenders to raise capital. The Supreme Court in various judgements have clearly ruled that creation of pledge does not imply incurring of additional liability by the pledgor other than the pledge itself.

The concept of 'pledge' has been elucidated by the Supreme Court in *PTC India Financial Services Limited v. Venkateswarlu Kari and Another,*[17] with reference to the provisions of contract of bailment and specific provisions concerning the

[17] PTC India Financial Services Limited v. Venkateswarlu Kari, (2022) 9 SCC 704 (Ind.).

pledge as a subset of bailments.[18] The law of pledge contemplates special rights for the pawnee in the goods pledged, i.e., the right to possession of the security, and in case of default, the right to bring a suit against the pawnor, as well as the right to sell the goods after giving reasonable notice to the pawnor. The general rights or ownership rights in the property remain with the pawnor, and wholly reverts to him on discharge of the debt or performance of the promise. In other words, the right to property vests in the pawnee only as far as it is necessary to secure the debt.

It has been observed by the Supreme Court that a person having only security interest over the assets of corporate debtor (like the instant third-party securities), even if falling within the description of 'secured creditor' by virtue of collateral security extended by the corporate debtor, would nevertheless stand outside the sect of financial creditors.

In practice, there have been cases wherein a pledge also includes a covenant to pay the obligations secured by such pledge. It could have been argued that such a covenant to pay constitutes a guarantee which would in turn constitute an indirect borrowing by the pledgor. The Supreme Court had the opportunity to delve into this argument while interpreting the meaning of 'financial debt' as provided in the Insolvency and Bankruptcy Code, No. 31 of 2016 ("**IBC**"), sec. 5(8).[19] The Supreme Court stated that sec. 5(8) of the IBC is an inclusive definition and means a debt along with interest, if any, which is disbursed against the consideration for the time value of money. Thus, the main part of the definition, provides that financial debt means a debt "which is disbursed against the consideration for the time value of money" and includes a "guarantee".

Sec. 126 of the Indian Contract Act, 1872 defines "Contract of guarantee" as a contract to perform the promise, or discharge the liability, of a third person in case of his default. It was observed that the pledge agreement was limited to pledge of 40,160 shares as security and that the corporate debtor had never

[18] PTC India Financial Services Limited v. Venkateswarlu Kari, (2022) 9 SCC 704 (Ind.).
[19] Phoenix ARC Private Limited v. Ketulbhai Ramubhai Patel, (2021) SCC OnLine SC 54 (Ind.).

promised to discharge the liability of borrower. It was accordingly held that the appellant was not a financial creditor of the corporate debtor.

The Supreme Court recently has reiterated the position, in a judgment dated May 4, 2023, in the matter of *Vistra ITCL (India) Limited and Others v. Mr. Dinkar Venkatasubramanian and Another, Civil Appeal no. 3606 of 2020 (Ind.)*[20] wherein it has been held that by virtue of a security created by a corporate debtor in favor of a lender to secure the loan facility advanced to a third-party, the lender would be considered as a secured creditor of the corporate debtor and not be considered as a financial creditor.

Therefore, pledge of securities (in the absence of a covenant to pay) has been looked at by the Supreme Court time and again only as a contract creating security and not an additional obligation in form of a guarantee.

IV. AFTERMATH: CONCERNS, RE-MODELLING AND ALTERNATIVES

The order passed by SEBI has raised multiple concerns and confusions as it may adversely impact the popularity of AIFs as an investment vehicle including by limiting the borrowing limits of the portfolio companies. SEBI appears to have restricted AIFs from undertaking pledges on the premise that the unit holders will need to be protected from the AIF undertaking leverage which could go beyond the value of the investments made by such AIF. However, it has not been the intent of SEBI to provide downside risk protection to unitholders as AIF investments are always subject to market risk. Given the risk that is sought to be mitigated by SEBI, it appears a complete ban on creation of pledge by AIFs is excessive.

The market participants have raised concerns about the consequences of the SEBI Order which includes stifling of the ability to raise credit i.e. this ruling may have a multi-fold effect starting with restricting the ability to raise credit of

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[20] Vistra ITCL (India) Limited v. Dinkar Venkatasubramanian, (2023) 7 SCC 324 (Ind.).

portfolio companies of AIF investors which in turn may lead to an increase in the cost of lending for such portfolio companies due to additional transaction costs incurred by the lenders and thereby this SEBI Order could ultimately fetter investments in certain sectors via the AIF route.[21]

Albeit, it is necessary to distinguish between pledges that have a covenant to discharge the secured obligations as against pledges that are not combined with such covenant to pay. In the absence of a covenant to pay, the obligations of the AIF are limited to the value of the securities pledged by the AIF. In simple terms, if an investment in an investee company goes bust, the value of such securities would become NIL. Similarly, if an investee company defaults on its debt, then the liability of an AIF is limited solely to the invocation of such pledge. In both cases the recovery made by the AIF for an investment that has gone bad is NIL. While the former is permitted by SEBI, the latter has sought to be prohibited by virtue of the SEBI order. Consequently, in order to ensure a level playing field for AIFs across different sectors, permitting such pledges wherein the obligation of the AIFs is limited solely to the securities pledged is imperative.

Recognising the difficulties in conducting the business as an AIF for certain sectors with such a blanket ban on pledges, SEBI in its board meeting held on March 15, 2024 has approved a proposal to allow Category I and II AIFs to create an encumbrance on the equity of its investee companies in infrastructure sector to facilitate raising of debt/loan by such investee companies, subject to certain conditions, including compliance with RBI regulations.[22] The amendments to the regulations are still awaited to ascertain the extent to which this exception is available to the AIFs.

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[21] Siddharth Shah et al, *Why SEBI Order Against GIP can stifle growth of AIFs and their Portfolio Firms*, VCCIRCLE.COM (July 05, 2023), https://www.vccircle.com/whysebi-order-against-gip-can-stifle-growth-of-aifs-and-their-portfolio-firms.

[22] Press release, SEBI, SEBI Board Meeting (Mar. 15, 2024) https://www.sebi.gov.in/media-and-notifications/press-releases/mar-2024/sebi-board-meeting_82286.html.

It remains to be seen if there are any additional disclosure requirements that SEBI may specify in cases wherein pledge of shares of investee companies is being contemplated by the AIF including details such as (i) end-use, (ii) lender and (iii) status of payment or (iv) default. Albeit this is a step in the right direction for the regulator in fostering a business-friendly environment for AIFs while at the same time looking out for the larger interest of the investors in these AIFs. Further, it will need to be seen if SEBI is forthcoming in relaxing the restrictions for other sectors as well such as real estate wherein pledges are a necessary constituent of any security package.

In conclusion, it is necessary to be alive to the commercial reality of finance that pledge of securities is imperative for conduct of business. The move by SEBI to prohibit such pledge altogether appeared knee jerk and excessive. SEBI has rightly identified the concern with "covenant to pay" combined with pledge being in the form of indirect borrowing. However, a blanket ban does not take into account nuances that have developed over years of practice in relation to such pledge. It is expected that SEBI, being a market regulator, will take cognisance of these nuances and temper its own stand on pledges. The latest development in permitting such pledge for certain sectors is definitely a step in the right direction.

SECTION 29-A, IBC & RESOLUTION APPLICANTS: RESOLVING INSOLVENCY OR MAGNIFYING COMPLEXITY?

Nityesh Dadhich[*]

ABSTRACT

Insolvency and Bankruptcy Code, 2016 is a landmark statute as it introduced deep structural reforms. Under this framework, the Resolution Applicants are invited to submit their Resolution Plans for insolvency resolution of the corporate debtor. Till 2017, any person could submit a Resolution Plan, however, a subsequent amendment led to introduction of Section 29-A which prohibited the original promoters, directors, erstwhile managerial personnel, or any connected person(s) from submitting a resolution plan. This article looks at the evolution of law in relation to Resolution Professional in India and various judicial interpretations which have introduced a lot more clarity in the existing system. However, as the market evolves, this framework continues to face new challenges requiring even greater efforts to balance the underlying uncertainties.

The article deals with the framework adopted in United Kingdom and the United States, and this analysis gives an understanding that the post-2017, with the introduction of Section 29-A, the Indian Government has adopted a lot more stringent set of regulations when compared with these two jurisdictions. Subsequently, the article also identifies the leading grey areas and challenges giving suggestions on how these issues can be resolved. To give a comprehensive understanding of the issue, the article looks into the variety of suggestions and alternatives offered by the UNCITRAL's Legislative Guide on Insolvency, and it evaluates the extent to which those suggestions found their relevancy in the Indian context. Lastly, the article offers several recommendations in relation to the provision dealing with Resolution Applicant, and regulations as provided under IBC ("CIRP") Regulations.

Keywords: Insolvency and Bankruptcy, Resolution Applicants, Corporate Insolvency, CIRP Regulations.

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I. INTRODUCTION

Insolvency and Bankruptcy Code, 2016 ("**IBC, 2016**" or "**the Code**") consolidates and amends the law for insolvency regulation and reorganization of corporate persons, partnership firms and individuals in a time-bound manner.[1] The IBC, 2016 aims to achieve threefold objectives. *Firstly*, insolvency resolution and reorganization of debts; *secondly,* maximization of the value of the assets of the corporate debtor, and *thirdly,* to promote entrepreneurship, while ensuring availability of credit and ensuring best of the interest of all the stakeholders involved.[2] IBC aims to ensure that funds do not remain idle within an economy, and should be invested in productive activities. The IBC, 2016 overhauled the insolvency and bankruptcy mechanism in India, and the Bankruptcy Law Reforms Committee (2015) recommended that the Courts should keep their

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[1] The Insolvency and Bankruptcy Code (Amendment) Act 26 of 2021, Statement of Objectives and Reasons.

[2] Binani Industries Limited. v. Bank of Baroda, CA (AT) (Insolvency) No. 82 of 2018; Kuldeep Sharma, *IBC and its impact on the Indian Economy,* L. Street (Dec. 10, 2021), http://www.lawstreetindia.com/experts/column?sid=633#:~:text=The%20IBC%20provides%20for%20a,%2C%20and%20time-bound%20mechanism.

policy intervention at a minimum so that the foundational principles of IBC are not altered.[3] Section 5(25) of the IBC, 2016 defines "Resolution Applicant" as a person who individually or jointly, submits a resolution plan to the Resolution Professional ("**RP**"), pursuant to an invitation made under Section 25(2)(h).[4] Resolution Plan is proposed by the prospective resolution applicants for insolvency resolution of the corporate debtor, and may even propose restructuring of the corporate debtor.[5] The RP is required to prepare an information memorandum containing information as specified by the Board to formulate a resolution plan, and the same shall be shared with the Resolution Applicant. The information memorandum enables the Resolution Applicant to prepare a Resolution Plan, and a duty is imposed upon the Resolution Applicant to ensure to maintain confidentiality, and to comply with the laws in force at that time.[6]

Before 2017, any person could present a Resolution Plan for a corporate debtor. This allowed the original promoters, directors, erstwhile management personnel, or any connected person to prepare and present a resolution plan.[7] The persons whose decisions resulted in the company's default were allowed to become Resolution Applicant and regain control over the Corporate Debtor.[8] This could hamper the process of IBC, therefore, through the Insolvency and Bankruptcy Code (Amendment) Act, 2018, Section 29A was inserted in the Code. This section lays down the eligibility criteria for persons to be appointed as resolution applicant.[9] Section 29-A bars the following persons from becoming

[3] MINISTRY OF FINANCE, GOV'T OF IND., THE REPORT OF THE BANKRUPTCY LAW REFORMS COMMITTEE VOLUME I: RATIONALE AND DESIGN. (2015) http://ibbi.gov. in/BLRCReportVol1_04112015. pdf.

[4] Insolvency and Bankruptcy Code, No. 31 of 2016, § 25(2)(h) (Ind.); Insolvency and Bankruptcy Code, No. 31 of 2016, § 54-K (Ind.)

[5] Insolvency and Bankruptcy Code, No. 31 of 2016, § 5(26) (Ind.)

[6] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29 (Ind.)

[7] THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA & THE INTERNATIONAL FINANCE CORPORATION, UNDERSTANDING THE IBC: KEY JURISPRUDENCE AND PRACTICAL CONSIDERATIONS – A HANDBOOK (2020), https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf.

[8] *Id.*

[9] Chitra Sharma v. Union of India, (2018) 18 SCC 575 (Ind.) ¶ 38.

resolution applicant, which includes, the persons individually, or acting jointly or in concert with such persons, who is an undischarged insolvent, or willful defaulter, or has been convicted for an offence with punishment as specified, or is disqualified to act as a director, or is prohibited by Securities and Exchange Board of India ("**SEBI**"), and such other conditions as are provided under Section 29-A.[10] The disqualification extends to individuals who are "connected" to the persons which fall directly within the provisions of Section 29A.[11] In *Arun Kumar Jagatramka v. Jindal Steel,*[12] the Supreme Court said that the persons ineligible under Section 29-A also become ineligible to make a compromise or an arrangement under Section 230 of the Companies Act, 2019. The Court said that Section 29-A has been added to facilitate larger public interest in ensuring effective corporate governance, and Section 29-A eliminates the possibility or backdoor entry of erstwhile management of the corporate debtor into the Corporate Insolvency Resolution Process ("**CIRP**").[13] This article is divided into three parts. First part shall deal with the evolution of law relating to resolution applicants, and how the courts have interpreted the role of a resolution applicant. Second chapter shall deal with the international practices. It mainly focuses upon the United States ("**US**") and United Kingdom ("**UK**"), and attempts to put India's insolvency law in relation to these two. Third part deals with the grey areas which need to be settled, and puts forth certain suggestions and ideas to develop the law relating to resolution applicants.

II. EVOLUTION OF THE LAW AND JUDICIAL DECISIONS

IBC, 2016 attempts to find a viable mechanism to protect the Corporate Debtor as a going concern. When a default takes place, a CIRP can be initiated. The process is overseen by Interim Resolution Professional/Resolution

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[10] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29-A (Ind.)
[11] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29-A(Ind.)
[12] Arun Kumar Jagatramka v. Jindal Steel and Power Ltd. & Anr., Civil Appeal No. 9664 of 2019.
[13] Gautam Bhatikar, *Supreme Court clarifies the Restrictions under Section 29A IBC to schemes of Compromise or Arrangement*, MONDAQ (Apr. 16, 2021) https://www.mondaq.com/india/insolvencybankruptcy/1058488/supreme-court-clarifies-the-restrictions-under-section-29a-ibc-to-schemes-of-compromise-or-arrangement.

Professional, and it creates a clam period, enhancing the chances for the corporate debtor to survive. For 180 days when CIRP is operational, the Committee of Creditors ("**CoC**") consider various revival plans, and decide upon the next course of action. When 66% of CoC approve on a revival plan, the plan becomes binding upon all the remaining stakeholders. If the same majority decides that the complexity of the case requires more deliberations than a one-time extension up to 90 days can be sought with the approval of the Adjudicating Authority.[14] Hon'ble Supreme Court in *Kridhan Infrastructure v. Venkestesan Sankarnarayan,*[15] said that "*time is the essence of the Corporate Insolvency Resolution Process"* because unnecessary delays would only reduce the chances of a successful insolvency resolution of the corporate debtor.[16]

Section 25(2)(h) makes it the duty of the Resolution Professional to invite expression of interest from prospective resolution applicants, provided that they satisfy the criteria as laid down by the Resolution Professional with approval of the CoC. Regulation 36-A of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**") provides that the Resolution Professional shall publish the invitation for expression of interest within seventy-five days from the insolvency commencement date.[17] A prospective resolution applicant may submit their expression of interest within the time specified.

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[14] ICAI, HANDBOOK ON RESOLUTION PLAN UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2 (2016) https://resource.cdn.icai.org/65474cibc52815-4rp.pdf

[15] Kridhan Infrastructure Pvt. Ltd. (now known as Krish Steel and Trading Pvt. Ltd.) v. Venkatesan Sankaranarayan & Ors, Civil Appeal No. 3299 of 2020.

[16] Vasanth & Saurabh, *Time is the Essence of the Corporate Insolvency Resolution Process: Supreme Court of India,* MONDAQ (Mar. 23, 2021) https://www.mondaq.com/india/insolvencybankruptcy/1050184/time-is-the-essence-of-the-corporate-insolvency-resolution-process-supreme-court-of-india.

[17] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Gazette of India, Extraordinary, Part III, §4, Reg. 36-A (Nov. 30, 2016) ("**CIRP Regulations**").

Section 25(h) makes it the duty of the Resolution Professional to prepare an Information Memorandum,[18] providing relevant information to the eligible prospective resolution applicants so as to them to make informed decisions during the CIRP process.[19] In *NTPC v. Rajiv Chakraborty*,[20] the Supreme Court said that the purpose of the information memorandum is to only provide relevant financial information and in no way decides validity of any claim, or claim amount. The information memorandum is provided to the resolution applicant to enable the preparation of resolution plan.[21] Section 25(2)(h) lays down that the Resolution Professional of the Corporate Debtor invites resolution plans from the Prospective Resolution Applicants.[22]

Earlier, Section 5(25) defined Resolution Applicant as "*any person*" who submits a resolution plan to the Resolution Professional. Moreover, no criteria were provided for selection of the resolution applicant, which created a loophole enabling backdoor entry of the Corporate Debtor's erstwhile management to regain control over the organization. This definition was amended, first through an Ordinance,[23] and subsequently through an Amendment Act.[24] The definition subsequently limited resolution applicant as the persons who submit a Resolution Plan in response to the invitation made by the Resolution Professional under Section 25(2)(h).[25] Thus, a person would be eligible to submit a resolution plan on satisfaction of two requirements -

a) Satisfy the requirements as decided by the Resolution Professional and approved by the Committee of Creditors;
b) should not be disqualified under Section 29-A, IBC 2016

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[18] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29(1), 29(2); CIRP Regulations, Regulation 36.
[19] CIRP Regulations, Reg. 36(2).
[20] NTPC v. Rajiv Chakraborty, (2021) 10 SCC 480 ¶ 6.
[21] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29(2) (Ind.)
[22] Sikha Bansal & Richa Saraf, *Ineligibility Criteria U/S 29A Of IBC: A Net Too Wide?* VINOD KOTHARI CONSULTANTS, http://vinodkothari.com/blog/section29a-ibc-a-net-too-wide/.
[23] Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 dated 23rd November 2017.
[24] Insolvency and Bankruptcy Code (Amendment) Act, 2018.
[25] Insolvency and Bankruptcy Code, No. 31 of 2016, § 5(25) (Ind.)

The eligible prospective resolution applicants then produce resolution plan, suggesting a detailed plan to resolve the insolvency of the corporate debtor. Such plan should not be mechanical, rather it should be a prudent plan involving application of mind. Regulation 37 of CIRP Regulations provides that resolution plan can involve the induction of professional management, infusion of additional finance to maintain the corporate debtor alive,[26] transfer or sale of assets of corporate debtor, merger, amalgamation of corporate debtor, or any such other measures as the resolution applicant may find prudent.[27] The resolution plan prepared by each resolution applicant is scrutinized by the Resolution Professional, who forwards it to the CoC to evaluate, deliberate and vote on all such plans simultaneously. If two or more resolution plans are put to vote, the plan receiving the highest votes and satisfying the requisite minimum vote percentage shall be approved.[28]

III. INELIGIBILITY OF RESOLUTION APPLICANTS VIS-À-VIS SECTION 29-A OF IBC, 2016

Section 29-A lays down the persons who are ineligible to be Resolution Applicant, which can be categorized into four layers for better understanding.[29] *Firstly*, the persons mentioned under Section 29-A themselves. *Secondly*, the persons "connected" to an ineligible person. *Thirdly*, the related parties of connected persons. *Lastly*, the persons acting in concert or jointly with the persons mentioned under the first, second or third level of ineligibility as mentioned above.[30] Section 29-A(c) debars a person acting jointly or in concert with any person who has a non-performing asset ("**NPA**") account, or is a

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[26] ICAI, *supra* note 14.
[27] CIRP Regulations, Reg. 37.
[28] CIRP Regulations, Regulation 29. The three possible situations can be explained factually as follows -

1) If Plan A receives 50% votes and Plan B receives 55% - Both plans are rejected
2) If Plan A receives 70% votes and Plan B receives 75% votes – Plan B is selected due to higher vote share
3) If Plan A and Plan B receive equal vote share – CoC shall approve either of the plan as approved before the voting.

[29] Bansal & Saraf, *supra* note 22.
[30] *Id.*

promoter or in management of or in control of a corporate debtor whose account is classified as NPA, and such restriction is imposed if the account is classified as NPA for at least one year. In *RBL Bank v. MBL Infrastructures Ltd.,*[31] NCLT said that Section 29-A(h) is not to disqualify promoters as a class from submitting Resolution Plan, rather it aims to prevent such persons who, considering their antecedents, may hamper the insolvency resolution process under the IBC. The IBC, 2016 aims to provide a way-out mechanism for a struggling corporate debtor, however, the wide import granted to Section 29-A extending across four layers, might restrict the legitimate Resolution Applicants.

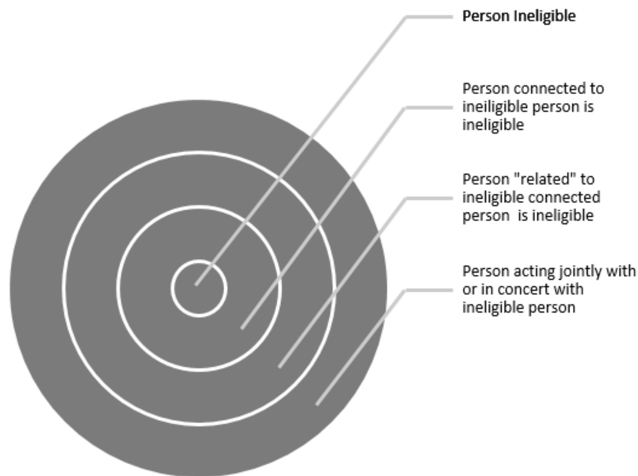

Figure 1: Section 29-A's domain, spreading to a broad extend[32]

In *Swiss Ribbons v. Union of India*, a fourfold attack was made on the validity of Section 29-A of the IBC, 2016. *Firstly*, Section 29-A stands contrary to the objectives of the IBC, 2016, and in particular the objective of achieving speedy

[31] RBL Bank v. MBL Infrastructure Ltd., CA(IB) No. 523/KB/2017 order dated 18 December 2017 https://ibbi.gov.in/webadmin/pdf/order/2017/Dec/18th%20Dec%202017%20in%20the%20matter%20of%20MBL%20Infrastructures%20Limited%20C.P%20(IB)-170-KB-2017%20(Interim%20Order)_2017-12-22%2012:31:15.pdf
[32] Bansal & Saraf, *supra* note 22.

disposal of resolution process by leading to challenges before the Adjudicating Authority, which slows down the insolvency resolution process.[33] *Secondly*, a blanket-ban on all the erstwhile promoters of the company, and not limiting it to the unscrupulous promoters who are responsible for the financial deterioration stands against the interests of the company. This violates Article 14 as it treats 'unequals as equals'. *Thirdly*, Section 29-A contravenes the objective of maximizing the value of an asset, as a Resolution Applicant who might have the highest bid would still be ineligible because he was earlier a promoter, or a person connected as mentioned under Section 29-A. Similarly, Section 29-A(j) bars the related parties of the promoters, even when they had no business connections with them.[34] *Lastly*, Section 29-A(c) classifies an account as an NPA, even when such person is not a willful defaulter.

In *Arcelor Mittal v. Satish Kumar Gupta*,[35] the Court held the provision is of wide import, and it extends to all persons who may be acting in concert with the persons submitting a resolution plan. The court favored purposive interpretation of Section 29-A, as literal interpretation would not permit the lifting of corporate veil to determine eligibility of a person as a Resolution Applicant.[36] In *Chitra Sharma v. Union of India*,[37] the Court again adopted purposive interpretation to conclude that Section 29-A is adopted to facilitate larger public interest of ensuring effective corporate governance.[38]

Firstly, the Court held that a statute is not retrospective merely because a part of its action derives from a time antecedent to its application.[39] The Court said that the Resolution Applicants have no vested rights to participate in the recovery process. Agreeing with its earlier decision in *Arcelor Mittal judgment,* the Supreme Court said no such rights are taken away through the application of Section 29-A merely because certain Section 29-A relies upon certain antecedent

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[33] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.) ¶5.
[34] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.).
[35]Arcelor Mittal v. Satish Kumar Gupta, (2019) 2 SCC 1 (Ind.).
[36] Arcelor Mittal v. Satish Kumar Gupta, (2019) 2 SCC 1 (Ind.) ¶ 31.
[37] Chitra Sharma v. Union of India, (2018) 18 SCC 575 (Ind.).
[38] Chitra Sharma v. Union of India, (2018) 18 SCC 575 (Ind.).
[39] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.) ¶97.

facts in its determination.[40] *Secondly*, the Court said that Article 14 is not violated on the contention that Section 29-A treats the guilty promoters at par with the innocent promoters. Section 29-A does not require a person to be a criminal to debar him as a Resolution Applicant. For instance, Section 29-A(a) debars an undischarged insolvent even if his insolvency is due to no fault of his, or a director who failed to submit the requisite financial statements on time under Section 164 of the Companies Act, 2013 is also debarred through Section 29-A(e).[41] Thus, in light of the legislative purpose, such classification stands valid. However, this portion of the judgment is criticized as it reached its conclusion without considering the tests laid down for Article 14 of the Constitution.[42]

Thirdly, the court rejected the contentions challenging the bar imposed upon 'related persons'. Section 5(24-A) gives an expansive definition of "related party" in relation to a corporate debtor. Section 5(24-A) shows that the disqualification under Section 29-A(j) arises only when the person is connected with the business activity of the resolution applicant, and in absence of the same, such person cannot be disqualified.[43] Thus, the provision rightly debars a person who is connected to the person in management or control of the business of the corporate debtor during the implementation of a resolution plan. *Lastly,* the Court said that a defaulter is ineligible to submit a resolution plan. The restriction is not limited to willful defaulters. The legislative policy aims to debar any person who is unable to service his/her loans shall be ineligible to be a resolution applicant.[44] The Court relied upon the Committee Report to review IBC, which said that there is no conclusive way to determine the ideal duration of continuance of NPA for the disqualification to be applicable. Being a new legislation, it would be prudent to see the market reaction for a sufficient

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[40] The same issue was earlier raised in *Arcelor Mittal judgment,* and its reasoning was adopted by the Court.

[41] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.) ¶100.

[42] Dhruva Gandhi & Sahil Raveen*, The Supreme Court's Judgment and the Continuing Problems with 'Manifest Arbitrariness*, CONST. L. AND PHIL. (Dec. 8, 2019) https://indconlawphil.wordpress.com/2019/12/08/guest-post-the-supreme-courts-ibc-judgment-and-the-continuing-problems-with-manifest-arbitrariness/

[43] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 ¶ 109.

[44] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.) ¶ 105.

duration before any amendments are introduced to the provision. Moreover, the one-year period is reasonable period for clearance of any dues, and therefore, it is not arbitrary.[45] Thus, the Court held that disqualification under Section 29-A extends to any resolution applicant including any connected persons at the time of the submission of the resolution plan.[46]

Thus, the validity of Section 29-A was upheld, and thereby all the claims raised by the applicant. With regards to the objectives of the IBC, two *prima facie* concerns arise. *Firstly*, the Prospective Resolution Applicants found ineligible under Section 29-A would challenge this determination, and which only would delay the insolvency resolution process i.e. a process where time is of utmost importance. For instance, consider a "relative party" to an erstwhile promoter, debarred under Section 29-A. The Court said that the terms "related party", "relative", "connected persons" once read harmoniously do not raise the concerns of arbitrariness. Here, instead of clarifying the law, the Court increased confusion by vague holding that "*in absence of showing that such person is 'connected' with the business of the activity of the resolution applicant, such person cannot possibly be disqualified under Section 29-A(j).".* *Secondly*, in a situation where an erstwhile promoter who outbids all other applicants, then the rejection of such resolution plan contravenes the objective of 'maximizing the value of the assets'.[47] The Court left this argument unanswered in its decision. A better approach for the Court might be to shift towards explicit adoption of 'case-to-case' based determination. This approach raises the possibility of arbitrariness in interpretation by the judges, however, it would have permitted the legitimate resolution applicants to submit their plans. This clarity presently lacks in the wide net adopted under Section 29-A.

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[45] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.) ¶13.
[46] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.) ¶106.
[47] Sudipta Routh & Pooja Dadoo, *Swiss Ribbons and Its Implications: The Supreme Court on the Constitutionality and Key Provisions of The Insolvency and Bankruptcy Code*, MONDAQ (Feb. 12, 2019) https://www.mondaq.com/india/insolvencybankruptcy/781154/swiss-ribbons-and-its-implications--the-supreme-court-on-the-constitutionality-and-key-provisions-of-the-insolvency-bankruptcy-code.

IV. INTERNATIONAL PRACTICES

The India's insolvency framework borrows certain underlying principles from UK and the US.[48] UK adopted a 'creditor-in-control' model, while the US adopted a 'debtor-in-control' model. However, despite the different insolvency mechanism adopted by these two jurisdictions, both the jurisdictions attempt towards rescue and rehabilitation over liquidation of the institution. India, on the lines of UK, adopted a 'creditor-in-control' regime, where insolvency process is led by a creditors approved insolvency professional, under the overall control of CoC.[49] Under the Indian model, Resolution Professional resembles the "Administrator" under UK's Insolvency Act.[50] The final decision, whether to liquidate the corporate debtor or to approve the resolution plan, is approved by the Adjudicating Authority.[51] Under Section 31(2), the Adjudicating Authority can even reject the resolution plan.

Interestingly, "Resolution Applicant" is an Indian innovation and no similar professional is prescribed under UK's or the US's insolvency regimes.[52] Section 29A further provides a long list, enlisting the persons who are disqualified from proposing a resolution plan as a resolution applicant.[53] Section 29-A protection was introduced to prevent the persons who earlier contributed to default of a company from becoming resolution applicant.[54] The same concern is addressed by the UK's insolvency regime by preventing the incumbent management from managing corporate debtor during the administration proceedings. Through Section 29A IBC, 2016 takes a step further to all together prevent the erstwhile

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48 M.P. Ram Mohan & Vishakha Raj, Section 29A of India's Insolvency and Bankruptcy Code: An instance of Hard Cases making Bad Law? Ind. Inst. of Man. Ahmedabad, Working Paper No. 2021-07-01 (2021).

49 THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA & THE INTERNATIONAL FINANCE CORPORATIONs *Supra* note7.

50 Mohan & Raj, *supra* note 48 at 3.

51 Insolvency and Bankruptcy Code, No. 31 of 2016, § 31 (Ind.)

52 Mohan & Raj, *supra* note 48 at 3.

53 Insolvency and Bankruptcy Code, No. 31 of 2016, § 29-A(Ind.)

54 THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA & THE INTERNATIONAL FINANCE CORPORATION s*upra* note 7.

management, persons holding NPAs or their connected persons, *inter alia,* from participating the future of the company.[55]

A. UNITED STATES

Title 11 of the United States Code ("**the Bankruptcy Code**") governs the insolvency proceeding in the US. In contrast to the Indian insolvency proceedings, US follows a debtor-in-control model where the debtor continues to run the business during insolvency proceedings. Under Chapter 11, debtor gets the exclusive right to propose a reorganization plan. The reorganization details how the debtor's assets shall be utilized among different class of equity and credit-holders.[56] Under Chapter 11, the creditors and shareholders are divided into different classes depending upon the similarities of their claims. The creditors whose claims are impaired may vote on the proposed reorganization plan, which on receiving the required votes can be confirmed by the Court.[57] Even if the plan receives the required votes, the Court independently considers whether the plan stands in the "best interest of the creditors and the estate".[58]

B. UNITED KINGDOM

As mentioned earlier, UK adopts a "creditor-in-control" method, similar to what had been adopted in India, however, with the passage of Corporate Insolvency and Governance Act, 2020 ("**CIGA Act**"), more debtor friendly processes are adopted.[59] For instance, CIGA Act, 2020 introduces a 'standalone moratorium' where the directors remain in control of the company, taking additional duties imposed by the moratorium. The entire process is supervised

[55] *Id.*
[56] Title 11, U.S.C. § 1121(b), (d)(2)(A).
[57] UNITED STATES COURTS, CHAPTER 11 – BANKRUPTCY BASICS https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics.
[58] United States Bankruptcy Code of 1978, Title 11, U.S.C § 1121(b) (1978); *See also* Donald Bernstein, et al, *The Insolvency Review: USA,* THE L. REV (Oct. 25, 2022) https://thelawreviews.co.uk/title/the-insolvency-review/usa#footnote-187-backlink.
[59] Milbank LLP, *In Review: Insolvency Law, policy and procedure in United Kingdom (England and Wales)*, LEXOLOGY (Oct. 26, 2022), https://www.lexology.com/library/detail.aspx?g=2f1f27f3-45a6-4f23-a289-03ffa83756a9.

by a 'monitor', including a duty to end the moratorium if the company's rescue seems unlikely. Under this, restructuring moratorium can be initiated even without the initiation of a formal insolvency process,[60] and this enables the management to retain its control over the company under supervision of a 'monitor'. Moreover, this is similar to the moratorium under administration process under the UK's Insolvency Act, 1986.Even under CIGA Act, during the moratorium, security cannot be enforced, or insolvency or legal proceedings cannot be initiated.[61]

Likewise, 'Administration' is a rescue mechanism for reorganizing the corporate debts and realization of the assets. As a safeguard for the corporate debtor, a statutory moratorium is implemented to protect corporate debtor from creditor enforcement,[62] except when the court permits.[63] Administration process aims to achieve either of these three objectives, *firstly,* rescue the company as a going concern; *secondly,* achieve better results for the company's creditors compared to the usual winding up procedure; and *thirdly,* realize the company's property if achieving the first two objectives is not practicable.[64] The administration process is led by an "administrator", a position similar to "Resolution Professional" in India,[65] and it continues for a one-year period unless specifically extended by the Court. The administrator is required to submit a rescue plan to the creditors within the first few weeks of the administration process.[66]

This depicts the different approaches adopted by the three above-mentioned jurisdictions. In the US, the corporate debtor continues to manage the corporate

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[60] M.P. Ram Mohan & Muskaan Wadhwa, Stigma, Corporate Insolvency, and Law: International Practices and Lessons for India, W.P. No. 22-05-01, Ind. Inst. of Management Ahmedabad, Working Paper No. 2021-07-01, (2021).
[61] *Id.*
[62] The British Insolvency Act of 1986, c. 45, sch. A1.
[63] The British Insolvency Act of 1986, c. 45, sch. B1 ¶¶ 43-44.
[64] The British Insolvency Act of 1986, c. 45, sch. B1 ¶ 3.
[65] Mohan & Raj, *supra* note 48.
[66] Karen McMaster et al, *The Insolvency Review: United Kingdom – England and Wales*, THE L. REV. (Oct. 25, 2022) https://thelawreviews.co.uk/title/the-insolvency-review/united-kingdom-england--wales#footnote-112-backlink

debtor, and he has to propose a "reorganization plan". In the UK, the burden of proposing a plan is upon the administrator. Administrator is a licensed Insolvency Professional, recognized by the professional bodies. Whereas, in India, the bodies. Whereas invites resolution applicants to submit their resolution plans, which are subsequently scrutinized and voted upon by the committee of creditors.[67] UK's position lies somewhere between the extreme positions adopted by the US and India. While UK's position depicts a skepticism towards the incumbent promoters and management officials, it does not go as far as the Indian position to specifically prevent them from regaining control over the company by proposition a resolution plan. Needless to say, the restriction is wide enough to restrict even the person "connected" with the individuals mentioned in Section 29-A. IBC, 2016 adopts a cautious approach coupled with ample opportunities to rectify the mistakes which might arise.[68]

V. GREY AREAS TO BE SETTLED AND THE WAY FORWARD

The participants in insolvency proceedings have different capabilities and responsibilities, depending upon the manner in which insolvency law is designed within a jurisdiction. Inherent questions before any jurisdiction include: who all should be allowed to propose a resolution plan, should the parties be allowed to propose at the same time or in a sequential manner, depending upon the acceptability of the plan proposed. Similarly, certain restrains should necessarily be imposed such as, the voting requirements for plan approval, or whether all the creditors should be allowed to vote upon the resolution plan, whether time limit should be imposed on insolvency resolution framework, and similarly other policy considerations.[69]

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[67] CIRP Regulations, Reg. 29.

[68] M.S. SAHOO, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, A JOURNEY OF ENDLESS HOPE, INSOLVENCY AND BANKRUPTCY CODE: A MISCELLANY OF PERSPECTIVES, 10 (2019) https://www.ibbi.gov.in/uploads/publication/2019-10-11-191135-wv5q0-2456194a119394217a926e595b537437.pdf.

[69] UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAW 211 (United Nations Publications 2005) https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf

Across the jurisdictions, there are four possible frameworks for the parties permitted to propose a resolution plan. It can be proposed by the corporate debtor, by the creditors, by the insolvency representatives, or my multiple parties.[70] IBC, 2016 permits the prospective resolution applicants to submit their resolution plans.[71] These plans are subsequently voted upon by the creditors, and once such plan is approved with a vote of not less than sixty-six percentage, then such plan is put before the Adjudicating Authority for their final approval.[72] On analysis of the existing insolvency process, following suggestions are offered.

Firstly, 2016 imposes wide restrictions upon the persons eligible to offer resolution plan.[73] Only such resolution applicants, who are not disqualified under Section 29-A are eligible to submit resolution plan. Corporate Debtor is ineligible to submit resolution plan; however, the unique position of corporate debtor puts him at an advantage because he can prepare a resolution plan, in consultation with the creditors and any concerned parties, even before the initiation of insolvency proceedings. Corporate Debtor's familiarity with the business helps in effective reorganization of the business. However, this freedom of corporate debtor needs to be effectively balanced while ensuring the creditors' confidence in the process. This position is adopted in the US, where the corporate debtor has exclusive opportunity to suggest a resolution plan within the first 120 days from the initiation of insolvency proceedings.[74] While preparing such plan, the debtor should cooperate and negotiate with the stakeholders involved. Only if such plan fails, then the opportunity to suggest such resolution plan is transferred to the other corporate debtors.

Secondly, Explanation [*I*](ii) to Section 29-A provides that "*any person who shall be…in the management or control of the business of the corporate debtor during the implementation of the resolution plan*" is ineligible to submit a resolution plan under

[70] *Id* at 211-213.

[71] Insolvency and Bankruptcy Code, No. 31 of 2016, § 30(Ind.)

[72] Insolvency and Bankruptcy Code, No. 31 of 2016, § 31(Ind.)

[73] Bansal & Saraf, *supra* note 22.

[74] United States Bankruptcy Code of 1978, Title 11, U.S.C § 1121(b), 1121(d)(2)(A)(1978); *See also* Donald Bernstein, et al, *The Insolvency Review: USA* The L. Rev. (Oct. 25, 2022) https://thelawreviews.co.uk/title/the-insolvency-review/usa#footnote-187-backlink.

Section 29-A(j) of IBC, 2016. This provision effectively debars the Resolution Professional from submitting a resolution plan. However, *UNCITRAL's Legislative Guide on Insolvency Law* suggests such debarment is not a popular approach. A Resolution Professional, through his earlier experience during the insolvency proceedings, becomes well placed to identify measures viable for the business, and he also becomes a viable link to negotiate resolution plans between the parties, thereby reducing the possibility of failure of the resolution plan. However, under the existing framework, the resolution applicants are provided an Information Memorandum, containing "such relevant information as may be specified by the Board".[75] The Information Memorandum prepared by the Resolution Professional is provided to the prospective resolution applicants to enable them to prepare a resolution plan.[76] The information memorandum majorly consists of information on the financial position of the company.[77]Regulation 36(3) provides that "*a member of the committee may request the Resolution Professional for further information of the nature as described in the regulation*", and such information shall be provided to "*all the members of committee of creditors"* if such information has a bearing on the resolution plan.[78] This provision effectively means that such right to seek additional information does not extend to prospective resolution applicants, moreover, the Resolution Professional is under no obligation to provide such additional information to the prospective resolution applicants even when such information has a bearing on the resolution plan. When compared to the existing framework, it is prudent to argue that Resolution Professional would benefit from his experience and knowledge of the company, and an absolute ban upon their ability to propose a resolution plan should be done away with. Once such plan is proposed, it should be scrutinized through the existing two-tier scrutinization process involving the committee of creditors and the adjudicating authority, and this would eliminate the concerns on conflict of interest and/or misuse of power by the Resolution Professional, if any.

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[75] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29 (Ind.)
[76] Insolvency and Bankruptcy Code, No. 31 of 2016, § 29 (Ind.)
[77] CIRP Regulations, Reg. 36(2); NTPC v. Ranjit Chakraborty (2021) 10 SCC 480 ¶ 6.
[78] CIRP Regulations, Reg. 36(3).

Thirdly, a jurisdiction like India where various prospective resolution applicants who are found eligible by the Resolution Professional are eligible to submit a resolution plan, it is suggested that measures should be taken to ensure that a number of competing plans are not submitted simultaneously.[79] While such competing plans may promote a mutually acceptable plan, it can also potentially complicate the proceedings thereby causing further confusion. The resolution applicants are provided limited duration within which they have to provide a detailed resolution plan. In order to improve the quality of resolution plans being offered, it is suggested that the corporate debtor should be allowed to offer his suggestions to ensure the company continues as a going concern. Further, a provision should be introduced within the CIRP resolutions requiring the corporate debtors, creditors, and other stakeholders involved to offer their utmost cooperation to the prospective resolution applicants. Moreover, the erstwhile management of the corporate debtor should also be allowed to offer their comments upon the resolution plans offered by the prospective resolution applicants. Such comments should need not have any binding force but they would offer a novel perspective from the corporate debtor's perspective, and shall provide another consideration while the committee votes upon the resolution plans. Because once the resolution plan is approved, it becomes binding upon all the stakeholders involved, therefore, seeking comments from the erstwhile management would only improvise the insolvency resolution process.

VI. CONCLUSION

Insolvency and Bankruptcy Code, 2016 has proved to be a deep structural reform, and has brought far-fetched developments in the Indian economy. With each passing day, new challenges are coming forth, and this article limits itself to the process involving resolution applicants. And through these challenges, the law is undergoing substantial transformation. In CIRP process, the Resolution Professional publishes an Expression of Interest inviting prospective resolution applicants. Eligible resolution applicants are selected, and a deadline is set for the

[79] UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, *supra* note 69.

Resolution Professionals to submit resolution plan(s).[80] The resolution plan is then voted upon, and if accepted, is sent to the adjudicating authority for its final approval. In *DBS Bank v. Sharad Sanghi*,[81] the Supreme Court held that if a resolution plan falls short of the prescribed sixty-six percent voting requirement because of which the corporate debtor shall subsequently be liquidated, then within 270 days the members of the committee have the option to change their opinion subsequently with the approval of the rest of the members of the CoC.

Consider another instance, the resolution applicants are required to submit their resolution plans within a specified duration. However, there have been instances where plans were submit after the stipulated deadline, which were not considered considering the sanctity of the timeline,[82] whereas in certain cases, resolution plans were considered beyond the stipulated deadline holding that the tribunals lack the power to review the commercial decisions of CoC.[83] Thus, it is suggested that the CIRP regulations should provide a clear mechanism for reviewing late submissions of resolution plans.[84] Similarly, CIRP resolutions do not permit unilateral revision of resolution plans. This has seen divergent approaches by the tribunals which has created uncertainty in the process, because in certain cases revisions have been allowed in the interest of maximizing the value available to the creditors.[85] In this regard, the insolvency law committee suggested implementation of Swiss challenge method to revise the plans submitted after the deadlines.[86]

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[80] CIRP Regulations, Reg. 36B (3).
[81] DBS Bank v. Sharad Sanghi (2022) 5 SCC 694 (Ind.).
[82] iLabs Hyderabad Technology v. R. Nagbhushan IA No. 3341/(ND)/2020 in CP No. (IB) 893/ND/2018 dated 15 September 2020 (NCLT- New Delhi).
[83] Kalpraj Dharamshi v. Kotak Investment Advisers Ltd., CA Nos. 2943-2944 of 2020 dated 10 December 2021 (Supreme Court).
[84] MINISTRY OF CORPORATE AFFAIRS, GOV'T OF IND., REPORT OF THE INSOLVENCY LAW COMMITTEE 36 (2022) https://ibbi.gov.in/uploads/resources/f841a45902d901ef311fe6d76127d094.pdf.
[85] Patna Pragati v. Amit Prateek, CA(AT) Insolvency No. 515 of 2020.
[86] MINISTRY OF CORPORATE AFFAIRS, GOV'T OF IND., REPORT OF THE INSOLVENCY LAW COMMITTEE 36 (2022) https://ibbi.gov.in/uploads/resources/f841a45902d901ef311fe6d76127d094.pdf.

Lastly, consider the last step in CIRP process where the resolution plan is finally approved by the adjudicating authority. Once the resolution plan is submitted, no modification is permitted. However, a resolution applicant with a pending resolution plan might want to modify his/her plan or withdraw it altogether considering substantial change in the commercial basis of the resolution plan during the pending insolvency proceedings. However, in *EBIX Singapore Pvt. Ltd v. Committee of Creditors of Educomp Solutions*,[87] the Supreme Court said that "*long delays in approval of the Resolution Plans by the Adjudicating Authority affect the subsequent implementation of the plan. These delays if systematic and frequent, will have an undeniable impact on the commercial assessment that the parties undertake during the course of negotiation"*. Additionally, this disincentivizes the resolution applicants from participating in the insolvency resolution process. The court called for putting in best efforts to "*strictly adhere to the timelines stipulated under the IBC"*. The Insolvency Law Committee ("**May 2022 Report**") suggested that the CIRP regulations should be amended to require the adjudicating authority to approve or reject a resolution plan within 30 days of receiving such plan.[88] And if it fails to take an action within the stipulated deadline, then the reasons mentioning such special reasons should be provided. Thus, considering the series of recommendations being offered, it is apparent that IBC, 2016 is going through its nascent stage. Frequent amendments indicate that utmost efforts are put in to strike the right balance, satisfying the interests of all the stakeholders involved.

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[87] Ram Chander v. The State of Chhattisgarh &Anr, (2022) 3 SCC 401 (Ind.).

[88] MINISTRY OF CORPORATE AFFAIRS, GOV'T OF IND., REPORT OF THE INSOLVENCY LAW COMMITTEE 36 (2022) https://ibbi.gov.in/uploads/resources/f841a45902d901ef311fe6d76127d094.pdf.

CORPORATE GOVERNANCE IN INDIAN VENTURE CAPITAL FUNDS: ADDRESSING INEFFICIENCIES IN CORPORATE FORM AND DISPUTE RESOLUTION

*Ryan Joseph & Sanjitha Ravi**

ABSTRACT

Venture Capital Funds ("VCF's"/"Funds") play a phenomenal role in boosting the capital account of India. Despite their significant economic contribution, they have received very little scholarly attention. The severity of this problem is accentuated by the fact that the absence of scholarly scrutiny has allowed the malaise of agency costs to spread across the industry and affect it to a great extent. This paper attempts to find a potion to this malaise by closely studying the agency costs and the commercial or pragmatic necessities that have allowed for these costs to inflate over time. This paper finds two predominant causes; one in the corporate form of VCFs and the other in the dispute resolution mechanisms available to aggrieved stakeholders. Commercially, funds need corporate structures that provide regulatory flexibility and relatively lax compliances. However, this is a double-edged sword for the latitude also enables agents ("funds managers") to extract private benefits at the expense of their principal ("the investors"). As a remedy to this problem, this paper proposes the use of Variable Capital Companies as an alternative to trusts when incorporating Venture Capital Funds, for this structure finds the right balance between governance standards and commercial flexibility. In addition to the foregoing, due to the non-arbitrability of trust disputes, the incorporation of funds as trusts poses challenges in the private enforcement of rights by investors under Indian law. In order to remedy this limitation, this paper analyses the legal position surrounding the arbitrability of trusts and draws comparisons from the arbitrability of oppression and mismanagement claims to this end.

The paper then proposes a solution by paving the way for a change in arbitration jurisprudence that allows disputes arising in VCFs organised as trusts to be arbitrable. In conclusion, having identified two sources of agency problems in VCFs; the corporate structure and poor mechanisms for principals to enforce their rights, this paper proposes adequate remedies to ameliorate corporate inefficiencies on both fronts. In each case, this paper begins by

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analysing the existing regime and the concomitant inefficiencies they generate. The paper then proposes an alternative that may be suitable for the Indian commercial markets.

Keywords: Venture Capital Funds, Agency Costs, AIF Regulations, Trusts, Commercial Markets.

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I. INTRODUCTION

Over the decades, India has emerged as one of the fastest-growing economies in the world. The country's impressive economic growth, combined with a large and diverse consumer market, a skilled workforce and a business-friendly environment, has made it an attractive investment destination for investors. India has seen a significant increase in Venture Capital ("**VC**") investments in recent years, with the country emerging as a hotbed for startups and innovation. Indian start-ups received a total of US $20.9 billion in VC investments in 2022.[1] Venture Capital Funds are classified as a Category I investment vehicle[2] under the Securities and Exchange Board of India ("**SEBI**")

[1] The Economic Times, *VC Investments in Indian startups plunge 38% in 2022*, THE ECON. TIMES (Jan. 24, 2023) https://economictimes.indiatimes.com/tech/startups/vc-investment-in-indian-startups-plunge-38-in-2022/articleshow/97279702.cms.

[2] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Gazette of India, Gazette of India, pt. III sec. 4, Reg 3(4) (21st May 2012).

(Alternative Investment Funds) Regulations 2012 ("**AIF Regulations**"), and as such are organized as trusts, limited liability partnerships ("**LLPs**"), and incorporated companies. In India, VCFs are predominantly organized in the form of trusts. Scholarly articles on VCFs exist in abundance, but these have been written on VCFs in other countries such as USA,[3] Europe[4] and China[5].

The business form of VCFs organized as trusts gives room to a considerable number of agency and enforcement problems which renders the trust form akin to a cocoon that VCFs ought to soar. Particularly, a complicated problem with substantial layers arises in dispute resolution concerning VCFs organized in this form as trusts in Indian law are non-arbitrable.[6] A notable contribution by Lin and Varottil[7] on the issues arising out of the business form of VCFs in India makes a reference to this private enforcement issue. Barring this, however, there is close to no literature on the issues surrounding the non-arbitrability of trusts in the context of VCFs in India. Accordingly, this paper attempts to fill this lacuna by illustrating the organization of VCFs as trusts in India, the numerous agency problems arising out of such a structure, and the public and private enforcement issues concerning VCFs in India. The paper will then present the legal position on the arbitrability of issues arising from the VCF trusts through an extrapolation with the legal position of the arbitrability of oppression and mismanagement claims arising from shareholders' disputes in India. Towards this, the paper will suggest that the Supreme Court in India provides clarification and allows the arbitrability of VCF trust disputes. The paper will take the further and final leap in combating agency and enforcement issues arising from VCF trusts in India by proposing Variable Capital Companies ("**VCCs**") as an alternate corporate structure to trusts to house VCFs. This recommendation will

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[3] Anat Alon-Beck, *Alternative Venture Capital: The New Unicorn Investors*, 87 TENN. L. REV. 983 (2020).
[4] Edita Culinovic-Herc et al., *New regulation of Private Equity and Venture Capital Funds and Open Questions*, 38 ZBORNIK PRAVNOG FAKULTETA SVEUČILIŠTA U RIJECI 51(2017).
[5] Lu Haitian et al, *Venture Capital and the Law in China,* 37 HK L. J. 229 (2007).
[6] Shri Vimal Kishor Shah v. Jayesh Dinesh Shah, (2016) 4 ICC 634.
[7] Lin Lin & Umakanth Varottil, Venture Capital in China and India: Does Business Form Matter?, (Nat'l U. of Sing., Working Paper No. 017 of 2019) https://law.nus.edu.sg/cals/wp-content/uploads/sites/4/2020/04/017_2019_Lin-Lin_Umakanth.pdf.

be substantiated by highlighting the benefits of VCCs such as the existence of constitutional documents, a board of directors, general meetings and the presence of mandatory audited financial disclosures. This paper will then proceed to argue that VCCs allow for higher standards of corporate governance without compromising the commercial advantages of using trusts for setting up VCFs.

II. VENTURE CAPITAL FUNDS AS TRUSTS IN INDIA

The rationale behind the preference of trusts over other structures in India can be attributed to the low costs and simplicity of setting up trust deeds which are executed between the settlor and trustees.[8] The registration and amendment of trust deeds are not cumbersome, unlike LLPs or companies.[9] Furthermore, unlike companies, trusts do not have minimum capitalization requirements, and they offer great flexibility for raising and redeeming capital.[10] Taxation of trusts is performed at only one level as opposed to companies which have double taxation owing to the latter being a separate legal entity from its owners.[11] The rigidity of compliance and disclosure requirements surrounding companies and LLPs do not affect trusts. There are no separate disclosure requirements for VCFs set up as trusts other than those mandated in the AIF Regulations.[12]Above all, there are duties and obligations on the parties to the trust the question of who are "parties" in this case is a separate debate altogether and will be addressed in the subsequent sections –conferred by the Indian Trusts Act 1882; however, there is still adequate room for such parties to enter into separate agreements with their own set of commercial obligations.[13]

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[8] GOVERNMENT OF INDIA, REPORT OF THE EXPERT COMMITTEE ON THE FEASIBILITY OF THE VARIABLE CAPITAL COMPANY IN INTERNATIONAL FINANCIAL SERVICES CENTRES IN INDIA (INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY 23 (2021) vcc-report-final-version-18062121062021111219.pdf (ifsca.gov.in).
[9] *Id.*
[10] *Id.*
[11] *Id.*at 2.
[12] *Id.*
[13] Lin & Varottil, *supra* note 7.

The principal parties involved in this structure are the trustee, investment manager, and investors as the beneficiaries of the trust.[14] The settlor sets up the trust and enters into a trust deed with a trustee a third party who provides trusteeship services for numerous funds at a fee.[15] This trustee only discharges a nominal role, and the active role of managing the VCF is conferred upon an investment/fund manager through an investment management agreement. The added layer between the trustee and the investment manager provides the advantage of ring-fencing to the latter by segregating their liability as a counterparty service provider from that of the VCFs.[16] It serves in the best interest of the fund to not bind the manager to those of the fund in this manner so that the manager may act without bias in exercising his duties.[17] The beneficiaries of the trust, i.e., the investors in the VCF, are roped in via contribution agreements between themselves and the trustee as well as the investment manager.[18] This can be understood through the following figure:

[14] Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996, Gazette of India, pt. III sec. 4 (Dec. 4, 1996).
[15] Government of India, *supra* note 8.
[16] Lin & Varottil *Supra* note 7.
[17] *Id.*
[18] Saikrishna Bharathan & Ganesh Rao, *Alternative Investment Funds in India: Unlocking Sophisticated Investment*, 3 NAT'L L. SCH. BUS. L. REV. (2017).

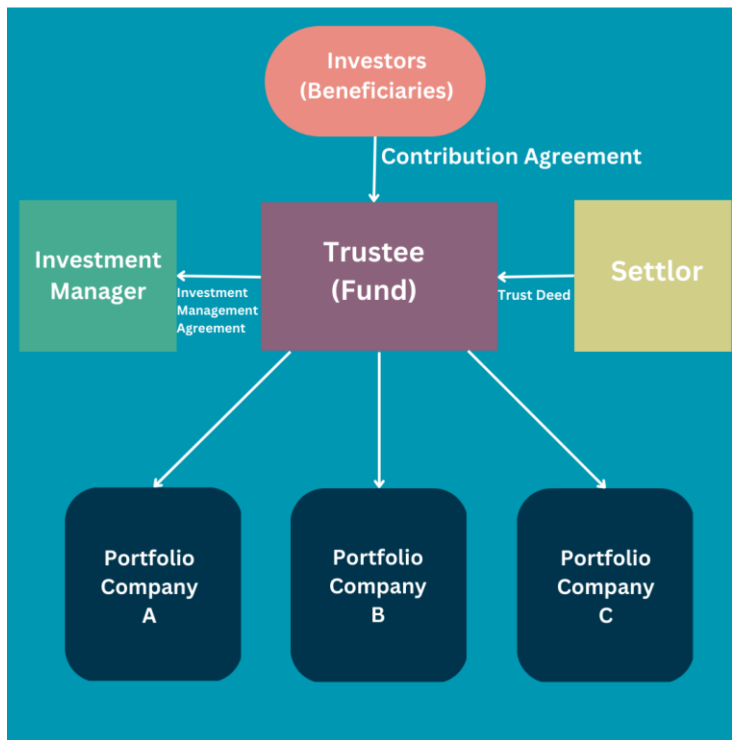

Figure 1: A Typical Venture Capital Fund Trust Structure

III. THE AGENCY COSTS IN VCF TRUSTS

Agency costs are inefficiencies in a relationship where the welfare of one actor ("**the principal**") is contingent upon another actor ("**the agent**") acting in the best interests of the principal.[19] Typically, the principal would entrust the agent with her resources and the agent is expected to use these resources in the best interests of the principal. The obvious problem in this relationship is that it is very difficult for the principal to monitor all the actions of the agent and ensure that the agent does not act in prejudice to the interests of the principal. Quite often agents exploit the information asymmetry to their benefit which creates inefficiencies. Owing to the ubiquitous existence of information asymmetry in agency relationships, agency costs have become an intrinsic facet

[19] Steven Ross, *The Economic Theory of Agency: The Principal's Problem* 63 AM. ECO. REV. 134 (1973).

of such relationships. Whether it's a relationship between shareholders and directors[20] or founders and investors[21] these inefficiencies are present in relationships across the spectrum. Regulators around the world are scratching their heads trying to come up with countermeasures to ameliorate these costs. Similarly, most of our corporate jurisprudence is devoted to addressing these costs.[22] In this vein, this section will shed light on the agency costs that are rampant in the funds industry. The subsequent sections will then identify two solutions that could be used to address the issues raised in this section.

A. AGENCY COSTS IN VCFS

High-net-worth individuals often have so much money that they struggle to deploy their capital in an efficient manner that maximises profits.[23] Fund managers on the other hand are experts in deploying capital and often have decades of experience with it. Cognizant of this fact, High-net-worth individuals often invest their capital with fund managers who then identify the right investments to provide their clients with market-beating returns. By virtue of the liberty given to fund managers to identify the right investments, they are in a position to impose considerable costs on their principal; the investors.[24] Commentators have remarked that the agency costs between fund managers and investors are particularly high owing to the palpable information asymmetry between the fund managers who deploy the capital invested, and the investors who cannot scrutinise every such deployment closely.[25] This problem is further accentuated when fund managers have to manage too many funds. With their time and attention divided amongst many funds, managers may not exercise the

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[20] John Armour, et al, *The Essential Elements of Corporate Law: What is Corporate Law?*, (Harv. L. Sch. John M. Olin Ctr. for L., Econ. and Bus, Discussion Paper No. 63 , 2009) http://www.law.harvard.edu/programs/olin_center/papers/pdf/Kraakman_643.pdf.

[21] Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 NYU L REV. 967 (2006) at 993.

[22] Armour, *Supra* note 20.

[23] Houman B. Shadab, *Improving Hedge Fund Governance*, 18 STAN. J.L. BUS. & FIN. 141 (2013).

[24] *Id.*

[25] William A. Sahlman, *The Structure and Governance of Venture-Capital Organizations*, 27 J. FIN. ECON. 473, 493 (1990).

necessary diligence and care when investing.[26] Often the managers are under so much pressure from investors that they may make decisions that may benefit investors in the short run at the expense of their welfare in the long run.[27] There have been numerous instances when fund managers have resorted to tacit window dressing by making untimely exits from investments to ensure the performance of the portfolio is not stymied in the short run.[28] For instance, pension fund managers in the United States were found to have oversold stocks that did not meet their targets for a quarter only to allay any fears in the minds of the investors about the performance of the fund.[29] While the duties of a fund manager would mandate the manager to treat their investors equally, a prevalent market practice is for fund managers to use "side letters" to provide preferential terms to certain investors that are not offered to all investors.[30] Such market practices impose an agency cost on the investors who do receive such treatment.

Certain agency costs are very common and unique to the fund industry. Frontrunning and artificially improving the performance of the portfolio by co-investing is one of the most prominent ones.[31] The SEBI defines frontrunning as the practice of using confidential information to buy securities in advance of a large order in the same security.[32] As fund managers and other senior employees at VCFs are aware of the trades they are about to enter into, at times, an employee may purchase the same security and once the value of the security skyrockets owing to the large order placed by the fund, the employee may exit

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[26] Christopher Gulinello, *Venture Capital Funds, Organizational Law, and Passive Investors*, 70 ALB. L.REV..303, 341-342 (2006).
[27] Robert P. Bartlett III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 47, 72-73 (2006).
[28] Joseph Bankman & Marcus Cole, *The Venture Capital Investment Bust: Did Agency Costs Play a Role – Was it Something Lawyers Helped Structure*, 77 CHI. KENT L.REV. (2001) 211, at 231.
[29] Lakonishok et al, *Window Dressing by Pension Fund Managers*, 81 AM. ECON. REV. PAPERS AND PROCEEDINGS, 227–231 (1991).
[30] Armour, *supra* note 20.
[31] Lin, *Private Equity Investor Protection: Conceptualizing the Duties of the General Partners in China*, 15 BERKELEY BUS. L.J. 43, 52 (2018).
[32] Securities and Exchange Board of India, Amendment to the Consent Circular dated 20th April 2007, (May.25, 2012). https://www.sebi.gov.in/legal/circulars/may-2012/amendment-to-the-consent-circular-dated-20th-april-2007_22808.html

the position and net the profit. Recently, at Axis Mutual Fund, the chief dealer, Viresh Joshi was found to have made wrongful gains to the tune of Rs. 30.56 crores by frontrunning the investments that the mutual fund was making.[33] Similarly, the fund manager may use the capital from a well-performing fund to invest in the securities of an ailing fund to artificially improve its performance.[34] There have also been instances where fund managers have misappropriated fund assets for themselves.[35] An investigation by the Securities Exchange Commission ("**SEC**") into the activities of Harbinger Capital Partners LLC revealed that the Fund advisor, Philip A. Falcone used fund assets to satisfy his tax liability, invest in an IPO, trade in the securities market on his behalf and gave preferential treatment to certain investors over others.[36] In the United States, the agency problems are exacerbated by the fact that their federal laws allow funds to exist either as regulated or unregulated.[37] The latter are not bound to value their assets in accordance with SEC guidelines which enables funds to misreport with impunity.[38] At times, the fund may inflate the value of its portfolio value through end-of-month trades,[39] or it may delay or revise historic performances that were below market expectations.[40]

B. AGENCY PROBLEMS ARISING FROM VCFS AS TRUSTS

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[33] National Stock Exchange of India, *Interim Order-cum-Show Cause Notice in the matter of Front Running of the Trades of Axis Mutual Fund* (2023) https://archives.nseindia.com/content/circulars/INVG55814.pdf.

[34] William A. Sahlman, *The Structure and Governance of Venture-Capital Organizations*, 27 J. FIN. ECON. 473, 492 (1990).

[35] Larry E. Ribstein, *Fiduciary Duties and Limited Partnership Agreements*, 37 SUFFOLK U.L. REV. 927, 936 (2004).

[36] Press Release, US Securities and Exchange Commission, Philip A. Falcone and Harbinger Charged with Securities Fraud (Jun. 27, 2012) (https://www.§gov/news/press-release/2012-2012-122html).

[37] Armour, *supra* note 20.

[38] SEC Valuation and Liquidity Guidance for Registered Investment Companies, 87-102 (Inv. Co. Inst., 2011) http:// www.ici.org/pdf/pub_11_valuation_volume1.pdf.

[39] Itzhak Ben-David, Francesco Franzoni, Augustin Landier & Rabih Moussawi, *Do Hedge Funds Manipulate Stock Prices?*, 68(6) J. FIN. 2383, 2432 (2013).

[40] Aragon, George O. & Vikram Nanda, *Strategic Delays and Clustering in Hedge Fund Reported Returns*, J. of Fin. and Quan. Anal. 52 (2017).

In India, VCFs predominantly use trusts as a corporate structure.[41] While the numerous commercial benefits of this decision have been elaborated on above, there are certain disadvantages of corporate governance to these structures. Owing to the high standard of care expected from the trustee under the Indian Trusts Act and the statutory obligations placed on them,[42] in market practice, to limit the liability of the trustee, a corporate manager acts as a trustee instead of an individual.[43] The actions of the corporate managers are controlled by its board of directors; therefore, in effect, it is the board of directors of the corporate manager that acts as the trustee. However, in India; as is the case in common law[44] generally, the directors of a company owe no duties to the investors and only owe it to the company.[45] Therefore, the directors of the corporate manager, who virtually, that is trustee are not under an obligation to act in the best interests of the beneficiaries of the trust but are expected to act in the best interests of the corporate manager. In fact, in case of a potential conflict between the interests of the corporate manager and the trust, the directors of the corporate manager would be obligated to prioritise the interests of the corporate manager over that of the trust or the beneficiaries.[46] Furthermore, the directors are not accountable in any manner or form to the investors of the fund as these directors are appointed by the fund and not the investors.[47] As the corollary, even if the investors were aggrieved by the actions of the directors, they cannot vote the directors out. In addition to the foregoing, as a means to reduce their exposure to statutory liability, corporate managers that act as trustees often incorporate indemnity and waiver clauses in the investment agreement whereby, they can recuperate losses or penalties they may incur when carrying out the

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[41]*Supra* note 10.
[42] Indian Trusts Act, No. 2 of 1882, Pt. III, INDIA CODE (2019).
[43]*Supra* note 10.
[44] Percival v. Wright, (1902) 2 Ch. 421.
[45] Nanalal Zaver v. Bombay Life Assurance, AIR 1950 SC 172.
[46] AES OPGC Holding (Mauritius) v. Orissa Power Generation Corporation Limited MANU/CL/0103/2004.
[47] Ross, *supra* note 19.

operations of the fund.[48] Lastly, even in India, the standard of disclosure and governance expected to be complied with by funds is not very high.[49] As discussed in the previous section, even commercially, trusts as a structure have certain limitations as a corporate structure for funds. For instance, it is unclear whether a trust can claim benefits under the various tax treaties to which India is a party.[50] This misalignment of accountability and contractual indemnity once again exposes investors to considerable governance risks.

Prima facie, the ability of trustees to shield themselves in the foregoing manner may indicate that the legislative policy moulding governance in funds is ludicrous. However, commentators have justified these measures because excessive governance structures may shackle fund managers from engaging in bona fide transactions and may impose too many regulatory costs for trusts to be a viable corporate structure for sustaining funds.[51] Policymakers in India have explicitly acknowledged the commercial preference of trusts as the corporate structure for funds owing to the lax statutory obligations vis-à-vis using a private limited company as a corporate structure.[52] Few commentators go so far as to argue that when picking funds to invest in, investors place great reliance on the reputation of the fund and the fund manager; hence, fund managers cannot afford to not keep the best interests of their investors.[53] They argue that the reputational concerns are so important in the funds industry that even if the law were to not provide for stringent regulatory mechanisms, the guiding hand of the market would compel funds to uphold high standards of corporate

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[48] Shreya Rao & Vakasha Sachdev, *Can Trustees Contract Out of Fiduciary Liabilities*? IND. CORP. L. (Mar. 25, 2017) https://indiacorplaw.in/2017/03/can-trustees-contract-out-of-fiduciary.html.
[49] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, REPORT OF THE EXPERT COMMITTEE ON FEASIBILITY OF THE VARIABLE CAPITAL COMPANY IN INTERNATIONAL FINANCIAL SERVICES CENTRES IN INDIA 25 (2021) https://ifsca.gov.in/Document/ReportandPublication/vcc-report-final-version-18062121062021111219.pdf.
[50] *Id* at 25.
[51] Armour, *supra* note 20 at 28.
[52] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, *Supra* note 49.
[53] Kate Litvak, *Governance through Exit: Default Penalties and Walkaway Options in Venture Capital Partnership Agreements*, 40 WILLIAMETTE L. REV. 771, 772 (2004)

governance.[54] Notwithstanding the foregoing, other commentators argue that these reputation mechanisms may be an effective mechanism to uphold governance in developed financial markets. However, in developing markets, due to the lack of transparency and information asymmetry, reputation mechanisms are not effective enough to compel good governance on behalf of fund managers in China[55] or India.[56] When recommending policy suggestions to improve governance in funds, it is important to be mindful of commercial realities as arbitrarily increasing compliances would tarnish India's reputation as a pro-business state and may even motivate funds to seek alternate jurisdictions. Yet at the same time, the limitations of trusts as a corporate structure to balance the governance interests of investors with the need for flexibility and regulatory ease of funds have become very evident. Building on this premise, the final part of this paper studies Variable Capital Companies as a corporate structure for funds that may prove more effective in balancing the interests of multiple stakeholders.

IV. THE ISSUES SURROUNDING ENFORCEMENT IN VENTURE CAPITAL FUNDS

As mentioned in the introduction, VCFs in India are regulated by SEBI under the 2012 AIF Regulations. Investors are entitled to approach SEBI for enforcement of compliance with the regulations. However, this public enforcement role played by SEBI is limited to only breaches of the compliance requirements of the AIF Regulations. If, for instance, a VCF takes up an investment activity that is not included in the trust deed,[57] or if the investment manager fails to address all investor complaints,[58] the aggrieved investor may

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[54] Ronald J. & Gilson, *Engineering Venture Capital Markets: Lessons from the American Experience,* STAN. L. REV. 4, 1085-86 (2003).
[55] Lin, *The Private Equity Limited Partnership in China: A Critical Evaluation of Active Limited Partners*, 13(1) J. CORP. L STUD. 185 (2013).
[56]Lin & Varottil, *supra* note 7.
[57] Securities & Exchange Board of India (Alternative Investment Funds) Regulations,2012, Gazette of India, pt. III § 4, Reg. 4(a) (March 6, 2017).
[58] Securities & Exchange Board of India (Alternative Investment Funds) Regulations,2012, Gazette of India, pt. III § 4, Reg. 4(a) (March 6, 2017).

approach the Board for regulatory action. The extent of remedies that would be available to such aggrieved investors, nonetheless, is uncertain. It is also of note that to date, there has been no significant enforcement by SEBI in matters that have been taken to it regarding violation of AIF Regulations. There have been few instances of applications being filed before SEBI which resulted in remedies of the likes of a penalty being imposed on a deviant AIF which was engaged in lending unauthorized loans.[59]

A. A LENS ON PRIVATE ENFORCEMENT

Various agency costs arising in trusts, and consequently VCFs organized as trusts have been elucidated in the previous section of this paper. Aside from these, a pertinent issue that emerges as a particularly pointed needle amidst the others is private enforcement. The contribution agreements through which investors make their investments in the VCF serve as a means through which they might enjoy contractual recourse against the investment manager who is not a signatory to the trust deed. While it is true that a trust structure would allow investors as beneficiaries to initiate legal proceedings under the trustee vide the rights conferred on them by the Trusts Act of 1882; it becomes equally, if not more painfully, true that these proceedings before Courts would amount to significant delays.[60]As a result, investors in the current global marketplace lean towards arbitration as a means of dispute resolution. Unfortunately, the position taken by the Supreme Court of India is that disputes arising out of trusts are non-arbitrable.[61] Owing to this and other reasons such as the trust deed being in the public domain,[62] it is the contribution and investment management agreements that contain the meaty commercial clauses – meaning that an arbitration clause can be included among these which would be invoked in case of a dispute arising out of breaches of the individual agreements.

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[59] Securities & Exchange Board of India, Settlement Order in respect of SREI Multiple Asset Investment Trust and SREI Alternative Managers Limited (2018) https://www.sebi.gov.in/enforcement/orders/jul-2018/settlement-order-in-respect-of-srei-multiple-asset-investment-trust-and-srei-alternative-managers-limited-_39703.html.

[60] Lin & Varottil, *supra* note 7.

[61] Shri Vimal Kishor Shah v. Jayesh Dinesh Shah, 2016 (5) ABR 737.

[62] Lin & Varottil, *supra* note 7.

B. ARBITRATION AGREEMENTS IN TRUSTS

The inclusion of the arbitration clause in the investment management and contribution agreements, seems, through a glass window as an effective means of circumventing the fundamental non-arbitrable nature of trusts under Indian law. However, when one opens the window and is left facing the implications of such a prohibition on an investment structure, one becomes privy to more than what meets the shielded eye. To understand this, the rationale for trusts being non-arbitrable must be examined.

First, the Courts in India do not view trust deeds as contracts because they are not built on an exchange of promises as contracts are.[63] However, this take can be countered through the fact that the terms of the deed are negotiated between the trustee and the settlor and that there is an offer and acceptance.[64] It was in *Jagdish Chander v. Ramesh Chander and Ors.*[65] that the view of arbitration clauses in trust deeds not being invalid by virtue of meeting of minds of the parties involved was taken. The contractual nature of trust deeds is, regardless, just the tip of the iceberg as the establishment of a legal relationship between parties to the arbitration agreement would be enough for the dispute to be arbitrable. Certain kinds of disputes are intended by the legislature for adjudication at a public forum as a matter of public policy.[66] Accordingly, the most important reason as to why trust disputes are non-arbitrable is due to the rights arising out of trust deeds being rights in rem,[67] i.e., affecting the rights of the beneficiaries as third parties. The duties and obligations conferred on the parties to the trust deed are statutory rights vis-à-vis contractual rights, the breach of which would most definitely be arbitrable.[68] Additionally, the beneficiaries of trusts, more often than not, were minors or individuals who had

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[63] Shradha Rakhecha, *The Curious Case of Arbitration of Trusts Disputes*, 2 INDIAN J. ARB. L. 165-167(2013)
[64] Bhagivandas Goverdhandas Kedia v. M/s. Girdharilal Parshottamdas, AIR 1966 SC 543.
[65] Jagdish Chander v. Ramesh Chander (2007) 5 SCC 719.
[66] Avinash Kumar, *Arbitrability of Oppression and Mismanagement Petitions in India,* 36 STATUTE L. REV. 202, 203. (2015)
[67] *Id.*
[68] O.P. Gupta v. Shiv General Finance (P.) Ltd & Ors., (1977) 47 Comp Cas 279.

no say in the terms of the trust deed itself; so the Supreme Court deemed that Civil Courts would be the *forum convenient* for such aggrieved parties.[69] The landmark judgement of the Supreme Court in *Shri Vimal Kishor Shah & Ors. v. Mrs Jayesh Dinesh Shah & Ors.*[70] answered the legal question of trusts being arbitrable in the negative once and for all. The ratio for this judgement was two-pronged: that the beneficiaries could not be treated as parties to the contract due to the mere fact that they were not signatories to the trust deed and could not be said to be part of the arbitration agreement contained therein and that by virtue of the Trusts Act being a complete Code in itself which conferred legal remedies for those aggrieved (settlor, trustee, beneficiaries) upon a principal Civil Court of original jurisdiction, it implicitly ousted the jurisdiction of the Arbitral Tribunal. The Apex Court relied on its Constitution Bench's verdict in *Dhulabhai v. State of Madhya Pradesh*[71] which laid down the conditions under which the jurisdiction of Civil Courts could be ousted to rule that an Act specifically providing for the jurisdiction of a Civil Court ousted that of the Arbitral Tribunal. Interestingly enough, however, this verdict came before the 2015 Amendment to the 1996 Arbitration Act, which altered the ambit of Section 8[72] of the Arbitration Act to include individuals "claiming through" signatories to the arbitration agreement as parties in an arbitration. The first prong of the ratio, accordingly, could be removed by this amendment.

C. THE (NON?) ARBITRABILITY EXTRAPOLATION

It has been 7 years since the verdict in *VK Shah* and its position stands as sure as it did the day it was freshly laid. This begs the question: what implications does this position have on VCFs organized as trusts? To elucidate this better, the author draws the attention of the reader to the legal position concerning the arbitrability of oppression & mismanagement in India. The *Anupam Mittal v. Westbridge Ventures II Investment Holdings*[73] dispute had the Singapore Court of

[69] Shri Vimal Kishor Shah v. Jayesh Dinesh Shah, 2016 (5) ABR 737.
[70] Shri Vimal Kishor Shah v. Jayesh Dinesh Shah, 2016 (5) ABR 737.
[71] Dhulabhai v. State of Madhya Pradesh, AIR 1969 SC 78.
[72] The Arbitration and Conciliation (Amendment) Act, No. 3 of 2016, §8.
[73] Anupam Mittal v. Westbridge Ventures II Investment Holdings [2023] SCGA 1.

Appeal ("**SCA**") adjudicating on an oppression & mismanagement ("**O&M**") claim arising from a shareholders' agreement ("**SHA**") with an arbitration clause. The SCA referred the parties to arbitration, but it did so because it decided that Indian law would not be applicable to the dispute at hand (even though the parties had prorogated jurisdiction in favour of Indian law) as the arbitration clause (severable in nature) would lose meaning as oppression & mismanagement claims are non-arbitrable in India.[74]Much like relief claims from breaches of trust, O&M claims arise as a right in rem, conferred upon parties to the SHA by the statutory authority which ousted the jurisdiction of Arbitral Tribunals by expressly conferring jurisdiction for such claims upon the Company Law Tribunal. However, there have been instances wherein Indian Courts have allowed the referral of such matters to arbitration due to the satisfaction of two conditions which flowed from one another: one, that the claim arose from a breach of the contract with an arbitration agreement – a right, then, in personam and not in rem – and two, that the matter, consequently, was capable of being settled by arbitration.[75] The legal position in India, therefore, cannot be said to be that oppression & mismanagement claims are altogether non-arbitrable – something, with all due respect, the SCA ought to have examined more closely before ousting the applicability of Indian law altogether in the *Anupam Mittal* case.

To tie the above illustration to VCFs organized as trusts, the Madras High Court judgement in *Probir Kumar Misra v. Ramani Ramaswamy and Ors.*[76] will be analyzed. The investment agreement (one of the other agreements which was part of the dispute) between the investor and the VC Fund (as a trust) in this case contained an arbitration clause; however, the dispute was in the nature of oppression & mismanagement.[77] The question of whether the Company Law Board (predecessor to the NCLT) ("**CLB**") had jurisdiction to decide issues referrable to arbitration as per the investment agreement was answered in the

[74] Anupam Mittal v. Westbridge Ventures II Investment Holdings [2023] SCGA 1.
[75] Booz Allen and Hamilton Inc. v. SBI Home Finance Ltd. and Ors., AIR 2011 SC 2507.
[76] Probin Kumar Misra v. Ramani Ramasyamy (2010) 154 Comp Cas 658.
[77] Probin Kumar Misra v. Ramani Ramasyamy (2010) 154 Comp Cas 658.

affirmative as the predominant issue in the case was of oppression & mismanagement.[78] Nevertheless, this did not prevent the High Court from criticizing the CLB for granting far-reaching relief which allowed the portfolio company to be reconstituted because it had the powers to do so as this resulted in the promoters retaining their shareholding leaving the investor unable to sell their shares and interest for a consideration (as directed).[79] The High Court ultimately decided that the aforementioned relief needed to be looked into and a new, proper and equitable order had to have been passed in that regard.[80]Aside from the time-consuming nature of adjudication, Courts could pass orders that could be detrimental to the parties. Keeping aside the latter as a reason for which investors could prefer arbitration, the most important lesson learned from the aforementioned case is that the CLB had jurisdiction in the matter even though the investment agreement had an arbitration clause.

D. THE REALITY OF THE ARBITRABILITY OF VCF ORGANIZED AS TRUSTS

Following the aforementioned position, if one of the parties involved in a VCF trust structure were to approach the Courts for relief in the event that their rights as trustees or beneficiaries had been breached, very little would stop Courts from exercising that jurisdiction. To make matters worse, AIFs organized as trusts tend to include clauses in the trust deed that state that the investment management agreement should be read as one with the trust deed.[81] One cannot blame them, as it is only logically coherent because the investment agreements would lack meaning without the original trust deed. The rights and obligations of parties in the investment agreements, therefore, are intrinsically linked with the trust deed. When the cause of action relates to both rights in rem and in personam, a bifurcation would not be possible.[82] The mere fact that the AIF Regulations allow for parties in a VCF to agree on the dispute resolution mechanism of their choice does not oust the jurisdiction of the Civil Court. In

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[78] Probin Kumar Misra v. Ramani Ramasyamy (2010) 154 Comp Cas 658.
[79] *Id.* at para 213.
[80] *Id.* at para 219.
[81] *See* Lin & Varottil, *supra* note 7.
[82] Sukanya Holdings Pvt. Ltd. v. Jayesh H. Pandya, (2003) 5 SCC 531.

fact, when SEBI floated the Draft AIF Regulations[83] over a decade ago in 2012 and invited comments, the critique made to the then dispute resolution provision was that there was no clarity as to whether the provision was recommended or mandatory.[84] SEBI, however, did not address this ambiguity when it passed the AIF Regulations in 2012.[85] When pit against an Act such as the Trusts Act which is a Code of its own, the freedom of choice of dispute resolution in the AIF Regulations might not exactly win.

VCFs would typically have two kinds of investors: domestic and foreign. Investment agreements with foreign investors/for investment into foreign companies are achieved through Bilateral Investment Treaties ("**BITs**") with that particular country.[86] If the dispute is between a foreign investor and an Indian VCF, the matter would fall under International Investment Arbitration.[87] For instance, if a foreign seat is chosen by the parties and the award is passed in favour of the foreign investor, the investor would have to enforce the award in India against the assets of the award debtor, i.e., the VCF.[88] However, enforcement would pose a hurdle as the execution proceedings would need to be filed before a High Court in whose jurisdiction the assets are located.[89] In India, the enforcement of international investment arbitration awards has been tricky in the past owing to India not being a party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1965.[90] The High Courts' position has not been uniform: Delhi High Court has maintained that the Arbitration Act is inapplicable and the award therefore

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[83] Securities and Exchange Board of India, Draft Regulations on Alternative Investment Funds (2012), https://www.sebi.gov.in/sebi_data/meetingfiles/1334566359541-a.pdf.
[84] *Id.* at 48.
[85] Securities and Exchange Board of India, (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III § 4, (March 6, 2017), Reg. 25.
[86] Vodafone International Holdings BV v. Republic of India, PCA Case No. 2016-35.
[87] Vodafone International Holdings BV v. Republic of India, PCA Case No. 2016-35.
[88] Union of India v. Khaitan Holdings (Mauritius) Ltd., 2019 SCC OnLine Del 6755; Union of India v. Vodafone Group Plc, 2018 SCC OnLine Del 8842; Board of Trustees of the Port of Kolkata v. Louis Dreyfus Armatures SAS, 2014 SCC OnLine Cal 17695 (Ind.).
[89] *Id.*
[90] The World Bank, Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965.

cannot be enforced,[91] while the Calcutta High Court has held that it does and enforced the award[92] – this difference was due to the inclusion of investment under the ambit of the word "commercial" under Indian law.[93] However, the Supreme Court has clarified in multiple instances that agreements arising out of BITs would fall within the contours of a "commercial relationship" under the scope of the Arbitration Act; meaning that such disputes would fall under Part II of the Act.[94]

With the enforcement already being as difficult as it is, the allowing of applicability of the Arbitration Act by Courts could still find the award debtor urging the Court to set aside such an award, as the subject matter (dispute arising out of a contract intrinsically linked to a trust deed) would be incapable of settlement through arbitration in Indian law[95] (as trust disputes are non-arbitrable). This would be true even if it was a domestic arbitration or a foreign one. Additionally, the *Anupam Mittal*[96]case served as an example that showcased the ousting of the applicable law (as prorogated by parties expressly in the original contract) by the seat due to the arbitration agreement losing its meaning sans such an ousting. Parties might have intended for Indian law to apply to the arbitration proceedings only to see it ultimately be ousted as a consequence of the subject matter being non-arbitrable under Indian law.

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[91] Union of India v. Khaitan Holdings (Mauritius) Ltd., 2019 SCC OnLine Del 6755; Union of India v. Vodafone Group Plc, 2018 SCC OnLine Del 8842 (Ind.).
[92] Board of Trustees of the Port of Kolkata v. Louis Dreyfus Armatures SAS, 2014 SCC OnLine Cal 17695.
[93] Renusagar Power Co. Ltd. v. General Electric Co., (1984) 4 SCC 679; Koch Navigation Inc. v. Hindustan Petroleum Corpn. Ltd., (1989) 4 SCC 259; R.M. Investments and Trading Co. (P) Ltd. v. Boeing Co., (1994) 4 SCC 541.
[94] United Trade Commission on International Trade Law, Model Law on International Commercial Arbitration r/w The Arbitration and Conciliation Act, No. 26 of 1996 §34; United Trade Commission on International Trade Law, Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958), art. 1(3) r/w The Arbitration and Conciliation Act, 1996, No. 26 of 1996 §48; Government of India, Model Text for the Indian Bilateral Investment Treaty, art. 27.5 (Ministry of Finance, 2016).
[95] The Arbitration and Conciliation Act, No. 26 of 1996, §34, 48.
[96] Anupam Mittal v. Westbridge Ventures II Investment Holdings [2023] SCGA 1.

One way to remedy this private enforcement issue is by allowing disputes in trusts that are of a commercial nature such as VCFs to be arbitrable. The gap of uncertainty surrounding beneficiaries being joined in an arbitration has been filled by the 2015 Amendment to the Arbitration Act.[97] The added issue of beneficiaries being a weak party and not having a say is not a concern in VCFs as they are the investors who hold a significant number of trump cards if not all of them. Contribution agreements are tailored to the preferences of the respective investors, and therefore, would still contain the minutiae of the arbitration agreement. The trust deed, however, would contain an arbitration agreement with the essentials: an express intent between those involved,[98] to a tribunal competent to hear the matter (as per the decision of parties in contribution agreements),[99] and that the decision of the tribunal in that matter would be binding.[100] The Supreme Court even clarified that the characteristic features of the arbitration agreement would not be mandatory if the specific and direct expression of the intention of parties involved (signatories and those claiming through them)[101] is present.[102] Once again drawing on the oppression & mismanagement illustration, it is of note that the Supreme Court has placed on the defendants the onus of proving that the claim for oppression & mismanagement filed by the petitioners was mala fide and vexatious, in nature along with the existence of a clear agreement to arbitrate.[103] No clarification, however, has been provided on what would constitute malice in this regard. Due to their similar nature, this could be extended to VCFs with Courts placing the same obligations on the defendants to the breach of trust claim filed before the Court.

All said and done, this is merely to elucidate the immediate need for the Supreme Court or SEBI to issue a clarification in this regard as to the

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[97] The Arbitration and Conciliation (Amendment) Act, No. 3 of 2015 §4.
[98] Jagdish Chander v. Ramesh Chander (2007) 5 SCC 719.
[99] *Id.*
[100] *Id.*
[101] The Arbitration and Conciliation (Amendment) Act, No. 3 of 2016, §8.
[102] Jagdish Chander v. Ramesh Chander (2007) 5 SCC 719.
[103] Rakesh Malhotra v. Rajinder Malhotra, Company Appeal (L) No. 10 of 2013.

arbitrability of VCFs as Trusts. With the SC and Regulators dithering on the issue, VCFs organized as trusts are surrounded by a cloud of dangerous uncertainty qua dispute resolution. The following section, therefore, will attempt to overcome this agency problem surrounding trusts (among others discussed in the previous sections) by proposing an alteration to VCF investment structures altogether.

V. THE VARIABLE CAPITAL COMPANY STRUCTURE

A Variable Capital Company ("**VCC**") is a corporate structure that was created specifically keeping in mind the needs of the funds' industry. They have been introduced with great success in jurisdictions such as Singapore,[104] Hong Kong, Luxembourg, Ireland,[105] Mauritius[106] and the United Kingdom.[107] In Singapore, right after the law regarding VCCs was enacted, around 100 VCCs registered themselves with the Singaporean authority.[108] The success of these structures can be attributed to the fact that they aim to combine the features of trusts or limited partnerships that are appealing to funds with the governance features of a company that safeguard the interests of investors and other stakeholders.[109] Taking cognizance of the success of this structure, even Indian policymakers have been mulling over proposals to introduce VCCs in India. Two committees, the KP Krishnan Committee[110] and the MS Sahoo Committee[111] have drafted reports addressing the need to introduce VCCs in India and have made policy recommendations on the legislative changes that

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[104] Variable Capital Companies Act, 2018 Sing. Stat. Online (2020) https://sso.agc.gov.sg/Act/VCCA2018.

[105] Irish Collective Asset Management Vehicles Act, 2015 (Act No. 2 of 2015).

[106] The Variable Capital Companies Act (Act No. 3 of 2022).

[107] VCC referred to as "Open Ended Investment Companies" ("**OEIC**") are defined and provided for under the Financial Services and Markets Act, 2000 ("**FSMA**").

[108] Rao & Sachdev, *supra* note 48 at 31.

[109] *Id.*

[110] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, *Supra* note 49.

[111] International Financial Service Authority, Report of the Expert Committee on feasibility of the Variable Capital Company in International Financial Services Centres in India (2021) https://ifsca.gov.in/Document/ReportandPublication/vcc-report-final-version-18062121062021111219.pdf.

would be needed for the same. As India does not have legislation at the time this paper was written when discussing the features of a VCC, reliance has been placed on the recommendations made in the two committee reports.

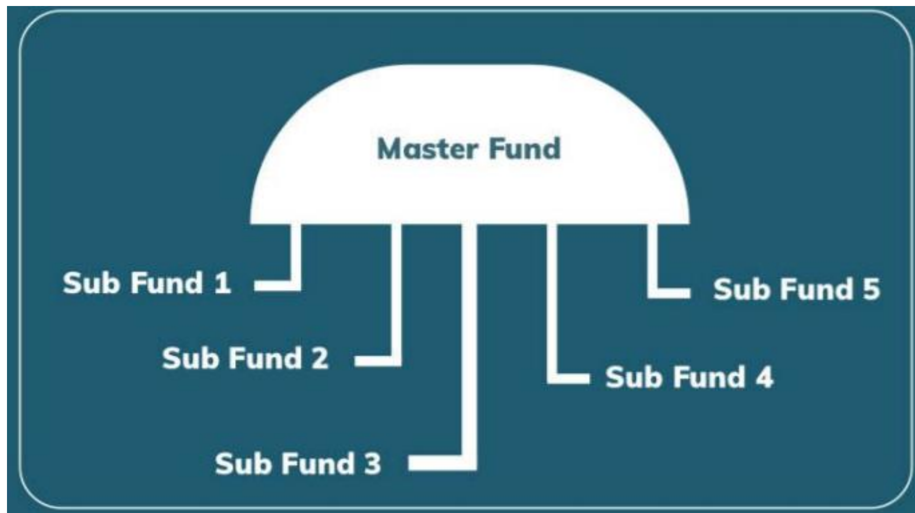

Figure 2: A Depiction of a VCC[112]

As the figure depicts, a VCC contains a master fund under which it can create numerous sub-funds. Similar to a company, a VCC has a separate legal identity vis-à-vis its shareholder and its sub-funds (the sub-funds inter se are also separate legal entities) and has the capacity to hold property, enter into a contract, and sue or be sued.[113] Yet the governing legislations do not impose onerous obligations or reporting requirements to which a typical company would be subjected. The most crucial relaxation is the ease with which a VCC can change its capital.[114] Funds unlike companies, collect investments from investors and see investors exit very frequently and the capital of a VCC is never fixed and constantly fluctuates. Therefore, imposing the obligations of passing numerous resolutions and obtaining shareholder consent that a company is subjected to is

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[112] The Singapore Variable Capital Company, What is VCC Singapore, AGNES CHEN.COM (June 20, 2020) https://agnes-chen.com/2020/06/30/the-singapore-variable-capital-company/.
[113] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, *Supra* note 49 at 36.
[114] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, *Supra* note 49.

an unviable obligation to be imposed on funds. Therefore, the capital of VCCs need not be fixed and can be changed with relative ease. Moreover, these structures also have asset ring-fencing provisions that allow for the hedging of risks.[115] At the time of insolvency, a sub-fund is treated as a separate legal entity from all the other sub-funds and the umbrella fund which ensures that the assets of healthy funds shielded from the creditors of the ailing fund and their claims are restricted to the assets of the fund in which they have a monetary interest.[116]

E. CORPORATE GOVERNANCE BENEFITS IN VARIABLE CAPITAL COMPANIES

This paper has at great length established the limitations of governance mechanisms in trusts to reduce agency costs. Furthermore, it has also demonstrated why the governance standards of a company cannot be arbitrarily imposed on a fund. A VCC unlike a trust is a vehicle that is specifically created for investment funds and has the benefit of hindsight with trusts to create a structure that contains tools to ameliorate agency costs yet not shackle the flexibility of fund managers to make the structure commercially viable.

Constitutional documents of a company such as the Memorandum of Association ("**MOA**") and the Articles of Association ("**AOA**") are the touchstones upon which the actions of a company are predominantly assessed. Unlike trusts where the relationship between the investors and the fund is governed by the contribution agreement, VCCs have constitutional documents such as an MOA and an AOA. These documents further corporate governance by setting out the legal framework within which a company can operate and define the relationship between the VCC's shareholders, the board of directors, and the executive management. They establish rules and procedures for corporate decision-making, define the rights and responsibilities of all parties involved, and provide a foundation for transparency and accountability. Moreover, every investor in a VCC will be able to access the constitutional documents of a VCC and will be privy to the rights of other investors. This

[115] *Id* at 43.
[116] *Id.*

helps mitigate agency costs between investors by ensuring that fund managers will not be able to favour certain investors over others by secretly granting them preferential rights. Lastly, by virtue of the existence of constitutional documents, even the regulator will be in a position to effectively require VCCs to adopt specific provisions that further governance. Albeit even in the trust structure, the trust deed must be submitted to SEBI when applying to operate as an AIF, as was addressed before, funds circumvent the requirement by submitting a minimalistic trust deed and incorporating most of the clauses in the contribution agreement.[117] However, funds would not be able to skirt regulatory scrutiny when acting as VCCs. At the outset, the inability to create an underlying vehicle to hold the governing documents of the VCC would necessitate fund managers to have all the essential articles in the MOA & AOA of the VCC.

The Board of Directors plays a paramount role in minimising agency costs in a company.[118] They act as agents who keep a check on the actions of the executive management of the company and ensure that any action taken by them is in the best interests of the company.[119] Earlier in this paper, it was highlighted that in practice, most trustees are corporate managers and the directors of these corporate managers act in the best interests of the corporate manager (the trustee) and not in the interests of the trust or its beneficiaries which creates a double agency problem.[120] VCC on the other hand, will have a board of directors[121] who are de jure obligated to further the interests of the company (the VCC) which in effect furthers the interests of its shareholders as a whole. Although even the relationship between shareholders of a VCC and its directors would be an agency relationship, this is not a major concern as corporate jurisprudence has evolved over time to incorporate measures that keep such agency costs in check.[122] For instance, the directors in a VCC would be directly

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[117] Securities and Exchange Board of India, (Alternative Investment Funds) Regulations, 2012, Gazette of India, pt. III § 4, (March 6, 2017).
[118] *Ross, supra* note 19.
[119] *Id.*
[120] Lin & Varottil, *supra* note 7.
[121] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, *Supra* note 49.
[122] *Ross, supra* note 19.

appointed by the investors which makes them directly accountable to the investors. Also, both, the Krishnan and the Sahoo committee reports recommended that VCCs must hold annual general meetings and extraordinary general meetings where shareholders would be able to ratify any actions taken by the directors that substantially affect the rights of the shareholders.[123] Even on the disclosures front, the two committee reports have envisaged a scheme for VCCs that mandates financial disclosures to all shareholders of the VCC in accordance with appropriate financial reporting standards.[124] Furthermore, the reports also suggest that the shareholders of the VCC must be empowered to appoint an auditor to audit the books of the VCC and enable the auditors to report any financial malpractices.[125] Trusts long have been the ideal choice as a corporate structure when incorporating funds. While these structures served a great social utility for decades, with time, new structures such as VCC have evolved and it is time that a new structure that has the governance standards of a company and the flexibility and agility of a trust is given a chance to house funds.

VI. CONCLUSION

The only phenomenon that enjoys permanence in the world of today is impermanence. Business trends and tremendous commercial growth have led to an increased flow of investment in India. VCFs serve as a vehicle through which Indian start-ups gain their footing and thereby become the irreplaceable stepping stones to the success of Indian entrepreneurs. However, the organization of VCFs as trusts in India have made way for numerous agency problems and private enforcement issues. The agency problems arising out of the VCF structure in India have been illustrated in this paper, along with a presentation of the complications surrounding the legal position of the non-arbitrability of trust disputes in India and its impact on disputes arising in VCFs, qua domestic and international investments. Towards this, the paper suggested that the Supreme Court in India allow for disputes arising from VCF trusts to be arbitrable to

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[123] INTERNATIONAL FINANCIAL SERVICE AUTHORITY, *Supra* note 49.
[124]*Id.*
[125]*Id.*

facilitate ease of dispute resolution and enforcement. Further, as an overarching solution to the agency problems arising out of trusts and the issue surrounding private enforcement qua arbitration, this paper proposed incorporating funds as Variable Capital Companies instead of trusts. This solution was established as a mélange of high governance standards of companies such as the existence of constitutional documents, a board of directors, general meetings, and mandatory audited financial disclosures, and the commercial benefits of trusts such as lower statutory compliances and tax benefits. Following the analysis and conclusions from this paper, it is evident that the growth of the global market place and the changes that ensue from it can only be sustained through adaptation in policies governing commerce. This research contributes to the ongoing dialogue about the necessary adaptations that must be made to policies governing commerce to sustain the growth of the global marketplace. By embracing change and implementing effective solutions, India can continue to attract investment and promote the success of its entrepreneurs in the dynamic and ever-changing world of commerce. Change, therefore, is the cause; and change, ultimately, becomes the cure.

EVOLUTION OF CORPORATE GOVERNANCE: A COMPARATIVE ANALYSIS OF THE CONCEPT OF CEO – CHAIRMAN DUALITY IN THE US, UK, AND INDIA

Atharva Aggarwal & Samruddhi Varma[*]

ABSTRACT

In the dynamic arena of global corporate affairs, power struggles have long been a defining feature. Within the intricate web of corporate structures, clashes often erupt as various factions vie for control. Corporate governance, in essence, has sought to mediate these conflicts, aiming to rectify the inherent imbalances that exist between management and the company's shareholders or stakeholders. A pivotal mechanism in attaining this balance has been the developing idea of separating the positions of Chairman of the Board and Chief Executive Officer (CEO), a concept that had traditionally garnered strong backing in nearly all corporate structures worldwide. However, a series of disastrous financial crises across different nations prompted the proposition of delineating these two functions followed by a growing trend advocating for the division of responsibilities between the CEO and the chairperson of the board. Although numerous companies continue to have a single individual occupying both the roles of CEO and chair, investors regularly voice their apprehensions regarding the potential negative impact of this duality of CEO-chair position on the board's independence and its ability to function effectively. Efforts to address this issue have spanned across the globe, with various approaches and degrees of success.

This paper embarks on a journey to trace the evolution of corporate governance practices in three influential nations: the United States, the United Kingdom, and India. The objective is to tap the progress made in these countries and dissect the rationale put forth by regulators worldwide for maintaining a separation between these pivotal positions.

Keywords: Corporate Governance, Imbalances, Duality of CEO-Chairman, Board's Independence.

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I. INTRODUCTION

In the ever-shifting realm of global business, a tempestuous wind of change has swept through, rearranging the corporate chessboard with unprecedented force. This transformative gust bears the name of "corporate governance," a complex dance of interests and objectives, accountability, transparency, and responsibility. It is the very soul of the corporate world, now at an all-time high attention. The catalyst for this seismic shift can be traced to the brink of disaster that loomed over multiple financial giants. This near-collapse sent shockwaves throughout the global business landscape, and suddenly, the voices from the highest echelons of corporate management grew louder, reverberating across boardrooms and stock exchanges. The call for accountability and transparency resonated with a resounding urgency.

In response, a harmonious effort of nations set out to craft a collective action plan, a symphony of regulations aimed at making corporations accountable to their shareholders and stakeholders alike. This concerted effort unfolded against the backdrop of power dynamics within the corporate structure, with an individual often perched at its zenith. Regulators and investors alike came to realize the perils of unchecked power, a realization that rippled through the corridors of power. This outrage by shareholders & investors can also be evidently observed through the change in the board composition, over the years, of the top S&P 500 companies (As of June 2022, the share of independent board chairs in the S&P 500 surged from 30% in 2018 to 37%,

while companies uniting the chair and CEO roles dwindled from 49% to 44%.) listed on the world's largest stock market of the United States.[1]

At the heart of this transformation lays one of the most contentious issues in corporate governance worldwide: Should the CEO simultaneously serve as the chairman of the board? A strategy to separate these positions was proposed in numerous nations, including India, where a stalwart in its support for the dual roles was no exception. In India, where 54% of the top 500 listed companies still resist the voluntary compliance of separating the CEO and Chairperson roles, the debate raged on.[2]

Strikingly, despite the global clamour for the separation of CEO and Chairman roles and the backing of shareholders and institutional investors, the empirical evidence remains elusive. While influential committee reports like the Kotak and Cadbury reports[3] advocated for this separation, we lack substantial proof that board independence genuinely enhances a company's efficiency. Research yields mixed results, with some studies finding no significant correlation between board leadership structure and firm performance.

Amid this inconclusive empirical landscape, shareholder activists and governance experts press on, tirelessly pushing for the division of these roles. The argument is clear: Having a dual CEO/Chairman situation in a company is akin to marking your own exam papers, as the inherent conflicts between the roles demand separation. In a world where shareholder activism takes centre stage, having the strongest form of independent board oversight becomes paramount. It's a move that can uplift shareholder morale and bolster trust.

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[1] Press Release, The Conference Board, To Accommodate Growing Workloads, Boards are Electing Independent Board Chairs, Experimenting with Committee Structures, and Holding More Meetings (July 18, 2022) https://www.conference-board.org/press/boards-are-electing-independent-board-chairs.

[2] Press Release, Securities and Exchange Board, SEBI Board Meeting (Feb. 15, 2022) https://www.sebi.gov.in/media/press-releases/feb-2022/sebi-board-meeting_56076.html.

[3] THE CADBURY REPORT, THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, https://www.ecgi.global/code/cadbury-report-financial-aspects-corporate-governance.

Moreover, Under Section 2(18) of the Act, a CEO means *"an officer of a company, who has been designated as such by it".*[4] Further, Section 2(54) of the Act defines MD as *"a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called."*[5]

Thus, an MD or a CEO is the one who enforces substantial power in the management of the day-to-day affairs of the Company. On the other hand, a Chairperson, as defined under the LODR Regulations shall be a non-executive director.[6]

This paper embarks on a journey through the intricacies of this separation, exploring how different nations crafted their own laws to mandate the divide between the CEO and Chairman roles. It's a story that unfolds against the unique economic and financial landscapes of each nation, a narrative of adaptation and evolution in the ever-evolving symphony of corporate governance.

II. RESEARCH ANALYSIS

A. Insights Into The Roles Of CEO & Chairman In The Governance Of The Corporation

1. Delving Into the Positioning and Roles of the Chairman & CEO in Governance Vis – A – Vis Management of the Company.

As the central organ within the modern corporation, the chairman, in collaboration with the board of directors, bears responsibility for a range of pivotal functions in corporate governance. Firstly, the board actively participates

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[4] The Companies Act, No.18 of 2013, § 2(18) (Ind.)
[5] The Companies Act, No.18 of 2013, § 2(18) (Ind.)
[6] Separation of roles of Chairperson and MD/CEO, Securities and exchange board of India (SEBI) (2022) https://www.sebi.gov.in/sebi_data/meetingfiles/mar-2022/1646214623121_1.pdf.

in making critical business decisions for the corporation, including topics related to mergers, matters related to issuance stocks, and modifications to the company's governance documents.[7] Parallelly, the board frequently delegates the majority of day-to-day operational decision-making to the management team. Secondly, the board functions as an invaluable resource for the management, serving as a source of insight, guidance, and facilitating the firm's connections with various resources.[8] Thirdly, the board assumes a monitoring role, holding a fiduciary duty to represent the interests of the corporation's shareholders in relation to the management.[9] However, it should be noted that specific responsibilities of the chair may vary from company to company, but it typically involves acting as a bridge between the board and the C-suite (the executive-level managers within a company), ensuring transparent communication and the smooth flow or exchange of information between these leadership groups.

Beyond these responsibilities, the chair's role extends into the realm of orchestrating board gatherings, crafting the board's strategic itinerary, wielding the power to greenlight or veto financial dealings, offering counsel on policy intricacies, determining the compensation packages of top brass, and guiding the intricate dance of succession planning for leadership. Moreover, the chair frequently acts as the bridge to shareholders when the need arises. It's worth noting that the chair occupies a commanding position within the board's hallowed chamber, granting them the ability to shape discussions and influence the direction of crucial votes. In essence, the chair stands at the helm of the board, steering its course through the realms of decision-making, advisory duties, and vigilant oversight, both in formal proceedings and behind-the-scenes interactions.

In the realm of corporate governance, boards of directors bear a sacred trust, charged with pivotal roles in decision-making, consultation, and vigilant

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[7] *See* STEPHEN M. BAINBRIDGE, CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 40 (2012).

[8] *Id.*

[9] Michelle M. Harner, *Corporate Control and the Need for Meaningful Board Accountability*, 94 MINN. L. REV. 541, 583 (2010).

oversight. However, the essence of their role has undergone a transformation in recent decades, with the advisory aspect yielding precedence to vigilant monitoring.[10] It has become customary for boards to delegate a significant share of operational authority to the capable hands of corporate officers. These officers, as the daily helmsmen, navigate the intricate waters of business. Yet, the board's paramount duty transcends these operational realms. Their true calling is that of vigilant overseers, ensuring that executives' interests unfailingly align with the interests of shareholders, instead of their self-interest.

In simpler terms, boards of directors stand as stalwart protectors of shareholder interests, akin to the frontline defenders against any spectre of managerial inadequacy. Their mandate is clear: safeguard the shareholders and serve as the first defence against mismanagement. These 180 degrees turn towards emphasizing the watchdog role of corporate boards has ignited a spirited debate about the board's optimal composition. In today's corporate arena, the presence of directors donned with the badge of 'independence', endorsed by both the company and the wider public, stands as an unequivocal standard. Shareholders now elevate the board's prowess, or at least the illusion of it, in the realm of meticulous management scrutiny, placing it on a pedestal above the board's traditional functions of networking, business counsel, and sagacious insights.

Critics have brandished a critical spotlight upon a conspicuous deficiency in corporate boardrooms – their perceived failure to vigilantly monitor and appraise the performance of the CEO. Shareholders no longer merely seek the board as a convivial companion to management but as a sentinel standing sentinel over the company's day-to-day operations. Often grappling with conflicts of interest distinct from those of the shareholders, the board is now summoned to serve as the ultimate defence against management's potential excesses.

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[10] Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 43-44 (2017).

Now, apart from the chairman which disposes of a very important position in an organization, the position of a CEO is regarded to be of equal importance. The CEO is the highest-ranking executive responsible for managing the day-to-day operations of the company. The CEO reports to the board of directors and is considered responsible for the entire executive functioning of the company, which requires constant implementation of corporate strategies, review of operational activities and overall performance of the company. They work closely with other executives and senior management to undertake key decisions, allocate resources, and implement strategic initiatives.[11] Ultimately, the CEO is accountable for the company's success and is responsible for delivering value to shareholders and stakeholders.

A CEO is the top executive in a company, responsible for making key decisions and overseeing the overall operations. They focus on setting and achieving the company's strategic goals, delegating tasks to achieve those goals, and ensuring that operations align with the company's vision and values. CEOs also monitor financial performance, manage relationships with stakeholders, and maintain the company's public image.[12] In contrast, the chairman of the board oversees the board of directors, ensuring that their decisions align with the company's interests and shareholders' expectations. While the CEO reports to the chairman in many cases, there's a separation between the CEO's operational focus and the chairman's strategic oversight. In some instances, the CEO may also hold the position of chairman, but this can raise concerns about conflicts of interest, particularly regarding executive compensation decisions.

2. Arguments in Support and in Contrast with the Concept of Duality of CEO/Chairmanship Role in a Company.

i. Arguments Supporting Separate Positions

[11] Aviral Chauhan et al, *SEBI Relaxes Separation of Roles of Chairperson and CEO – A blessing in disguise?* (2022) CYRIL AMARCHAND MANGALDAS (Feb. 21, 2022) https://privateclient.cyrilamarchandblogs.com/2022/02/sebi-relaxes-separation-of-roles-of-chairperson-and-ceo-a-blessing-in-disguise/.

[12] NW., *CEO vs chairman: Key Roles & Distinct Difference*, (Aug. 21, 2023) https://northwest.education/insights/management/the-ceo-and-the-chairman/.

Separating the CEO and chair roles aims to enhance effective management oversight by the board.[13] Combining these roles may lead to excessive power and conflicts of interest between the board and management. This becomes evident when considering their specific responsibilities.[14]

The CEO manages day-to-day operations, while the chair supervises management decisions for shareholders' benefit. Having one person in both roles can create conflicts, particularly in areas like performance evaluation, executive pay, succession planning, and director recruitment. An independent chair is more likely to provide an unbiased assessment of management, whereas a CEO-chair may tailor information for their own interests, potentially harming the shareholders. In essence, a dual CEO-chair is like "grading their own exam papers."

Furthermore, when a company is led by a CEO-chair, the board faces an awkward situation of evaluating their own chair's performance.[15] This scenario may cause directors to avoid their duty of impartially assessing management. Given that management's decisions can affect directors' positions and careers, they might hesitate to intervene in the CEO-chair's actions, as the CEO-chair effectively holds a higher rank.[16] This reduced oversight and evaluation could unintentionally empower CEO-chairs and lead to excessive compensation.

Apart from reducing agency costs and improving management oversight, separating the CEO and chair roles offers other benefits, such as enhancing board performance and decision-making. Some experts suggest that dividing these roles allows the CEO and chair to focus more effectively on their specific responsibilities. This separation enables the CEO to concentrate solely on

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[13] Independent Board Leadership, COUNCIL OF INSTITUTIONAL INV., https://www.cii.org/independent_board.
[14] David F. Larcker & Brian Tayan, Chairman and CEO: The Controversy Over Board Leadership Structure (Stan. U Graduate Sch of Bus, Working Paper No. 16-32, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800244.
[15] Thuy-Nga T. Vo, To Be or Not to Be Both CEO and Board Chair (Wm. Mitchell L Stud., Working Paper No. 2011-06, 2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1755233.
[16] *Id* at 88 – 90.

strategy, operations, and organizational matters, while the chair can focus on overseeing management, leading the board, and handling governance-related issues.[17] Additionally, if an independent outside chair is introduced as part of this division, they can bring a fresh and unique perspective to the board, facilitating swift improvements in the company's operations and decision-making processes.

ii. Arguments Supporting Combined Positions

The division of roles has potential drawbacks, primarily concerning its impact on the board's management functions rather than its monitoring role. Opponents of role separation argue that combining the CEO and chair positions strengthens the board's management capabilities by reducing information-related costs, promoting unified leadership, and ensuring consistency in CEO succession. Critics of separation argue that it can increase information costs. They suggest that having a chair with the CEO's strategic expertise and deep knowledge of the company's operations and finances benefits the organization. This CEO-chair can lead the board in understanding and making key business decisions. Combining the roles also maintains a "unity of command," providing clear authority for effective leadership, which is crucial for organizational stability and accountability.[18]

Another concern is the CEO succession process. Many U.S. companies follow a "pass the baton" succession approach, where the outgoing CEO temporarily becomes the board chair to facilitate a smooth transition for the new CEO. Permanent role separation could disrupt this process and add transition costs. Whether these costs outweigh the benefits of separation, depends on specific circumstances.

B. CORPORATE GOVERNANCE IN UNITED KINGDOM

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[17] S*upra* note 8, at 1.

[18] Katharina Pick & Richard Leblanc, *Separation of Chair and CEO Roles*, THE HARV. LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (2011) https://corpgov.law.harvard.edu/2011/09/01/separation-of-chair-and-ceo-roles/.

1. **CEOs and Chairmen aren't BFFs Anymore - Time-Travel Adventure Through the Evolution of UK Corporate Governance Structures.**

The necessity for a robust corporate governance framework has been acknowledged globally, and the United Kingdom is no exception. In the 1980s, certain UK companies experienced corporate governance failures, exemplified by cases like Maxwell Communications and Polly Peck,[19] characterized by ineffective board performance. Responding to these failures, the Cadbury Committee [20] in the UK took action in 1992 by introduction of the Code known for its Best Practice. Since then, various enhancements have contributed to fortifying corporate supervision/governance in the UK. Subsequent updates to the UK codes were prompted by global business failures and financial scandals, with the goal of preventing situations where an individual within a company holds unchecked power to manage and make decisions for the organization. The Cadbury committee's report was commissioned following significant corporate scandals, including the downfall of the Bank of Credit and Commerce International ("**BCCI**"), Polly Peck, Coloroll, and Maxwell Publishing.

Over time, the corporate governance framework in the United Kingdom has been widely regarded as an exceptionally effective model, serving as a prominent benchmark for many other jurisdictions in Europe and Asia. This system is particularly appealing to international companies seeking access to a diverse pool of investors. These investors are reassured by the stringent governance standards applied to issuers, regardless of where their primary business operations are located.

The United Kingdom's corporate governance unfolds as a rich tapestry, weaving together an intricate blend of laws, codes of conduct, and market norms. Its authority is derived from a harmonious symphony of obligatory and

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[19] Mallin, C.A., & Farag H., *Balancing the Board: Directors' Skills and Diversity. Institute of Chartered Accountants in Scotland* (2017).
[20] The Cadbury Report, *supra* note 3 at 5.

customary rules, deeply rooted legal principles from centuries of common law tradition, and legislative acts like the Companies Act, 2006. Regulatory frameworks, including the Listing Rules and the Disclosure and Transparency Rules, are sculpted and enforced by the Financial Conduct Authority ("**FCA**"), which is a venerable statutory guardian.

While some of these regulatory threads trace their lineage to European law, others are finely tailored to the unique contours of the United Kingdom's governance landscape. In the arena of corporate control, the City Code on Takeovers and Mergers, known as "the Takeover Code," stands as a formidable sentinel, endowed with legal stature.

But the beating heart of this governance mosaic is none other than the UK Corporate Governance Code, affectionately referred to as "**the Code**." This pivotal code of conduct, a creation of the venerable Financial Reporting Council ("**FRC**"), itself a guardian enshrined in statute, is periodically crafted and refined. It serves as a guiding star, illuminating the path of corporate governance within the United Kingdom.

In the United Kingdom, large corporations, as a part of best practice requirements and after considering commercial needs, have generally adhered to the separation of roles. Presence of a combined chair and executive role is rare in the UK corporate landscape. The said division of roles has been a result of the much-awaited oppression from investors especially, institutional investors to maintain this distinction, and that should be accompanied by voluntary guidelines outlined in the Combined Code.

2. <u>UK's Code Of "Comply or Explain" – A Distinctive One</u>

Despite these clear recommendations favouring the separation of roles, the Combined Code has granted companies a significant flexibility in this matter. The Combined Code is structured into three levels: primary principles, supporting principles, and code provisions. The first two components have been integrated into the listing rules of the London Stock Exchange, making them obligatory for all listed companies. The code requirements, however, work on the "comply or explain" tenet, enabling a corporation to deviate from them as long as it notifies its shareholders beforehand. In such cases, the corporation

must explain its justifications to the shareholders, who then vote in favour of or against the decision via a resolution. The obligatory guidelines specified in the Listing Rules and the code requirements specifically address this discrepancy between the two responsibilities.

After examining the regulatory requirements and the leeway afforded concerning the separation of CEO and Chairman roles, it is crucial to explore the factors motivating investors to advocate for this division. Investors are driven by the desire for the companies they invest in to thrive, ultimately increasing their own returns. This motivation shapes their engagement with the board and underscores the significance of transparency and accountability. Consequently, the first rationale behind investor pressure is their belief that companies exhibit greater stability and face fewer long-term risks when they resist consolidating power in a single CEO/Chairman.

Secondly, institutional investors in the UK, in particular, are increasingly of the opinion that the Chairman's role should be held by a non-executive director, underscoring the need for a clear separation between these two functions. It's worth noting that some European countries, like Germany and the Netherlands, adhere to a 'two-tier board' structure, mandated by law, which necessitates the division of CEO/Chairman roles by establishing two distinct boards.[21]In this system, the supervisory board, chaired by non-executive members, oversees corporate governance, while the CEO or its equivalent leads the management board. However, this two-tier structure is not legally enforced in the UK, rendering such compliance mechanisms non-binding by law. Consequently, the majority of UK firms adopt a unitary board structure in which both executive and non-executive directors serve on the same board.

3. **<u>The Trail of Historical Evolution of Separating the Roles of CEO and Chairman In UK.</u>**

[21] Shivam Bhardwaj & Shreyangshi Gupta, *Anatomy of The Great Divide – Separating The Roles of Chairman and CEO*, 8 NUJS L Rev 129–152 (2015).

The formation of joint-stock businesses in the 17th century maybe linked to the historical development of the separation of the CEO-Chairman responsibilities in the United Kingdom. These early businesses had a lot of issues with accountability, agency issues, and conflicts of interest. A distinct separation of duties between shareholders and management was required to overcome these problems.[22] Companies got bigger and more complicated as capitalism evolved throughout the industrial revolution. As a result, the focus on the separation of ownership and control increased as shareholders looked for ways to guarantee that their interests were safeguarded. As a representation of shareholders' interests, the Chairman—often a non-executive person—emerged, while the CEO assumed control of the day-to-day management of the business.[23] The historical precedent of this dual leadership structure laid the foundation for the modern practice of separating the roles of CEO and Chairman. Over time, this separation became more pronounced, with the Chairman serving as a counterbalance to the CEO's operational authority.

For a better understanding of the reasons as to why United Kingdom follows the separate person rule, we would like to narrate the advantages of the same in a whimsical manner. As we embarked through the annals and laws governing the UK corporate governance structures, we unravel the intriguing reasons behind the estrangement of CEOs and Chairmen. This investigation reveals five compelling narratives that have reshaped the corporate landscape:

- Enhanced Board Independence:

We encounter the first chapter—enhanced board independence. For Instance, Picture an independent Chairman as the guardian of shareholder interests, wielding a critical perspective that ensures board decisions are untainted by the operational concerns of the CEO. In this narrative, the

[22] Van Essen et al, *Assessing Managerial Power Theory: A Meta-Analytic Approach to Understanding the Determinants of CEO Compensation,* 41(1*)* J. MGMT. 164-202 (2015).
[23] Minichilli, A. et al, *Weathering the Storm: Family Ownership, Governance, and Performance through the Financial and Economic Crisis*, 24(6) CORP. GOV.: AN INT'L REV. 552-568 (2015).

Chairman's role transcends mere oversight, becoming a stalwart defender of shareholders' best interests.

- Checks and Balances:

In the next chapter, the landscape transforms into a system of checks and balances. Here, the Chairman's role evolves to include the vital task of overseeing the CEO's performance, ensuring accountability, and averting the perils of power concentration. This narrative paints a vivid picture of harmony within the board, where the Chairman's allegiance to shareholders counterbalances the CEO's operational prowess.

- Transparency and Investor Confidence:

Our journey throughout the research uncovers another facet—transparency and investor confidence. Imagine investors from diverse backgrounds seeking assurance in a global marketplace. Here, the independent Chairman emerges as a beacon of transparency, instilling confidence in shareholders' hearts. In this narrative, the Chairman becomes the guardian of investors' interests, fostering trust in the organization.

- Mitigation of Potential Conflicts:

As we venture further, we encounter the narrative of conflict mitigation. The separation of CEO and Chairman roles acts as a shield against potential conflicts of interest. The Chairman's independence ensures that decisions resonate with the broader interests of the company and its shareholders. In this narrative, the Chairman's impartiality safeguards the integrity of corporate decisions.

- Effective Leadership Structure:

Finally, we witness the establishment of an effective leadership structure. Here, the CEO is unburdened by governance concerns, allowing them to dedicate themselves entirely to operational matters. Simultaneously, the Chairman assumes the mantle of governance, strategy, and shareholder advocacy. This division of labour creates a harmonious equilibrium, enabling both roles to operate with precision and unwavering dedication.

While studying the same we find that these narratives collectively reveal the intricate reasons why the UK's CEOs and Chairmen have chosen separate paths. While this separation may seem distant in history, its echoes continue to resonate in the present, shaping the corporate governance landscape for the better.

4. A Socio-Economic and Market Factors Investigation in the United Kingdom

Market forces exert a profound influence on the adoption and performance of the CEO-Chairman separation model within the United Kingdom. This relationship between corporate governance practices and market dynamics is intricate, marked by moments of alignment and divergence.[24]

- Market Capitalization and Ownership Structure

Separation patterns often differ between large-cap and small-cap companies. Large-cap firms may prioritize separation due to their complex structures and diverse shareholder base, while small-caps may opt for combined roles for simplicity.

- Investor Activism and Shareholder Demands

The rise of activist investors has put pressure on companies to adopt governance practices aligned with shareholder interests, potentially driving separation. Shareholders increasingly demand transparency and accountability, favouring separation as a means to achieve these goals.

- Market Volatility and Economic Conditions

The popularity of the separation model can fluctuate with economic conditions. During economic downturns, cost-saving measures may lead to role consolidation, while growth periods may encourage independence. Heightened market volatility can underscore the need for effective governance, prompting companies to consider role separation.

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[24] Nordberg D. & McNulty T, *Creating Better Boards through Codification: Possibilities and Limitations in UK Corporate Governance*, 55(3) BUS. HIS. 348-374 (2013).

C. DECIPHERING THE POSITION OF STATUTORY MANDATE IN THE UNITED STATES

In the vast landscape of American corporate models, where managerial influence reigns supreme, a perpetual tug-of-war unfolds. On one side, the allure of a well-established ownership structure beckons, while on the other, the shadow of safeguarding investor and shareholder interests looms ominously. Within this intricate tapestry of ownership dispersion, a conundrum emerges—a battle of interests between management and shareholders.

In this complex web, investors who diversify their holdings often find themselves bereft of the zeal to actively police management or allocate resources for such vigilant oversight. This void in vigilant guardianship paves the way for managers to advance their personal agendas, occasionally at the expense of those they are meant to serve—the shareholders.

However, the chronicles of recent years reveal two pivotal shifts that have acted as a balm to soothe the frictions of this conflict. First, a groundswell of both active and passive shareholders has arisen, resolute in their determination to hold corporations and their stewards accountable for their deeds. Second, the spotlight has shifted onto corporate boards, cast now as the primary sentinels guarding the sacred interests of shareholders.

This accentuation of board independence manifests in diverse ways. It includes the emergence of new federal statutes born from the Sarbanes-Oxley and Dodd-Frank Acts, a surge in scrutiny from discerning investors and erudite scholars focusing keenly on the concept of board independence.[25] Moreover, Delaware courts, with their venerable jurisprudence, have increasingly relied upon the imprimatur of independent directors in addressing this perturbing concern, particularly in matters of conflicted transactions.

1. Tracing the Trail of the Evolution of Statutory Mandates in United States

25 *See* Commonsense Principles 2.0, Governance Principles, http://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf.

In the US, the question of splitting the CEO and Chairman roles has emerged due to a complex interplay of factors, including a challenging economic climate, heightened regulatory measures, and growing dissatisfaction among investors. During the early 2000s, stock markets experienced a severe crash that resulted in steep declines in stock prices and big scandals involving the manipulation of stock values and deceptive trading practices. Companies like Enron and WorldCom, initially enjoying soaring stock prices, subsequently went bankrupt, revealing significant accounting/auditing frauds and manipulations that in the past had inflated their values artificially. Other companies, such as Tyco and Adelphia, were discovered to be weaker, especially financially weaker than previously believed, mainly due to executives engaging in extensive self-dealing transactions and personal enrichment.[26]

Serious issues with conflicts of interest between auditors and securities analysts as well as the lack of proper monitoring to protect auditor independence were brought to light by these events. It became clear that these failures were significantly influenced by poor corporate governance procedures and insufficient transparency rules. There is no way to ignore the urgent need for significant changes in light of these appalling examples of wrongdoing that caused widespread anxiety. In light of these changes, shareholders and corporate directors started to doubt the ability of a single leader to successfully oversee the day-to-day operations, along with the governance of an organisation, regardless of their competence or talent.

This gave rise to a growing debate about the potential benefits of separating the roles of CEO and Chairman, as the necessity for such separation became increasingly apparent. The question of whether such a division could be advantageous for a company and its stakeholders gained momentum and remains a central topic in discussions on corporate governance in the United States. In the face of these trials, the U.S. government took a bold action,

[26] Robert Charles Clark, Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too (John M. Olin Ctr. for L., Econ. and Bus., Harv. Law Sch., Working Paper No. 525, 2005), http://www.law.harvard.edu/programs/olin_center/papers/pdf/Clark_525.pdf

crafting precise mandates to rekindle public trust. Their aim: to elevate financial reporting's credibility, refine audit quality, and foster self-regulation via independent committees, all while enforcing harsher penalties for transgressions. This symphony of governance breathed life into a landscape tainted by doubt and uncertainty.[27]

2. Statutory Analysis

The "Sarbanes-Oxley Act of 2002" and the "Dodd-Frank Act of 2010" emphasized the significance of establishing a corporate board of directors that includes a major share of independent directors. They also underscored the importance of having essential board committees responsible for overseeing audits, executive compensation, and the selection of new independent directors dedicated to implementing reforms. These measures serve as advocates for sound corporate governance practices and are the outcome of accumulated policy stances, informed by practical exposure and broader policy-based arguments.

i. The Sarbanes-Oxley Act, 2002[28]

This act of the year 2002, often called SOX, was a response to corporate scandals marked by major bankruptcies, questionable accounting practices, and neglect by audit firms. SOX's primary goal was to enhance the accuracy and reliability of corporate disclosures required by securities laws to protect investors.

Title III, named Corporate Responsibility, outlined provisions to strengthen corporate governance, requiring specific actions from companies and their management while specifying prohibited activities. Title II, focusing on Audit-Related Changes, mandated that the audit committee comprise entirely external board members. This ensured that no company management member,

[27] Ernst & Young, The Sarbanes-Oxley Act at 10, Enhancing the reliability of financial reporting and audit quality (Nov. 25, 2014) http://www.ey.com/Publication/ vwLUAssets/The_Sarbanes-Oxley_Act_at_10_-_Enhancing_the_reliability_of_ financial_ reporting_and_audit_quality/$FILE/JJ0003.pdf.

[28] The Sarbanes-Oxley Act of 2002, 15 U.S.C. (2002).

responsible for achieving company goals, could be on the audit committee responsible for overseeing essential processes like financial reporting for effective corporate governance.

However, because committees are typically chosen from the board of directors, the audit committee essentially acts as a subset of the board, reporting to the chairperson. So, having the CEO also as the chairperson could hinder the committee's effectiveness and potentially create conflicts of interest. This concern is amplified through sec.1514A,[29] which is the whistleblower provision of SOX mandating the audit committee to establish a mechanism for reporting fraud and misconduct directly to them without fear of retaliation. If the board is predominantly made up of management, employees may be hesitant to report issues directly, and the audit committee might not take decisive action on such reports if the CEO simultaneously serves as its chairman. Therefore, for the committee to function effectively, it should maintain maximum independence from management.

SOX aimed to address corporate governance problems but faced challenges and criticism, notably after the 2008 collapse of Lehman Brothers during the financial crisis. This event underscored the Act's limitations in effectively tackling all corporate governance-related issues.[30]

ii. <u>The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010</u>[31]

In July 2010, Dodd-Frank, a game-changer in financial regulation, revamped SOX. It beefed up whistleblower safeguards, impacting public and private firms alike. Unlike SOX, it doesn't demand a CEO-Chair separation but asks for a rationale to unite or divide these roles.[32] Post-Dodd-Frank, SEC tweaked

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[29] The Sarbanes-Oxley Act of 2002, 15 U.S.C. § 1514A (2002).

[30] *See* Rosalind Z. Wiggins et al, The Lehman Brothers Bankruptcy: An Overview(Yale Program on Financial Stability Case Study, Working Paper No. 3A-V1, 2015) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2588531.

[31] The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010, 12.U.S.C. (2010).

[32] The Dodd–Frank Wall Street Reform and Consumer Protection Act, 2010, § 972, 12.U.S.C. (2010).

Regulation S-K, part of the '93 Securities Act, setting rules for public firms' disclosures. It details how companies decide their board structure. If one person holds CEO and Chairman roles, disclosure's a must, including whether there's a lead independent director and why they're there.

C. THE EMERGING CONCEPT OF INDEPENDENT DIRECTORS IN THE UNITED STATE'S CORPORATE ORGANIZATIONAL STRUCTURE

In the quest to bolster board independence, some companies have embraced the practice of appointing a lead independent director alongside a CEO who also assumes the chairperson's role, striking a harmonious balance. This approach gains traction, partly influenced by a New York Stock Exchange mandate for executive sessions sans managerial presence, supervised by a 'presiding' director.

The lead independent director's role has blossomed in influence, with more firms adopting and fine-tuning its responsibilities. Proxy advisor Glass Lewis observed dwindling support for independent chair proposals, a trend seemingly propelled by the ascendancy of lead independent directors.[33] In 2017, only 11% of S&P 1500 companies lacked either a lead independent director or an independent chair, a remarkable improvement from 2009 when 33% lacked either.[34] Furthermore, 54% of these companies favoured a lead independent director over a 35% preference for an independent chair.[35] Among S&P 500 firms, the scales tipped towards lead independent directors, with 59% reporting their presence in 2018.[36] As of June 2022, the share of independent board chairs

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[33] Amy Lee Rosen, *Support for Independent Chairmen Waning, Proxy Firm Finds*, CQ. ROLL CALL WASH. CORP. GOV. BRIEFING, WL 3382203, (2016).

[34] KOSMAS PA PADOPOULOS ET AL., U.S. BOARD STUDY: BOARD ACCOUNTABILITY PRACTICES REVIEW 10 (2018) https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf

[35] *Id* at 10-11.

[36] Steve Klemash et al, *Today's Independent Board Leadership Landscape,* The Harv. L. Sch. For. on Corp. Gov. (2018) https://corpgov.law.harvard.edu/2018/11/20/todays-independent-board-leadership-landscape/.

in the S&P 500 surged from 30% in 2018 to 37%, while companies uniting the chair and CEO roles dwindled from 49% to 44%.[37]

The lead independent director's core functions include serving as an additional channel for shareholders with limited access to the board chair. They facilitate communication among board members, adeptly mediate conflicts, and importantly, provide a counterbalance to the board chair's influence, akin to the chair's oversight of the CEO, particularly vital when the CEO and chair share close ties. Additionally, the lead independent director spearheads the assessment of the chair's performance and, when necessary, the quest for a new chairperson.

While specific duties may vary, the lead independent director embodies an independent leader for the board, offering a viable alternative to splitting the roles of chairman and CEO. This role stands as a strategic tool for addressing activist investors and sidestepping shareholder votes on CEO-chair separation proposals.

D. Mapping One Of The Prominent And Substantial Corporate Debate In India: The CEO And Chairman Divide

There is a growing demand for enhanced supervision of the top leadership within companies. This need for improved governance is not only apparent on a global scale but is also gaining momentum in India. Historically, the Indian corporate sector strongly favoured the practice of combining the roles of CEO and Chairman of the board. Given that many Indian companies have a concentrated ownership structure, often with family members holding significant shares, there is a comparatively less opportunity for shareholder activism in contrast to countries like the U.S. or the U.K. As a result, the likelihood of a company voluntarily adopting separate CEO and Chairman roles is limited when such activism is absent. Recognizing India's reputation for informal corporate practices, Indian policymakers believed that a more structured approach to corporate governance was necessary.

[37] The Conference Board, *supra* note 1 at 4.

1. Going Down the Memory Lane

For more than five decades, the Companies Act of 1956,[38] referred to as the 'old Companies Act,' did not explicitly address the separation of the Chairman and CEO roles. The provisions related to the appointment of managers or whole-time directors primarily focused on the interests of peripheral stakeholders. Section 269[39] of the old Companies Act regulated the appointment process for directors and managers, with minimal mention of the differentiation between board and CEO responsibilities. This omission regarding role segregation may have been because it was assumed that a strong board would effectively represent stakeholder interests. However, this oversight neglected the crucial CEO responsibility of ensuring a company's profitability. At the time, legislative drafters likely did not consider this aspect due to the distinctive nature of the Indian corporate structure.

In the latter part of the 2000s, the corporate regulatory framework underwent significant restructuring in response to changes brought about by a liberalized economy. Prominent industrial groups and the Securities and Exchange Board of India ("**SEBI**") played a central role in advocating for these changes. SEBI introduced Clause 49 of the Listing Agreement[40], which served as the foundation for transforming corporate boards in India, leading to increased transparency and disclosure for stakeholders. SEBI's efforts continued with the establishment of the Birla Committee in 1999,[41] which recommended measures to enhance corporate governance for listed companies. These measures included the establishment of audit committees to bridge the gap between shareholders and management. These recommendations were subsequently incorporated into later amendments to Clause 49.

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[38] The Companies Act, No. 1 of 1956, (Ind.)
[39] The Company Act, No. 1 of 1956, § 269 (Ind.)
[40] Afra Afsharipour, A Brief Overview of Corporate Governance Reforms in India (UC Davis Sch. of L., Working Paper No. 258, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1729422.
[41] SEBI, GOV'T OF INDIA., COMMITTEE REPORT (1999-2000), https://www.sebi.gov.in/sebi_data/commondocs/corpgov1_p.pdf

Amid concerns about instability in the American markets, SEBI formed the Murthy Committee to address issues related to the structure and independence of corporate boards and insider trading. Two other committees also examined director independence and auditing reforms. Collectively, these committees reshaped India's corporate governance landscape.

Following the Satyam scandal, the Confederation of Indian Industries ("**CII**") conducted an extensive analysis, and various industrial groups established committees to assess the impact of the scandal.[42] While the CII took a defensive stance, characterizing the scandal as an 'isolated incident,' the Indian government-initiated inquiries by SEBI and the Ministry of Corporate Affairs ("**MCA**").[43] Interim measures were implemented, including the appointment of government-nominated directors, and SEBI and MCA introduced remedial measures, including amendments to the Listing Agreement and the Corporate Governance Voluntary Guidelines (2009). However, it's worth noting that the latter remained in the realm of recommendations, underscoring the need for more binding guidelines.[44]

2. Delving into Present Stand taken by SEBI

In a decisive board meeting on February 15, 2022,[45] SEBI shook things up, granting the top 500 listed companies the autonomy to decide whether they want to keep the positions of Board Chair and CEO intertwined or separate. This was a notable shift from their earlier stance, established in 2018 when SEBI amended

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[42] Press Trust of India, *CII Sets Up Task Force on Corporate Governance*, BUS. STANDARD, (Jan. 12, 2009) www.law.harvahttps://www.business-standard.com/article/companies/cii-sets-up-task-force-on-corporate-governance-109011200082_1.htmlrd.edu/programs/olin_center/papers/pdf/Kraakman_643.pdf.

[43] NARESH CHANDRA, REPORT OF THE CII TASK FORCE ON CORPORATE GOVERNANCE (2009) www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.

[44] Press Trust of India, *Satyam Fraud: Raju Sent to Central Prison*; *CFO Vadlamani Arrested*, THE ECON. TIMES (Jan. 10, 2009).

[45] Press Release, SEBI, SEBI Board Meeting (Feb. 15, 2022) https://www.sebi.gov.in/media/press-releases/feb-2022/sebi-board-meeting_56076.html.

the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015,[46] making it a requirement for the top 500 entities to ensure that the Chairperson was an unrelated non-executive director distinct from the Managing Director or CEO.

Originally slated for enforcement on April 1, 2020, the deadline was pushed to April 1, 2022, after industry voices expressed concerns. The initial push to segregate the Chairperson and CEO roles stemmed from the 2017 report by the Committee on Corporate Governance, commonly known as the Kotak Committee.[47] This recommendation aimed to strengthen board independence and reduce concentrated power. With a growing emphasis on the board's watchdog role, concerns surfaced about potential conflicts of interest if a single individual assumed both positions. The Companies Act, 2013, in Section 203,[48] explicitly prohibits the simultaneous occupation of the Chairperson and CEO roles, except when a company's articles of association allow it.

However, SEBI's decision to pivot toward voluntariness came after facing resistance from the industry and witnessing only a slight uptick in compliance rates, from 50.4% to 54.0% between September 2019 and December 2021.[49] Some contend that existing Indian corporate laws already encompass sufficient measures to address conflicts of interest. These include requirements for independent directors and limitations on voting by interested parties in related-party transactions. Given India's regulatory tradition, which historically leaned toward stringent corporate governance rules rather than flexible, soft-law approaches like the UK, SEBI's shift toward voluntary separation is a noteworthy departure. It aligns with the principle of shareholder democracy stipulated in Section 203, allowing each company's shareholders to decide whether they prefer a unified or a separate Chairperson and CEO structure.

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[46] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India Extraordinary, pt. III § 4 (Sept. 2, 2015).
[47] SEBI, GOV'T OF IND., COMMITTEE REPORT, (2017) https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html.
[48] The Company Act 2013, No. 18 of 2013, § 203 (Ind.)
[49] SEBI BOARD MEETING, *supra* note 2 at 4.

However, it's worth noting that voluntary governance measures have had limited success in India, unlike in some other jurisdictions.

3. Showing the True Essence Of CEO – Chairman Power Separation: The Cadbury Committee Report

When it comes to defining the roles and responsibilities of a Chairperson, the Companies Act 2013 lacks clarity. In such instances, we refer to the Cadbury Report,[50] which has established a global standard for corporate governance. The report's analysis underscores the significance of separating the roles of a CEO and Chairman to enhance oversight. The Cadbury Report states that the CEO is responsible for overseeing all executive operations of the business, including the execution of corporate strategy, evaluation of operational activities, and overall business performance. In contrast, a neutral party who is in charge of rating the CEO and the rest of the management team should hold the post of chairman.

It was clear that the appraisal process may be biased if the same individual, or someone closely related to the CEO, held both posts. As it would insufficiently reflect the interests of the stakeholders, this might jeopardise the whole evaluation process. As a result, it was suggested that the CEO and Chairman positions be held by different people.

It became clear that the CEO and Chairman jobs needed to be separated since many Indian businesses are family-owned and -operated. This division guaranteed the safeguarding of shareholder interests and avoided the consolidation of power in the hands of one person. The Cadbury Report's recommendations provide insightful information on the value of job separation in fostering accountability and openness in corporate governance.

4. Some of the Impediments for the Successful Implementation of the CEO – Chaiman Post Separation in India.

Lack of convincing data demonstrating that an independent chairman substantially impacts a company's performance or governance quality led SEBI

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[50] The Cadbury Report, *supra* note 3 at 5.

to decide against a rigid requirement for CEO and Chairman separation.[51] However, SEBI's insistence on the independence of the chairperson from the CEO presented challenges for succession plans, particularly in Indian family-owned businesses. A significant portion of India's top 500 listed entities are family-run, and it's customary for the senior family member to take on the role of chairperson while grooming a younger family member to become the CEO. Given that these families have most of their wealth intertwined with their businesses, the prospect of bringing in an external CEO or chairperson becomes unattractive.[52]

This intricate situation presented complexities for SEBI's reform agenda, and a more gradual, accommodating approach might have yielded better results, considering the vested interests at play. A more lenient stance on the related-party rule could have struck a balance. Nevertheless, it's crucial to acknowledge that the emphasis on separating the CEO and Chairman roles marks a positive step in enhancing transparency and accountability within corporate governance.

For companies where a single individual holds both the chairperson and CEO positions, a requirement to appoint a lead independent director ("**LID**") should be in place. Interestingly, even though the Kotak Committee recommended introducing the LID position in India, SEBI has yet to embrace this proposal. In the United States, LIDs emerged as a counterbalance to the combined chairperson-CEO role. They primarily oversee the board's chairperson, mirroring the chairperson's oversight of the CEO, and they provide an additional avenue of contact for shareholders. BlackRock's investment stewardship guidelines, effective in 2022, also advocate for empowering LIDs to shape board meeting agendas and facilitate separate meetings of independent directors.

III. CONCLUSION

[51] Jonathan Macey & David F. Larcker, The Chairman-CEO Controversy over Board Leadership Structure, 63 Bus. Law. 697 (2016).
[52] Umakanth Varottil, *The Great Divide: Chair and CEO roles*, NDTV PROFIT (Jan. 21, 2020) https://www.ndtvprofit.com/opinion/sebi-on-separating-chair-and-md-ceo-roles-the-great-divide.

Concluding from the above analysis, the separation of CEO and Chairman roles, a cornerstone of corporate governance in many Western nations, presents a complex issue for India. The nation's unique corporate landscape, deeply rooted in family-centric businesses, concentrated ownership structures, and the significant influence of promoters, creates substantial hurdles for a blanket adoption of this practice.

However, recognizing that corporate governance isn't a one-size-fits-all model is crucial. India's "comply or explain" regulatory framework demonstrates a pragmatic approach, balancing flexibility with the need for good governance practices. This allows companies to tailor their leadership structure based on their specific circumstances.

Therefore, the decision to separate CEO and Chairman roles should be driven by a company's unwavering commitment to good governance. This necessitates a thorough evaluation of several key factors:

1) Stage of Development: Younger, high-growth companies with dispersed ownership structures might benefit more from separation, facilitating independent decision-making and attracting diverse talent. In contrast, established family-owned businesses may find alternative governance structures, like strong independent directors, to be more effective.

2) Board Composition and Expertise: A robust, independent board with diverse expertise is crucial regardless of the CEO-Chairman configuration. Such a board can provide strategic guidance, independent oversight, and mitigate potential conflicts of interest.

3) Stakeholder Focus: The decision should prioritize long-term value creation for all stakeholders, including shareholders, employees, and the broader community. This necessitates a shift from a promoter-centric control model to a more balanced approach.

<u>Suggestions for a Smooth Transition:</u>

Beyond the specific company considerations, here are some suggestions to navigate the complexities of separating CEO and Chairman roles in India's evolving landscape:

1) Promoting Independent Boards: Actively encourage the formation of truly independent boards with strong oversight capabilities. This ensures a healthy check and balance against concentrated executive power, irrespective of whether the roles are combined or separate.

2) Transparency and Disclosures: Implement robust transparency measures, including detailed disclosures on board composition, decision-making processes, and potential conflicts of interest. This fosters trust and accountability within the company and with external stakeholders.

3) Focus on Long-Term Value Creation: Shift the corporate mindset from short-term gains and promoter control to a focus on long-term value creation for all stakeholders. This requires fostering a culture of responsible leadership and ethical business practices.

By embracing these suggestions and conducting a thorough, circumstance-specific analysis, Indian companies can navigate the debate surrounding the CEO-Chairman roles. Ultimately, the goal is to cultivate a corporate governance framework that fosters transparency, accountability, and long-term value creation for all stakeholders, ensuring India's continued growth and prosperity.

HARMONY IN ANTITRUST: INSIGHTS TO THE SETTLEMENT AND COMMITMENT MECHANISM UNDER THE COMPETITION (AMENDMENT) ACT, 2023

Eshita Gupta & Yagya Agarwal[*]

ABSTRACT

In recent years, there have been significant developments in the Indian competition law considering technological developments, the booming digital market, the emergence of the e-commerce system, and the entrepreneurial environment, resulting in the need for the authorities to respond as per the dynamic and evolving market circumstances. These dynamic changes led to the introduction of Sections 48A and 48B, which led to the enactment of the settlement and commitment system in India. This essay critically analyses the efficacy of the proposed settlement and commitment procedures in India by considering the experience of other jurisdictions. This essay examines how the mechanism affects the leniency framework and appeal, seeking to thoroughly understand the ramifications of the suggested framework. Additionally, the essay delves into various intricacies of the challenges presented by the mechanism, such as the problem presented by the withdrawal from the settlement and commitment process and multi-jurisdictional concerns.

Keywords: Competition Law, Settlement and Commitment Mechanism, Competition Commission of India, Regulatory Fortification.

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I. INTRODUCTION

The economic reforms of the early 1990s drove demand for reasonable and equitable competition legislation in the expanding Indian market. This demand led to the enactment of the Competition Act,

2002, which replaced the out-dated Monopolistic and Restrictive Trade Practices Act, 1969. Unlike its predecessor, the new law adopted a piecemeal approach, viewing the economy through the lens of the "relevant market".[1] The dynamic movements in the market, which are marked by the growth of the digital economy, the introduction of innovative technological breakthroughs, and the development of e-commerce operations, all of which constitute aspects of the new-age economic paradigm, promoted a further amendment of the Competition Act, 2002.[2] As a response, the Competition (Amendment) Act was passed in 2023, marking a watershed moment in India's competition law landscape. This amendment, which was inspired by the 2020 amendment bill,[3]and the Competition Law Review Committee's recommendations,[4] is revolutionary for the competition environment in India. This amendment revealed Sections 48A and 48B of the Competition Act, which state the settlement and commitment mechanisms. Under Sections 48A and 48B, parties

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[1] Sumit Jain, *Competition Landscape in the Sports Industry: Unravelling CCI's Decisions*, CBCL-NLIU (2020) https://cbcl.nliu.ac.in/competition-law/competition-landscape-in-sports-industry-unravelling-ccis-decisions/

[2] Saachi Kale, *Unpacking the Competition (Amendment) Act 2023: An In-Depth Examination of Its Provisions and Consequences*, 5.2 NMIMS L Rev 32 (2023).

[3] The Draft Competition (Amendment) Bill, 2023, Bill No. 185-C of 2022, § 48 A, B.

[4] MINISTRY OF CORPORATE AFFAIRS, GOV'T OF IND., REPORT OF THE COMPETITION LAW REVIEW COMMITTEE, 41-46 (2019) http://www.mca.gov.in/Ministry/pdf/ReportCLRC_14082019.pdf.

may now seek settlement and commitment after the Director General submits its report before the Competition Commission of India's ("**CCI**") final ruling.[5]This contemporary framework enables the CCI to exercise control over the parties in the form of behavioural and structural adjustments, as well as, in some cases, by levying penalties under settlement procedures. This framework is enticing as it settles the dispute quickly and amicably without spending taxpayers' money on lengthy legal proceedings. This law further incorporated the fundamental idea of settlement and commitment, which was upheld by the court in the Tamil Nadu Film Exhibitors Association Case.[6]

This essay will focus on the settlement and commitment frameworks of the United States ("**US**"), the European Union ("**EU"**), and Turkey to further strengthen the Indian framework. The United States was the first country to establish the settlement and commitment mechanism in the globe, resulting in the formation of multiple fundamental norms for this framework over time.[7] The US system provides an established framework and extensive legal precedents, which offer valuable insights for India to strengthen its mechanism and foster greater clarity within the Indian framework. Furthermore, comparing the EU and India's settlement and commitment mechanisms is crucial, given that many laws in India are influenced by the laws of EU, such as the Data Protection Bill,[8] Trademark Act,[9] Patent Act,[10] etc. This illustrates the significance of taking inspiration from the EU framework for the current framework. Hence, this comparison will provide insightful information on navigating the intricacies related to settlement and commitment processes. Exploring similarities between Turkey and India reveals a comparative examination, as both countries recently adopted the settlement and commitment

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[5] The Competition (Amendment) Act, No. 9 of 2023, § 48A, B (Ind.).
[6] Tamil Nadu Film Exhibitors Association v. CCI, AIR 2015 Mad 106 (Ind.).
[7] Otis Elevator Co. v. United States, 18 F. Supp. 87 (1937).
[8] P. Sen, *EU GDPR and Indian Data Protection Bill: A Comparative Study,* SOC. SCI. RES. NETWORK (2021) https://doi.org/10.2139/ssrn.3834112; (*editor's note*: now The Digital Personal Data Protection Act, No. 22 of 2023, (Ind.))
[9] N. Rajam, *Reconceptualising the Fair Use Under European and Indian Trademark Law*, SOC. SCI. RES. NETWORK (2021) https://doi.org/10.2139/ssrn.2413112
[10] I. Interns, *A Comparative Study Of European And Indian Patent Laws*, INTEPAT IP (Nov. 19, 2022) https://www.intepat.com/blog/a-comparative-study-of-european-and-indian-patent-laws.

mechanism, with Turkey enacting it in 2020, followed by India in 2023. The EU's influence is reflected in Turkey's drive to execute its settlement and commitment system, akin to India's approach.[11] Thus, Turkey is a valuable case study for evaluating the efficacy and possible ramifications that India could face.

II. UNPACKING THE SETTLEMENT AND COMMITMENT MECHANISM

In common parlance, settlement refers to a peaceful conclusion between opposing parties outside of the courts, recognised by various legislation. The Civil Procedure Code, 1908 views the settlement as an extrajudicial agreement,[12] while the Income Tax Act, 1961 allows voluntary engagement of parties,[13] and the Securities and Exchange Board of India settlement process offers resolution without an express acknowledgement of guilt.[14]

Conventional antitrust procedures result in either the closure of a case or the finding of violations and the imposition of penalties. However, contemporary antitrust regimes provide a middle ground where parties can suggest ways to rectify problems on their own, known as commitment decisions, which are recognized globally by different names. In a commitment decree, voluntary remedies can be either behavioural, focusing on the company's conduct (e.g., supply obligations),[15] or structural, leading to amendments in the market's structure (e.g., divestiture of assets).[16] Commitments act as a medium for better enforcement of law and order within the market by addressing the competition concerns that triggered the inquiry.

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[11] Comert et al, *Commitment and Settlement Mechanisms in Competition Law*, 27 GSI ARTICLETTER 264 (2022).
[12] The Code of Civil Procedure Act, No. 05 of 1908, §89 (Ind.).
[13] The Income Tax Act, No. 43 of 1961, § 245B, (Ind.); The Income Tax Settlement Commission (Procedure) Rules, 1997, Gazette of India, Extra., pt. II, sec. 3(i) (Oct. 12, 1999).
[14] The Securities and Exchange Board of India Act, No. 15 of 1992, §15JB (Ind.); The Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018, Gazette of India, Extra., pt. III, sec. 4 (Nov. 30, 2018).
[15] Commission Decision EDF 2010 O.J. (C 133) 5.
[16] Commission Decision ENI 2010 O.J. (C 352) 8.

Section 48A and Section 48B provide the procedure for the settlement and commitment mechanisms, respectively, for the vertical anti-competitive agreements and abuse of dominant position. The commitment mechanism application procedure is similar to settlement processes, with the primary distinction being the timing of the application submission. In settlement, the application is submitted before final orders are passed under sections 27 or 28, but after the Director General's report. Nonetheless, commitment under Section 48B occurs upon receipt of the Director General's report under Section 26(4) and the CCI's order under Section 26(1). Then, the applications are assessed by the Commission on parameters of violations, gravity, and input from stakeholders. On that basis, the settlement and commitment proposals are either accepted or rejected. The accepted proposals are incorporated into the commission's order, while the rejection of proposals results in a further investigation under Section 26.[17]

III. A COMPARATIVE OVERVIEW OF THE SETTLEMENT AND COMMITMENT MECHANISM ACROSS THE GEOGRAPHICAL SPECTRUM.

A. THE UNITED STATES OF AMERICA

The US underwent a paradigm shift in antitrust laws, emphasising regulatory fortification and expeditious dispute resolution. The settlement and commitment mechanism were introduced, with approximately 90% of cases finding resolution through this method,[18] originating with the first consent decree entered in United States v. Otis Elevator Company in 1906.[19] The US model has inspired the globe to adopt the consent decree mechanism. The US employs commitments in civil non-merger antitrust actions and the settlement mechanism for cartels. There are two antitrust regulations, i.e., the Department

[17] The Competition Commission of India (Settlement) Regulations, 2023, Gazette of India, Extra., pt. III, sec. 4 (Jan. 15, 2023); The Competition Commission of India (Commitment) Regulations, 2023, Extra., pt. III, sec. 4 (Mar. 6, 2023).
[18] Sebastian Peyer, *Cartel Members Only Revisiting Private Antitrust Policy in Europe,* 60(3) ICLQ 627-57 (2011) www.jstor.org/stable/23017023.
[19] Otis Elevator Co. v. United States, 18 F. Supp. 87 (1937).

of Justice ("**DOJ**") and the Federal Trade Commission ("**FTC**"), that permit settlements and commitments to be offered by parties under investigation.[20] The process allows for precise resolution amounts through discussions with the parties. While the DOJ files consent decrees with the court's involvement without a trial, the FTC uses its statutory authority to issue consent orders with obligations.[21]

There are divergences between the US and Indian antitrust mechanisms. A consent agreement with the DOJ needs to be approved by the court,[22] unlike commitment decisions in India, which do not require court approval. In the USA, the consent decree applies to several categories of antitrust cases, such as cartels, merger disputes, abuse of dominance, and specific forms of anti-competitive agreements,[23] unlike in India, where cartels are excluded from the purview of the settlement process. In contrast to the Indian regulatory framework, which requires applicants to initiate discussions and meet prescribed deadlines and initiation requirements, the US imposes no time limit for settlements and lacks a prerequisite for the parties to be the first to propose an offer initially.[24]

B. THE EUROPEAN UNION

Introduced in 2004, the settlement and commitment known as the "Commitment Pathway"[25] technique has proved effective, closing over 60% of

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[20] Federal Trade Commission, *The Enforcers* (Jun. 8, 2022) https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/enforcers.

[21] *Id.*

[22] DIR. FOR FIN. AND ENT. AFFAIRS COMPETITION COMM., COMMITMENT DECISIONS IN ANTITRUST CASES (2016) https://one.oecd.org/document/DAF/COMP/M(2016)1/ANN5/FINAL/en/pdf.

[23] Re Concordia Healthcare Inc., Dkt. C- 4553; Par Pharmaceutical, Inc., Dkt. C-4554.

[24] Sebastian Peyer, *Cartel Members Only Revisiting Private Antitrust Policy in Europe,* 60(3) ICLQ 627-57 (2011) www.jstor.org/stable/23017023.

[25] MINISTRY OF CORP. AFFAIRS, GOV'T OF IND., REPORT OF THE COMPETITION LAW REVIEW COMMITTEE-2018, 41-46 (2019) https://www.ies.gov.in/pdfs/report-competition-clrc.pdf.

the cases concerning non-cartel antitrust cases swiftly.[26] There is a distinction between the settlement and commitment mechanisms, wherein settlement is available for cartels and commitment for all antitrust cases except cartels. Dissatisfied parties can appeal in the EU,[27] in contrast to the Indian legislation, where the right to appeal ceases. India's mechanism drew inspiration from the EU; however, it differs by excluding cartels from settlement procedures. In the EU, the right to appeal is allowed, unlike Indian law, which lacks this provision, marking a difference in the appeal procedure. In the EU, commitment entails legally binding obligations and duties for the concerned organisation to remedy anti-competitive concerns, rather than monetary penalties.[28] On the other hand, there is ambiguity in India concerning whether penalties are to be imposed or specific directions are to be fulfilled by the enterprise in the commitment mechanism. Furthermore, in the EU, the commitment may be adopted for a specified period of time after which the commission may re-assess the competitive situation in the market.[29] This assessment is facilitated by the comprehensive data provided by the parties as a part of the reporting obligation in the commitments. However, in India, there is no certainty regarding whether commitment can be adopted for some time. India can take inspiration from this approach to cater to the evolving market situation.

In the EU, the competition authorities have the authority to reopen the case, resume the investigation, and impose fines.[30] An example of this is seen in 2008, when the Commission investigated Microsoft for unlawfully bundling Internet Explorer with Windows, leading to commitments by Microsoft in 2009. However, in 2013, a fine of €561 million was imposed for non-compliance.[31]

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[26] OECD, Directorate for Financial and Enterprise Affairs Competition Committee, Commitment Decisions in Antitrust Cases, 7 DAF/COMP (2016) https://one.oecd.org/document/DAF/COMP(2016)7/en/pdf.

[27] OECD, Note by the European Union on the Roundtable on Commitment Decisions in Antitrust Cases 22 DAF/COMP/WD (2016), https://one.oecd.org/document/DAF/COMP/M(2016)1/ANN3/FINAL/en/pdf.

[28] European Commission Press Corner, *Antitrust: commitment decisions – frequently asked questions*, (Mar. 8, 2013) https://ec.europa.eu/commission/presscorner/detail/en/MEMO_13_189.

[29] *Id.*

[30] *Id* at 28.

[31] Commission Decision, Microsoft, 2013 O.J. (C 120) 15.

India can take inspiration from this precedent to enhance clarity in its laws, deterring entities from violating commitments.

C. TURKEY

In Turkey, commitment and settlement mechanisms were recently introduced in competition law through an amendment to Law No. 4054 in June 2020,[32] aligning with the EU's laws to modernise competition legislation. Unlike India, cartels are included in settlement mechanisms wherein enterprises accept the alleged violation and obtain a reduction in punishment in return for waiving some of their rights. The administrative fines can be reduced up to 25% on undertakings.[33] However, serious offences like clear and severe violations, such as price fixing, region or customer sharing, etc., are excluded.[34] In contrast, Indian law lacks categorization of the violations between settlement and commitment under Sections 48A and 48B. Harmonising with Turkey's approach could contribute to the principle of procedural economy and the efficiency of the competition authority.

IV. BRIDGING GAPS: STANDARDIZING SETTLEMENT AND COMMITMENT MECHANISM

A. THE RIPPLE EFFECT OF INTEGRATING SETTLEMENT AND LENIENCY FRAMEWORKS

Section 48A introduces a settlement procedure for concluding proceedings related to contraventions of Section 3(4) and Section 4.[35] However, it falls short by not extending the settlement procedure to cases of offences under Section 3(3), specifically cartelization, despite the CCI having the authority to grant leniency in cartel cases under Section 46, which serves as an investigative tool to

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[32] Oguz Comert & Zeynep Yazici, Commitment and Settlement Mechanisms in Competition Law 27 GSI ARTICLETTER 264 (2022).
[33] Singer Dikis Makineleri Ticare Anonim Irketi Case 21-42/614-301.
[34] Ibid at 32.
[35] The Competition (Amendment) Act, No, 9 of 2023, § 48A, (Ind.).

unearth information on cartel conduct.[36] On the other hand, the settlement procedure acts as a procedural efficiency tool, coming into play after the preliminary inquiry has been concluded by the Director General.[37] Both mechanisms serve as negotiation tools to incentivize applicants to contribute towards saving resources for commission. However, there is a difference in both. While leniency requires the applicant to admit contravention and preserves the right to appeal, the settlement procedure does not demand such admission and explicitly eliminates the right to appeal; hence, there is a need to reconsider the inclusion of cartel offences in the settlement framework.

The two types of cases may arise before the CCI and need to be resolved before allowing applicants to take advantage of both the settlement and leniency frameworks. The first case involves applying for leniency first, then applying for the settlement for additional discounts, and the second case involves applying for the settlement and then for leniency. The pivotal question arises: what can be the course of action for CCI in such cases? In the first scenario, in which an applicant seeks for leniency first and subsequently for settlement, a similar scenario is seen in the EU,[38] France,[39] and Turkey.[40] Applicants frequently seek settlement after admitting guilt using leniency, resulting in a further penalty reduction. For instance, in the Animal Feed Phosphates case,[41] an applicant earned a 10% reduction in fine under the settlement framework in addition to the benefit it received under the leniency framework. In the second situation, when an applicant seeks settlement before leniency, the CCI should only consider leniency if the applicant presents any relevant new information concerning the cartel that was not disclosed during the settlement procedure.[42]

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[36] Esha Sharma, *Leniency Regime in India,* LIVE LAW (May 27, 2022) www.livelaw.in/columns/competition-act-2002-leniency-programme-competition-commission-of-india-lesser-penalty-regulations-cci-200210.

[37] The Competition (Amendment) Act, No. 9 of 2023, § 48A, (Ind.).

[38] Animal feed phosphates, Case COMP/38866, Comm'n Decision (EU).

[39] Personal and Home Care ProductsDecision no 14-D-19 (French Competition Authority,14 December 2014).

[40] Beypazarıİçecek Pazarlama Dağıtım Ambalaj Turizm Petrol İnşaat Sanayi and Ticaret A.Ş. Turkish Competition Authority Decision No. 2022-23/379-158; Kınık Maden Suları A.Ş Turkish Competition Authority Decision No. 2022-17/283-128.

[41] Animal feed phosphates, Case COMP/38866, Comm'n Decision (EU).

[42] Automotive Wire Harnesses, Case COMP/39748, Comm'n Decision (EU).

In India, the CCI should allow applicants to benefit from both the settlement and leniency frameworks by expanding the scope of the settlement to include cartel offences. This will align the Indian framework at par with international standards, as excluding cartel offences from the settlement framework undermines the primary goal of the mechanism, as cartelization, being a public offence with direct consequences for the general public, warrants a mechanism for successful settlements.[43] Additionally, the inclusion of cartels in settlement procedures would offer parties the benefit of avoiding reputational damage. This approach allows for a nuanced and context-specific determination, ensuring that the unique circumstances of each cartel case are duly considered.

B. RULING OUT AN APPEAL: BALANCING JUSTICE

In India, the possibility of appealing a settlement and commitment decision by a party is explicitly ruled out by Sections 48A and 48B, which state that no appeal shall lie under Section 53B against any order passed by the Commission under this section.[44] This is in contrast with the EU, where parties retain the option to appeal a settlement or commitment decision.[45] During the formulation of the framework, the Indian authority appears to draw inspiration from the EU system but diverges with appeal rights and aligns more with the US approach of disallowing appeals.[46] An essential aspect of the US framework is that defendants waive their right to appeal on their own. However, a direct comparison of the Indian system with the US antitrust scheme, specifically in regards to the waiver of the right to appeal, would be flawed since, in the US the applicants have the liberty to negotiate the precise settlement amount with the authority,[47] which is not the case in India.

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[43] MINISTRY OF CORP. AFFAIRS, GOV'T OF INDIA, THE COMPETITION (AMENDMENT) BILL, 2022-FIFTY-SECOND REPORT, (2022), https://loksabhadocs.nic.in/lsscommittee/Finance/17_Finance_52.pdf.

[44] The Competition (Amendment) Act, No. 9 of 2023, § 48A and § 48B, (Ind.).

[45] Per Hellström et al, *Remedies in European Antitrust Law*, 76 (1) ANTITRUST L.J. 43–63 (2009).

[46] Sumit Jain & Pragati Tiwari, *Commitment and Settlement Scheme under the Indian Competition Law: A Step towards Better Enforcement of the Law,* 8 RGNUL FIN & MERCANTILE L. REV. 74 (2021).

[47] Milton Katz, *The Consent Decree in Antitrust Administration*, 53(3) HARV. L. REV. 415-47 (1940).

This poses a dilemma for the CCI as disallowing appeals in the context of settlement and commitment rulings in India has two significant drawbacks; Firstly, the prohibition of the right to appeal raises concerns about the potential violation of the principle of the rule of law, as the Court has emphasised that the appeal is a right to seek redress for errors made by the lower authority; Denying the right to appeal challenges the essence of the rule of law.[48] Secondly, the CCI has a lot of discretionary power in terms of accepting the framework, and if that also goes unchecked from the judiciary hand, it will lead to the development of soft jurisprudence because it will create a parallel authority to the judiciary of the country over which no authority lies, and lastly, as per law, if the appeal is not allowed for any order of authority, then a writ petition is maintainable against such an order.[49] Therefore, individuals aggrieved by the lack of appeal will have recourse for filing a writ under Article 227 of the Indian Constitution against an order passed by CCI under settlement and commitment proceedings, potentially rendering the prohibition on appeal in settlement and commitment decisions under Sections 48A and 48B ineffective.

Therefore, instead of a complete denial of the appeal, it is suggested that the appeal should be allowed on limited grounds to ensure the maintenance of the rule of law as well as judicial integrity. Hence, in two situations potential appellants should be allowed to challenge a settlement and commitment decision, but standing may be denied based on the grounds of appeal:[50] Firstly, the right to appeal should be granted to the party proposing settlement and commitments only in cases where fraud or coercion has been exercised over the party to the case while submitting the settlement and commitment decision. Secondly, the right to appeal should be granted to complainants when due process of law has not been followed and it has "materially affected" their legal rights. This provides an avenue for redress when procedural shortcomings adversely impact complainants' rights. The overall emphasis is on granting

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[48] Martin Shapiro, *Appeal*, 14 (3) LAW & SOCIETY REV. 629–61 (1980).
[49] Rita Choudhrie & Anr v. Samtya Dev & ANR, 2004 (72) DRJ 518; Mohan Lal v. GaonSabha, 2013 SCC OnLine Del 1953.
[50] Rab et al, *Commitments in EU Competition Cases: Article 9 of Regulation 1/2003, its application and the challenges ahead*, 1(3) EUR. COMPET. LAW REV, 171-188 (2010).

appeal rights in a limited sense where a "manifest error" has been committed by the commission.

C. Harmonizing Withdrawal Dilemma: Hybrid Approach

It is stated in the regulations that a Settlement and Commitment Application may be withdrawn by the applicant before the CCI makes an order;[51] allowing a withdrawal of the application at any time will create three conundrums before the CCI in the form of procedural challenges: Firstly, there's a possibility that applicants might withdraw at the last stage of the settlement and commitment proceedings, squandering the time and money spent on the procedures, which will defeat the purpose for which settlement and commitment decisions were initially introduced. Secondly, if there are several parties engaged in proceedings and some choose to withdraw from the proceedings and other parties do not, the CCI will be left with a dilemma as to how to proceed. Finally, if some of the applicants withdraw their application, they may challenge in court the CCI's settlement and commitment decision made for other parties who have not withdrawn from the proceedings.

To address such a scenario of application withdrawal, it is proposed to establish a hybrid settlement structure in which the CCI conducts both conventional investigations for some parties who have withdrawn their applications and settlement proceedings for others in the same matter of fact. This will resolve the above three dilemmas for the CCI, as even if applicants withdraw at the final stage of proceedings, the CCI's resources and time will not be squandered, as conventional proceedings will continue for those who have withdrawn, and the information disclosed by them in the settlement and commitment proceedings can be used by the commission in conventional proceedings. It would serve as a deterrent for applicants from withdrawing. Implementing this mechanism will bring Indian procedures in line with EU practice and international norms since hybrid settlements have been used in

[51] The Competition Commission of India (Settlement) Regulations, 2023, Gazette of India, Extra., pt. III, sec. 4 (Jan. 15, 2023); The Competition Commission of India (Combinations) Regulations, 2023.

cases including Yen Interest Rate Derivatives,[52] Animal Feed Phosphates,[53] and Euro Interest Rate Derivatives.[54] However, The CCI should have discretionary power to decide whether to continue with dual enforcement or use conventional procedures for all parties, allowing more case-specific flexibility.

V. GLOBAL ALIGNMENT: TACKLING MULTI-JURISDICTIONAL CHALLENGES

It is apparent that there is a discrepancy in legislation regarding settlement and commitment processes throughout the world, resulting in varied practices that may put numerous constraints on the CCI. Firstly, in cross-border competition law enforcement, a scenario may emerge where applicants might divulge more information to one authority due to lenient regulation of settlement and commitment while giving less to another due to more robust jurisdictional regulation. This disparity might result in variations in settlement and commitment orders between countries. Secondly, the inconsistency in information disclosure will result in applicants who committed the same violation in numerous countries facing different types of sanctions, reducing the attractiveness of the regulatory framework for applicants whose offences are connected to multijurisdictional breaches.

These discrepancies may impede successful competitiveness and law enforcement. To address such multi-jurisdictional challenges, it is proposed that settlement and commitment guidelines in India be harmonised with international standards by implementing standardised enforcement mechanisms that ensure no significant differences in proceedings and streamline the process for applicants. Furthermore, India could consider international cooperation in the form of bilateral and multilateral agreements that allow for the reciprocal flow of information and the acceptance of decrees. To prevent disparate disclosure of information to multiple competition authorities, even if disclosure is inconsistent, the authorities can share information under international accords. Similar instances of this can be found in the EU, where parallel investigations

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[52] Yen Interest Rate Derivatives, Case COMP/AT39861.
[53] Animal feed phosphates, Case COMP/38866.
[54] Euro Interest Rate Derivatives, Case COMP/39914.

into online hotel booking platform cases have been conducted by several European nations with the assistance of the European Commission, where one European nation passes a commitment decree and the same has been adopted by another.[55]

VI. CONCLUSION

Sections 48A and 48B of the Competition (Amendment) Act 2023, modelled after the EU, incorporate settlement and commitment measures, marking a significant step in ushering in India's competition law. The enforcement of settlement and commitment mechanisms in different jurisdictions, namely the US, UK, and Turkey, provides insightful information and valuable experience that might improve and enliven India's framework. Interestingly, unlike the EU model, it excludes cartels from settlement procedures. Appeal rights are expressly denied under Sections 48A and 48B, mirroring the US system. However, it is suggested that there is a need to broaden the scope of the settlement mechanism by including cartel offences, as it will bring Indian practices on par with international standards. Moreover, allowing appeals on limited grounds will make it more aligned with the principles of the rule of law. Furthermore, India can enhance its procedural economy through the adoption of the hybrid settlement structure by allowing flexibility to the CCI. Additionally, to alleviate international cooperation and improve efficiency, India should explore international bilateral and multilateral treaties with other countries in the context of settlement and commitment mechanisms to make the process more streamlined. Ultimately, the Competition (Amendment) Act, 2023, intends to provide efficient dispute resolution and market growth, which would ultimately improve the ease of doing business in India and provide a conducive environment for economic growth. Nonetheless, the CCI must persist in amending its regulations to align with changing market behaviours.

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[55] Junxian Wang, Online Hotel Booking System (2006) (unpublished M.S. thesis, California State University, San Bernardino), Theses Digitization Project, No. 3083, https://scholarworks.lib.csusb.edu/etd-project/3083.

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