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FOREWORD

It is our pleasure to introduce Volume IX, Issue 1 of the Journal on Governance. Organised around the theme “*India in the Global Governance Matrix: Calibrating Convergence with Domestic Complexities*,” this issue assembles five scholarly contributions on how Indian corporate and securities law is responding to technological disruption, regulatory reform, and the changing distribution of power among shareholders, creditors, controllers, and regulators, while measuring itself against international standards. The issue moves from market integrity in the era of algorithmic trading, through the friction between insolvency law and securities regulation, to the Reserve Bank of India’s new acquisition finance framework, the limits of judicial deference in controller transactions, and the mechanics of cross-border share swaps, and in doing so offers scholarship that is rigorous in its analysis and constructive in its proposals.

In contemporary times, capital markets are becoming more technologically advanced, and corporate structures more layered, faster than the law that governs them. India’s response cannot be framed in isolation. As the country integrates with global capital markets and looks to international benchmarks such as the European Union’s MiFID II, Delaware’s MFW framework, and the regulatory approaches of the United Kingdom, the United States, Hong Kong, and Singapore, it must calibrate convergence with domestic complexities, including promoter-dominated ownership, an insolvency regime that shifts control to creditors, and a tradition of prudential caution. Algorithmic and high-frequency trading, the transfer of control to creditors during financial distress, the entry of banks into acquisition financing, and the easing of rules on cross-border equity transactions each open up real opportunities, and each brings governance risks that existing legal doctrines were not designed to meet. The papers in the present issue examine the meeting point of corporate law, securities regulation, and financial policy with this tension in view. They do more than test settled doctrines: they ask where global models may be adopted, where they must be adapted, and where they should be resisted, and they put forward workable reforms so that change in the regulatory landscape remains

ties to accountability, transparency, and the protection of investors and minority shareholders.

In the first article, **“Rethinking Market Integrity in the Age of Artificial Intelligence,”** the author, Dr. Aparajita Bhatt, examines the benefits and risks that artificial intelligence and algorithmic and high-frequency trading pose to the integrity of India’s securities market. Using the Jane Street case as a point of departure, the paper explores the foundational and judicial understanding of market integrity, the challenges that AI-driven trading creates, and the extent to which the SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003 can address algorithmic market manipulation. The author finds that although the existing framework displays a degree of ‘regulatory sufficiency’, what is lacking is a robust infrastructural architecture and strong enforcement mechanisms. Drawing on the European Union’s MiFID II, the article advocates mandating explainable AI and calls for a redefinition of market integrity suited to technologically enabled markets.

In the second article, **“Creditor Control and Shareholder Return: Rethinking Corporate Governance Across Insolvency and Securities Law,”** the author Dr. Garima Gupta advances the thesis that Indian corporate governance is marked by a structural circularity, in which governance authority is displaced from shareholders to creditors under the Insolvency and Bankruptcy Code, 2016, and is then reconstituted in favour of shareholders once the firm exits insolvency, without any doctrinal reconciliation between the two regimes. The paper examines the resulting conflicts in relation to related-party transactions, minimum public shareholding, and disclosure obligations under the SEBI (LODR) Regulations, 2015, and identifies a participatory deficit for minority shareholders. In response, the author proposes a ‘distress-contingent’ governance framework that treats financial distress as a distinct regulatory phase, with independent oversight of related-party transactions, resolution-specific disclosures, and strengthened minority protections.

In the third article, **“From Prudential Restraint to Calibrated Liberalisation: India’s Acquisition Finance Framework in the Global**

Governance Matrix,” the authors Vedansh Goyal and Jhalak Bhatia analyse the 2026 reforms of the Reserve Bank of India permitting commercial banks to finance corporate acquisitions, ending a long-standing prudential restriction under which such deals were funded largely through Alternative Investment Funds and Non-Banking Financial Companies. The paper evaluates the framework’s eligibility requirements, leverage caps, and collateral restrictions, and asks whether it establishes a genuine leveraged buyout regime or merely a prudentially constrained form of acquisition finance. Through a comparative lens of the United Kingdom and the United States, the authors conclude that the framework is a cautious yet important step that favours strategically motivated corporate acquirers over highly leveraged sponsor-driven buyouts, and they offer suggestions for greater flexibility.

In the fourth article, **“The Business Judgment Rule and MFW: Rethinking Judicial Deference in Controller Transactions,”** the authors Siya Sharma and Kartikey Tripathi examine the failure of the business judgment rule to protect minority shareholders where a dominant shareholder stands on both sides of a transaction. The paper traces the evolution and limitations of Delaware’s MFW framework, which conditions the rule’s protection on an independent special committee and informed majority-of-minority approval, and contrasts it with India’s promoter-heavy landscape, where standing bodies such as audit committees and nomination and remuneration committees lack transaction-specific bargaining autonomy. Drawing on the approaches of Hong Kong and Singapore, the authors propose a materiality-triggered independent committee with advisor selection rights, mandatory minority approval supported by enhanced disclosures, and the conditional application of the business judgment rule as a reward for procedural compliance.

In the fifth and final article, **“Equity Without Borders: Legal Blueprint for India’s Cross-Border Share Swaps,”** the author Shivangi Nawalkha examines the 2024 amendments to the FEMA (Non-Debt Instruments) Rules, 2019 and the RBI’s updated Master Directions, which

expressly permit cross-border share-for-share swaps under the automatic route. Written as a practitioner's roadmap, the article distils five core compliance pillars, ranging from fair-value valuation and time-bound RBI filings to repatriation classification, corporate approvals, and tax obligations, and identifies three potential deal-breakers: breaches of the indirect investment cap, misclassification of FOCC and IOCC status, and the reporting of deferred payment tranches. The article concludes that a structured, risk-mitigated approach can convert regulatory complexity into seamless and enforceable cross-border equity transactions.

Taken together, the articles in this edition reflect the rapidly evolving nature of contemporary corporate law and governance in India. They engage with some of the most pressing questions confronting regulators, corporations, investors, and policymakers, while offering thoughtful solutions that reconcile regulatory reform and financial innovation with the enduring principles of accountability, transparency, and good governance. We hope that this issue will serve as a valuable resource for scholars, practitioners, policymakers, and students seeking to understand the legal challenges accompanying the next phase of India's corporate and financial transformation.

Lastly, we extend our heartfelt gratitude to the Editorial Board of the Journal on Governance. Their unwavering dedication, editorial precision, and collaborative spirit have been instrumental in bringing this issue to fruition. Every stage of the publication process reflects the team's commitment to academic excellence and meaningful legal scholarship. We are equally grateful to our authors, reviewers, and faculty advisors for their invaluable contributions, and it is our sincere hope that this volume will further enrich contemporary discourse on corporate governance and continue the Journal's tradition of fostering impactful and forward-looking legal research.

Akrati Trivedi & Dwija Rajan

Editors-in-Chief, Journal on Governance

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RETHINKING MARKET INTEGRITY IN THE AGE OF ARTIFICIAL INTELLIGENCE

*Dr. Aparajita Bhatt**

ABSTRACT

Artificial Intelligence systems are gradually becoming inevitable and quintessential to our existence. Given the huge benefits of speed, efficiency and accuracy AI systems offer, they have been integrated across all sectors including businesses and markets. The use of Artificial Intelligence systems is common in the securities market since 2008, and has been rising since then. However, given its inherent risks and threats, deployment of AI systems in the trading mechanism is subject to various enablers and regulatory restrictions.¹ Although the markets have seen immense benefits of AI systems including the benefits from algorithmic and high frequency trading; markets have also witnessed its immense potential of disrupting the market integrity. This paper aims to understand the benefits as well as the nature of risks posed by AI and algorithmic trading to market integrity. The paper also makes an attempt to understand and assess the existing regulatory framework, SEBI's efforts to regulate algorithmic trading. The fundamental question is that given the wide adoption of AI, algorithmic and high frequency trading in the securities market, how can we protect the investors from the harms caused by algorithmic trading? Whether SEBI's efforts to regulate Algorithmic Trading ("algo trading") and maintain market integrity are sufficient and effective? Whether abnormally high or low trading using algorithms or AI systems with an intention of manipulating the market is considered as violative of SEBI (Prohibition of Fraudulent & Unfair Trade Practices) Regulations 2003? The paper analyses the effectiveness of the regulatory structure under the SEBI (PFUTP) regulations to deal with algorithmic market manipulation and finds that although there is a 'regulatory sufficiency', what lacks is a proper infrastructural architecture as well as strong enforcement mechanisms. The paper also looks at cross jurisdictional best practices from the EU's Markets in Financial Instruments Directive II

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¹INT'L FIN. SERVS. CTRS. AUTH., CONSULTATION PAPER ON GUIDELINES FOR ALGORITHMIC TRADING ON THE STOCK EXCHANGE (Jan. 21, 2026), https://ifsc.gov.in/CommonDirect/ViewFile?id=36ff47aeb9222f627d166fe8655d5a1&fileName=Consultation_Algo_Trading_Final_21JAN2025_20260121_0603.pdf.

(“EU’s MiFiD ii”) and seeks to understand what approach can be undertaken by SEBI to mitigate the risks of Algo trading and high frequency trading.

Keywords: Artificial Intelligence, Algorithmic Trading, Securities Market Integrity, Market Manipulation, Investor Protection, Information Asymmetry, Securities Regulation.

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I. INTRODUCTION

New trading strategies like AI enabled algorithmic and high frequency trading in the securities market has drawn the attention of the securities market regulators worldwide. AI, which was defined by John McCarthy as “the art and the science and engineering of making intelligent machines” has evolved manifold since it was coined in 1955. With the emergence of large language models (“**LLMs**”) and generative AI (“**Gen AI**”) systems, AI has undergone significant development.² These intelligent machines possess human like or even better cognitive abilities of thinking, learning, analysing, reasoning and problem-solving and can perform complicated tasks with perfection and accuracy, at a speed which is beyond human capability. Over the years, AI has become a gamechanger for optimising financial gains across different sectors, including the stock market. AI systems with its other two distinct variants - Algorithmic Trading (algo-trading) and High Frequency Trading (“**HFT**”), offers unimaginable speed, efficiency, accuracy and financial gains to the players. Market players use different AI systems including machine learning, deep learning, reinforcement learning and natural language processing and optimally leverage this incredible technology in multiple ways such as supporting decision making, robo-advising, predictive analysis, investment R&D, enhance surveillance capabilities and automation of trading processes.³ Algo trading, also use AI systems for automating the trading process based on pre-programmed codes or instructions, which capitalises on the speed and accuracy of the used codes.⁴ The Securities market regulator SEBI, define algorithmic trading as “any order that is generated using automated execution logic.”⁵ On the other hand, High Frequency Trading (HFT) which is a subset of algorithmic trading use

²INT’L ORG. OF SEC. COMM’NS, ARTIFICIAL INTELLIGENCE IN CAPITAL MARKETS: USE CASES, RISKS, AND CHALLENGES, CR/01/2025, at (Mar. 2025), <https://www.iosco.org/library/pubdocs/pdf/IOSCPD788.pdf>.

³*Id.* at 2.

⁴Morton Glantz & Robert Kissell, *Algorithmic Trading Risk*, in MULTI-ASSET RISK MODELING: TECHNIQUES FOR A GLOBAL ECONOMY IN AN ELECTRONIC AND ALGORITHMIC TRADING ERA 247, (2014). <https://www.sciencedirect.com/science/article/pii/B9780124016903000081>

⁵SEC. & EXCH. BD. OF INDIA, BROAD GUIDELINES ON ALGORITHMIC TRADING, Circular No. CIR/MRD/DP/09/2012, ¶ 1 (Mar. 30, 2012), https://www.sebi.gov.in/sebi_data/attachdocs/1333109064175.pdf.

latency-sensitive trading strategies to execute massive orders at an extremely high speed.⁶ Both algo-trading and HFT are a form of AI systems, the key difference is that algo-trading may or may not use an AI system, HFT relies on AI/ML technology for achieved the desired edge and speed.⁷ While the stock market is witnessing a boom in the use of advanced technologies including AI systems, algo-trading and HFT, these technological advancements have a potential to undermine the market integrity to a great extent.

AI has the ability to predict new products and services as well as the ability of gaining incredible breakthroughs in the capital market. AI can be used to ensure social good by leveraging the technology in a best possible way. Maintaining integrity is fundamental bedrock of capital market. These advanced technologies have undoubtedly increased efficiency of the markets, but they also raise some critical concerns about the credibility of the trading mechanism. The market functions, thrives & sustains in the long run only when information symmetry and market egalitarianism are preserved. Market integrity also thrives by preserving fairness in the functioning of the capital market; when markets function in a transparent and accountable manner. However, some anti-market elements with an intention to make wrongful and quick gains from the market, tend to violate the normative codes of the market mechanisms, thereby causing a huge shock to the market equilibrium and loss to the investors. With the advent of powerful technologies like Artificial Intelligence, the possibility of market manipulation causing information asymmetry has increased manifold. Emerging technologies are challenging the traditional notions of fair trading, information symmetry and market equilibrium. Algorithmic and high frequency trading can cause a threat to the market integrity with regulatory issues like price volatility, market noise, unfair cost to be borne by non- algo traders, technological arms race and in many more ways with a limitation on the part of

⁶SEC. & EXCH. BD. OF INDIA, DISCUSSION PAPER ON STRENGTHENING OF THE REGULATORY FRAMEWORK FOR ALGORITHMIC TRADING & CO-LOCATION(Aug. 2016), https://www.sebi.gov.in/sebi_data/attachdocs/1470393485587.pdf.

⁷*See Difference Between High-Frequency Trading and Algorithmic Trading*, MASTERTRUST, <https://www.mastertrust.co.in/blog/algorithmic-vs-high-frequency-trading>.

the regulator to effectively regulate such trading mechanisms on account of insufficient surveillance mechanisms.⁸

II. A SAGA OF REGULATORY POWER AND CRITICAL GAPS- THE JANE STREET GROUP CASE STUDY

In 2025, SEBI's interim order in the case of Index Manipulation by Jane Street Group⁹ is testament to SEBI's efficiency in tracing and punishing a high frequency algorithmic-trading based market manipulation. However, there is clearly a lack of resources and infrastructure with the regulator to trace and address the challenges posed by AI to the market integrity. The Jane Street Group ("JS Group") case clearly explains how easy is it for the trading parties to manoeuvre, manipulate and artificially fabricate the volume and prices by algorithmic trading. The JS Group had indulged in an intra-day index manipulation by using 'pump & dump' strategy, which was observed on many occasions, clearly allowed them to intervene with the natural trading process and making an overall profit of INR 3914/- crore across fifteen days.¹⁰ The JS Group, interestingly were the single largest net buyer across BANKNIFTY during the first patch and were successful in aggressively accumulating long positions of INR 4,370.03 crores across both the cash and stock futures markets.¹¹ The Group contributed a remarkably dominant share of 15-25% of the overall market's traded value.¹² By placing a disproportionately high number of buy orders at or above the Last Trading Price in BANKNIFTY constituent stocks, the JS Group aggressively attempted to push up or support the price rise in the stocks.¹³ The Group then, indulged in rapid reversal of these large and aggressive trading in cash and futures without any rationale.¹⁴ This was done by selling significantly higher cash equivalent of INR 32,114.96 crores via BANKNIFTY options, by buying BANKNIFTY puts and selling

⁸*Supra* note 6.

⁹Interim Order in the Matter of Index Manipulation by jane Street Group, Available at https://www.sebi.gov.in/enforcement/orders/jul-2025/interim-order-in-the-matter-of-index-manipulation-by-jane-street-group_95040.html

¹⁰*Id.*

¹¹*Supra* note 9.

¹²*Id.*

¹³*Id.*

¹⁴*Id.*

BANKNIFTY calls in the much more liquid index options market, all by misleading the market participants by using the artificial support provided by the JS Group.¹⁵ Such a ‘marking the close’ trading strategy where an entity aggressively places large buy or sell orders in the final moments of a trading session & repeatedly indulges in the same pattern across cash and future segments, with the specific intent of influencing the closing price of a security or index to its advantage is illegal and concerning.¹⁶ Such an illegal trading behaviour by the JS Group came under surveillance due to the abnormal market dominance in both cash & future segments during the intra-day trading. SEBI was successful in assessing the problematic repetitive trading behaviour of JS Group as it observed a consistent behavioural pattern of not trading neutrally and completing the trades to artificially manipulate the BANKNIFTY index, without any economic rationale.¹⁷

This case study provides a mixed narrative of the Indian regulator’s preparedness to deal with the challenges of AI systems, algo-trading and HFT. The interim ex-parte order against the JS Group by the SEBI whole time member has been released under its wide powers under the SEBI Act 1992. The interim order is testament to a strong regulatory regime under which punitive action for alleged misuse of algo-trading and HRT can be taken. The scope of Indian securities market legislation as well as SEBI (PFUTP) Regulations 2003 is wide enough to penalize any such manipulative practices including those based on AI systems, algo-trading or HRT, which can disturb the market integrity. However, this case study also highlights some critical gaps such as lack of a proper and real-time regulatory surveillance mechanisms, lack of infrastructural architecture to detect such vulnerabilities at the initial stage, lack of adequate precautionary or preventive and ex-ante measures to prevent such an occurrence in the first place.

The JS Group case study clearly exemplifies the threat which AI enabled high frequency trading can pose to market integrity and calls for a better regulatory approach for securing investor protection. AI enabled trading

¹⁵*Id.*

¹⁶*Id.*

¹⁷*Id.*

including both algorithmic and high frequency trading can easily circumvent the securities market regulations and adversely affect the market integrity as well as the market equilibrium. There have been regulatory attempts to understand, analyse and regulate AI enabled trading mechanisms, however those attempts are not enough in comparison to other countries like EU which have taken a strict approach while allowing AI enabled trading. In its 2012 discussion paper, SEBI had indicated towards a higher possibility of adverse selection costs for non-algo traders and as well as flash crashes in the market.¹⁸

The first move in the direction to regulate AI enabled trading is to understand and define the concepts. High frequency trading has been defined as *“the subset of algorithmic trading that comprises latency-sensitive trading strategies and deploys technology including high-speed networks, colocation, etc. to connect and trade on the trading platform.”*¹⁹ International Organization of Securities Commissions (“IOSCO”) has highlighted the following peculiar characteristics of high frequency trading²⁰

—

- 1) *The use of sophisticated technological tools for pursuing a number of different strategies, ranging from market making to arbitrage;*
- 2) *Employment of algorithms along the whole investment chain: analysis of market data, deployment of appropriate trading strategies, minimization of trading costs and execution of trades;*
- 3) *A high daily portfolio turnover and order to trade ratio (i.e., a large number of orders are cancelled in comparison to trades executed);*
- 4) *Flat or near flat positions at the end of the trading day, meaning that little or no risk is carried overnight, with obvious savings on the cost of capital associated with margined positions. Positions are often held for as little as seconds or even fractions of a second;*
- 5) *Mostly employed by proprietary trading firms or desks; and*

¹⁸Supra note 2.

¹⁹Supra note 2.

²⁰Int'l Org. of Sec. Comm'ns, *Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools* (2012).

6) *Latency sensitive.*

In the EU, high frequency trading is regulated by the EU directive on the Market in Financial Instruments issued in 2014²¹ as well as Regulation on Market Abuse (“**MAR**”), which aims to safeguard market integrity and investor confidence by prohibiting market manipulation in the EU financial and commodity markets.²² The 2024 amendments to the MAR framework enables and empowers the competent authorities to access order data on an ad-hoc request as well as on an ongoing basis.²³ Such a power is clearly missing with SEBI. AI enabled algorithmic and high frequency trading can resort to such mechanisms which are considered as abusive and manipulative and hence need to be brought under the regulatory scrutiny.

III. THE ANATOMY OF MARKET INTEGRITY IN THE CAPITAL MARKET: FOUNDATIONAL, PHILOSOPHICAL AND JUDICIAL REFLECTIONS

For a stable and trustworthy global financial system, transparency, fairness and ethical conduct are the bedrock of market integrity.²⁴ There have been many discussions and scholarly work around market integrity where organisations, regulators and market experts have tried to decipher the traits of market integrity and have even interchangeably used some alternate terms like market fairness, manipulation-free market. Fairness, equal access, trading based on transparency and disclosures in the stock market architecture, characterize ‘market integrity’, rather than defining the same. In context of securities market, ‘market integrity’ can be defined as those practices which build public trust by guaranteeing fairness, transparency and accountability in the market, while giving an equal access to all by providing a level playing field and developing,

²¹Directive 2014/65, of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU, art. 17, 2014 O.J. (L 173) 349 (EU).

²²Regulation 596/2014, of the European Parliament and of the Council of 16 April 2014 on Market Abuse, 2014 O.J. (L 173) 1 (EU).

²³Regulation (EU) 2024/2809 of the European Parliament and of the Council of 23 Oct. 2024, art. 3, 2024 O.J. (L 2809).

²⁴INT’L FIN. SERVS. CTRS. AUTH., *Market Integrity* (last visited Apr. 12, 2026), https://ifsc.gov.in/Pages/Contents/Market_Integrity.

promoting, encouraging, providing and preserving an egalitarian and bias-free market to all players. It essentially rests on the foundation of market egalitarianism and information symmetry, where all market players get an equal opportunity to participate and reap the benefits, which the market offers.

Some of the foundational work towards explaining the significance of market integrity has been done by the International Organization of Securities Commissions (“**IOSCO**”), the International Financial Services Centres Authority (“**IFSCA**”) and the Bank of International Settlements (“**BIS**”). According to the IOSCO, real-time monitoring, global harmonization of regulations, risk-based supervision, and strong enforcement mechanisms are some of the key pillars for maintaining market integrity.²⁵ The Bank of International Settlements BIS also relies on sound market practices and strong governance framework for ensuring market integrity.²⁶ In alignment with the global standards, the IFSCA has developed and implemented robust risk-based supervision and enforced strong disclosure requirements.²⁷

One of the main objectives of securities or capital market regulations globally is to promote, ensure market integrity, fairness & transparency in transactions and investor protection. Without market integrity, investor’s interests cannot be protected. It is for this reason that all unfair, manipulative and fraudulent trade practices including insider trading as well as market abuse are prohibited in securities or financial markets worldwide. Securities market regulators worldwide, share a common objective of developing a strong regulatory framework to identify, investigate and punish those who deal in fraudulent, unfair and manipulative trade practices and negatively impact market integrity.

David Boies²⁸ explains in a very simple way how and why market integrity is important to an investor. David explains the significance of fairness & integrity, which are the basic values that must be preserved in the market.²⁹

²⁵*Id.*

²⁶*Id.*

²⁷*Id.*

²⁸David Boies, *Integrity in the Capital Market*, 28 NOVA L. REV. 261, (2004).

²⁹*Id.*

Market integrity is also the cornerstone of investors' trust and confidence, which is imperative for the growth of the securities market. A strong and growing securities market is the indicator of a nation's economic growth and development, as it fulfils all financial needs of a nation and its registered companies.

Even the judicial approach towards market integrity is quite settled. The Supreme Court, High Courts and SAT have considered maintaining market integrity of highest priority. In cases like *Sabara*³⁰, *N. Narayana*³¹ and *Kishore R Ajmera*³², the Supreme Court clearly highlighted the significance of preserving market integrity for the economic growth of the country, for national interest and securing investor confidence.

IV. CHALLENGES TO MARKET INTEGRITY IN THE AGE OF AI

Artificial Intelligence (“AI”) has proved to be a great catalyst of growth and development of the securities market. About 70% of the overall trading volume today is initiated through algorithmic trading.³³ AI has proven benefits of enhanced operations and automation in the securities market. As per the IOSCO, AI technologies are being used increasingly for the robo-advising, algorithmic trading, investment research and sentiment analysis.³⁴ AI systems may both strengthen the financial systems by identifying and mitigating the risks and threats involved; as well as pose a huge risk itself to the market integrity and blow away investor confidence.

Studies show that AI powered tools have the potential to minimize the barriers for entry of bad actors in the market. The new and highly sophisticated AI technology allows the fraudulent and malicious practices to take places at much more cheaper rates and automated scale.³⁵ AI is also being increasingly used for market manipulation including spreading misleading and fake

³⁰*Subrata Roy Sabara v. Union of India*, (2014) 8 SCC 470.

³¹*N. Narayanan v. Adjudicating Officer, SEBI*, (2013) 12 SCC 152.

³²*Securities & Exchange Board of India v. Kishore R. Ajmera*, (2016) 6 SCC 368

³³See *How AI and Machine Learning Are Changing Trading Strategies*, GROWW (Oct. 23, 2025), <https://groww.in/blog/how-ai-and-machine-learning-are-changing-trading-strategies>.

³⁴*Supra* note 2

³⁵*Id.*

information that create trading as well as price artificiality in the market; thus, signalling wrong narratives to the investors. Malicious use of AI system has the potential to erode investor confidence and undermine trust in the financial markets.³⁶

Information asymmetry or information bias stems as another challenge to the integrity of the securities market. Information asymmetries or biases which are considered as violation of symmetry standard are integral to an AI system.³⁷ AI based asymmetry can take different forms. It can lead to structural, informational, operational, speed and computational asymmetry, which can cause unprecedented inequalities & biases. What started as a mere digital divide in the eco-system has become a technological divide and promotes information asymmetry between haves and have nots. The 'haves' are those firms who have access to advanced AI systems and can optimally benefit from its operations on a millisecond basis. The 'have-nots' are those who do not have such access, are not able to reap the benefits of speed and computational accuracy and are at a disproportionate structural, operational and financial disadvantage. When one party has access to more or superior information, it might lead to unfair advantage to the bad actors in derogation of rights of other investors. An AI system can easily identify and manage asymmetric opportunities in the market and disrupt the market equilibrium.³⁸ Information asymmetry undermines market integrity and investor protection in more than one way. It is an anti-thesis to the concept of market egalitarianism, which is one of the basic premises of market integrity. As one party has access to more information over others, it prevents a fair opportunity to invest and participate in an equal manner. The asymmetric information problem poses huge moral hazards and adverse impact on those who do not have equal access to information.³⁹ Information asymmetry works against the level playing field which focuses on equal market access for all.

³⁶*Id.*

³⁷Gabriella Waters & Phillip Honenberger, *AI Biases as Asymmetries: A Review to Guide Practice*, 8 FRONTIERS BIG DATA 1532397, (2025).

³⁸Mike Shell, *Asymmetry Artificial Intelligence*, Shell Cap. Mgmt. (last visited May 10, 2026), <https://shell-capital.com/asymmetry-artificial-intelligence/>

³⁹See *Information Asymmetry in Capital Markets and the Principle of Investor Protection*, SENGUN L. FIRM (last visited May 10, 2026), <https://sengunlaw.com/information-asymmetry-in-capital-markets-and-the-principle-of-investor-protection/>.

Learning from the past lessons, the regulators globally have prohibited insider trading transactions on the basic premise that insiders have access to unpublished price sensitive information. Allowing trading by insiders will lead to unfair advantage on the basis of information asymmetry and thus unethical. This justifies stringent regulations globally to prohibit insider trading transactions.

The integration of AI technologies in the capital market raises some critical questions about information asymmetry by market participants. Actors with superior computational and data analytics resources will be at a higher advantage over those who do not have advanced data processing facilities. Actors having speed and frequency advantage by using HFT algorithms can be a great advantage over those without such algorithms. This results in uneven playing field. A pertinent case study is that of sell offs in Japanese and US Equity market, when the sophisticated AI model which was deployed led to turmoil when all hedge funds acted at once and together, as the algorithms spotted downward trend. This led to huge market volatility, followed by the market downfall.⁴⁰ Firms like Two Sigma Investments, based in the US, use extremely sophisticated AI systems identifying patterns and correlations that may be missed by human traders.⁴¹ They undoubtedly earn high returns even in adverse market conditions and successfully leverage information asymmetry in their favour. Studies show that there has been 84% accuracy in prediction by AI models in trading as 72% prediction accuracy in traditional models.⁴² Such an information asymmetry leads to a deterrence gap in the market, which deter other firms from participating in the market on an equal footing with those who have access to AI aided-information.

⁴⁰Tobias Adrian, *Artificial Intelligence and Its Impact on Financial Markets and Financial Stability*, Int'l Monetary Fund (Sept. 6, 2024), <https://www.imf.org/en/news/articles/2024/09/06/sp090624-artificial-intelligence-and-its-impact-on-financial-markets-and-financial-stability> (last visited May 10, 2026)

⁴¹*Supra* note 33.

⁴²Vandana Srivastava & Rajiv Sikrora, *AI and Algorithmic Trading: A Study on Predictive Accuracy and Market Efficiency in Fintech Applications*, 5 SHODHKOSH: J. VISUAL & PERFORMING ARTS 1098, 1103 (2024).

Another challenge posed by AI to the market integrity is through its black box conundrum. AI based trading including algorithmic trading can fetch excellent financial gains, however at the cost of transparency and explainability. It can be extremely hard to understand and interpret the complex algorithms and AI systems which lead the trades to occur in a given manner. Many studies have found that the opaque nature of AI, fail to identify as well as disclose algorithmic strategies which lead to market abuse or manipulation.⁴³ The complexity increases because of the self-learning AI models which fail to explain the reasons behind their trading decisions. Opaqueness to this extent can cause large scale market manipulation, disrupt the market integrity and lead to unpredictable market functioning. In addition to its black box problem, AI enabled trades also suffer from cognitive and implicit biasness. Bias and discrimination are integral to an AI system. As the AI systems heavily depend on the trained data sets, its outcome can be extremely unfair to some market participants, enabling them to take wrongful gain. AI systems can also lead to information arbitrage by dealing with and relying on alternative data sources, which is driven by multiple factors like regulatory gaps, structural information asymmetry, lack of adequate infrastructure with the regulators etc.

Given the volatile and untrusted nature of algorithms and AI eco-system and the manner in which it can cause harm to the market raises the question of safeguarding market integrity from the adverse impact of AI by enhancing the integrity standards. This requires us to understand the regulatory gaps and the way they can be filled.

V. THE REGULATORY GAPS & FILLERS

A fundamental gap in the regulatory framework is that there exist no definition of algorithmic trading including AI based trading under the Indian legal or regulatory framework on the capital market; except under the SEBI Guidelines on Algorithmic Trading issued on 30th March 2012 where algo trading is defined as “any order that is generated using automated execution logic shall be known as algorithmic trading.”⁴⁴ The absence of a statutory

⁴³*Id.*

⁴⁴*Supra* note 5.

definition of algorithmic trading indicates structural weakness in the legal framework and allows the market players to take undue benefit of this legislative flaw.⁴⁵ The regulatory framework on scrutinize fraudulent, manipulative and unfair trade practices in India exists under the SEBI Act 1992⁴⁶ and SEBI (PFUTP) Regulations 2003⁴⁷. The jurisprudence of prohibition of market manipulation has also been contributed by SEBI orders, SAT orders and some landmark judgments by the Supreme Court. In essence, market manipulation, which is an anti-thesis to market integrity factors around artificial inflation/deflation in price, artificiality in volume of trading and artificial variation in the trading pattern. The Supreme Court has held that prevention of market abuse and preservation of market integrity is the hallmark of Securities Law.⁴⁸ The apex court emphasised on the need to protect market integrity and ensure that securities market is based on free and open access to information, as the integrity of the market is predicated on the quality and the manner on which it is made available to market.⁴⁹ SEBI also, in its interim order against the JS Group considered such high frequency trading activities to disrupt the market integrity and artificially influencing the price of the index and also lead to information asymmetry for other investors and traders who are not informed about such artifices.⁵⁰

With an aim to leverage the benefits of algo-trading for the retail investors, SEBI introduced a Circular on Safer participation of retail investors in Algorithmic.⁵¹ The circular aims to securing the interests of retail investors in algorithmic trading while creating obligations on market players including stock brokers and algo providers and Market Infrastructure Institutions (“**MIIs**”).

⁴⁵Kavidharani R., *Legal Analysis of Algorithmic Trading and AI enabled Market Manipulation*, 8 INDIAN J.L. & LEGAL RSCH. (2024).

⁴⁶Securities and Exchange Board of India Act, No. 15 of 1992, § 12A (Ind.).

⁴⁷Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, Gazette of India, pt. III sec. 4, Reg. 4(2)(a), (b), (e) (July 17, 2003).

⁴⁸*Supra* note 31.

⁴⁹*Id.*

⁵⁰*Supra* note 9.

⁵¹SEBI Circular on Safer Participation of Retail Investors in Algorithmic Trading, SEBI/HO/MIRSD/MIRSD-PoD/P/CIR/2025/0000013 (Feb. 4, 2025).

The whole idea is to enable algo trading only if the algorithms are registered, monitored and tagged.⁵² The circular, which came into effect on 1st August 2025 provides a better oversight and transparency in algo trading, thus enhancing investor protection. In also-trading through an Application Programming Interface (“API”), the brokers are the principal, while the algo providers or vendors are the agent. To ensure transparency, all also orders are required to be tagged with a unique identifier. The SEBI framework requires the brokers to comply with the security standards like having systems and procedures to detect and categories algo orders, allow access only through unique vendor client specific API key, categorising algorithms as white-box and black-box. White box Algos or transparent Algos are those where logic is disclosed and black box Algos are opaque in nature, where logic is not disclosed. Such categorisation has been done with a view to classify the algo on the basis of their transparency or opaqueness and help investors to manage their risks, after being fully informed. White box algos which are more open and flexible allows modification of strategies and exercise more control over their trading decision. Black box algos, although provide lesser flexibility are subject to higher scrutiny, mandatory testing and oversight by the regulator.

Another safety mechanism is that authentication of algos can take place only through open authentication and access to API can be authenticated only through two factor authentication. SEBI also makes the stock brokers responsible for obtaining prior approval from the stock exchanges for each algo, to tag each algo order with a unique identifier and also for handling investor grievances related to algo trading.

VI. REDEFINING MARKET INTEGRITY IN THE TECHNOLOGICALLY ENABLED MARKET

The gaps in the securities market regulations and the patchwork circular or guidelines are not adequate to deal with the market manipulation caused by new age algorithmic trading phenomenon. Due to the very nature of AI enabled

⁵²See Revati Krishna, *SEBI Algo Trading Rules 2026: Complete Breakdown for Retail Traders*, SAHI (Feb. 25, 2026), <https://www.sahi.com/blogs/sebi-algo-trading-rules-2026-what-every-retail-trader-must-know-before-april.r>

algo-trading eco-system which is characterized by opaqueness, non-explainability, non-interpretability, bias and information asymmetry lead not only to upsetting the market egalitarianism but also undermine market integrity, causing adverse impact on the investors. This requires the regulators to redefine the parameters of market integrity in the age of AI and set higher thresholds of transparency, accountability, disclosure norms and information symmetry. The European Securities Market Authority (“**ESMA**”) has laid down an obligatory regulatory framework on algorithmic trading under the MiFiD ii, which is a comprehensive framework regulating securities market focussing on minimising the risks from algorithmic and high frequency trading and strengthening investor protection.⁵³ Under the MiFiD ii framework, the firms desirous of using algo-trading mechanisms are required to have effective systems and risk control mechanisms in place.⁵⁴ It also ensures that the algo-trading is allowed only subject to the thresholds and the firms should prevent erroneous orders and contributing to a disorderly market.⁵⁵ The trading systems need to be tested and monitored and adequate arrangements must be in place to deal with their failure.⁵⁶ The investment firms are also required to disclose the nature of algorithmic trading strategies, details of the trading parameters or limits to which the system is subject, the key compliance and risk controls. Information symmetry which is the cornerstone of market integrity depends on the level and extent of information disclosures made by the firms. The ESMA through its MiFiD ii aims to minimise the trading risks caused by algorithmic trading and hence creates an obligation on the firms to comply with its Regulatory Technical Standards (“**RTS**”) framework.⁵⁷ The RTS framework places a heavy reliance on transparency across its trading transactions. Under its MiFiD ii and MAR framework, the European Securities Market Authority has adopted regulatory strategies which emphasise on information sharing and disclosures before firms can engage in algo-trading, to secure market integrity.

⁵³Directive 2014/65, art. 17(1), 2014 O.J. (L 173) 349, (EU).

⁵⁴*Id.*

⁵⁵*Id.*

⁵⁶*Id.*

⁵⁷European Commission, *Technical Standards Under Directive 2004/39/EC (MiFID I), Directive 2014/65/EU (MiFID II) and Regulation (EU) No. 600/2014 (MiFIR)* (last updated Feb. 1, 2017), https://ec.europa.eu/finance/securities/docs/isd/mifid/its-rtis-overview-table_en.pdf

VII. OVERCOMING THE CHALLENGES- MANDATING XAI

Securities market regulators need to raise the threshold bar in order to maintain market integrity in the new AI world. Market integrity demands trust in the AI enabled trading and hence AI systems and trading algorithms including advanced HFT should be explainable and interpretable.

Explainable AI or XAI, created or coined by Van Lent et al⁵⁸ in 2004, is crucial for building and reimposing trust in the investors. XAI is a set of processes and methods that allows humans to comprehend and trust the results and output created by algorithms.⁵⁹ Sajid Ali & Others explain different methods or mechanisms of AI explainability such as scoop-based method which helps determine the way model outputs relate to inputs either showing the entire model's behaviour or a single prediction, model-based method which may be intrinsic, model based or model agnostics, complexity-based method which explain that interpretability or explainability is directly proportional to the complexity of the ML model.⁶⁰ Explainable or interpretable AI can be intrinsic or post-hoc interpretable depending on when interpretability is achieved.⁶¹ Intrinsic interpretability models are self-explanatory and have interpretability built right in whereas Post-hoc interpretability models are secondary in nature and develop as a surrogate of the original mode.⁶² Finally, the methodology-based method depends on the implemented methodology in the AI or ML such as back-propagation based, perturbation based or gradient based.⁶³ Such explainability methods are required to be integrated into the trading systems by the regulators where the users, investors and other stakeholders can understand the mechanisms in which the algorithms work.⁶⁴

⁵⁸See Michael van Lent, William Fisher & Michael Mancuso, *An Explainable Artificial Intelligence System for Small-Unit Tactical Behavior*, in PROCEEDINGS OF THE SIXTEENTH CONFERENCE ON INNOVATIVE APPLICATIONS OF ARTIFICIAL INTELLIGENCE 900-07 (2004).

⁵⁹*What Is Explainable AI?*, IBM (last visited May 10, 2026), <https://www.ibm.com/think/topics/explainable-ai>.

⁶⁰*Id.*

⁶¹*Id.*

⁶²*Id.*

⁶³Sajid Ali et al., *Explainable Artificial Intelligence (XAI): What We Know and What Is Left to Attain Trustworthy Artificial Intelligence*, 99 Info. Fusion 101805, (2023).

⁶⁴*Id.*

Other approaches such as the exogenous approach or surrogate approach are also helpful in explaining the way in which algorithms function. The exogenous approach depends on the external factors of explainability while the surrogate approach predicts the understanding and reactions of an AI model by either explaining the entire model or by making individual predictions on the basis of algorithms.⁶⁵ Explainable methods of AI are not devoid of their own challenges but they definitely can make the algo-trading a trusted experience. This calls for Public-Private Partnership framework or a collaboration between regulators and industry to develop explainable AI which are trustworthy and transparent. Many nations including the European Union have made the deployment of XAI a mandatory compliance. AI systems must be not only categorized based on underlying risks, but high-risk AI systems are required to compulsorily comply with the explainability feature. Such high-risk AI systems which have high volatility market crash possibility need to be monitored under greater surveillance and risk control measures. A framework like or better than the Markets in Financial Instrument Directive (MiFiD ii) which emphasize on transparency, transaction reporting, execution of trades in best possible manner in the best interests of the investors and the market, need to be created and enforced. Heavy fines and penalties for non-compliance with the regulatory framework, like the EU framework also acts as a deterrent, minimalizing the anti-market behavior. A separate ‘Oversight authority’ which will oversee and allow the algorithmic and high frequency trades only after ensuring firms’ compliance with transparency, explainability and disclosure related obligations is required to be constituted.

While developing AI guidelines or strategies for the securities market, internationally accepted principals on effective AI governance cannot be ignored. These principles form the bedrock of any strategy or regulatory framework on emerging tech and have equal relevance in the securities market. Singapore has clearly adopted these guiding principles including transparency, explainability, reproducibility with equal emphasis on safety, security, robustness,

⁶⁵Seungjun (Josh) Kim, *Explainable AI (XAI) Methods Part 5 — Global Surrogate Models*, Towards Data Sci. (Feb. 13, 2022), <https://towardsdatascience.com/explainable-ai-xai-methods-part-5-global-surrogate-models-9c228d27e13a/>.

fairness, data governance, accountability.⁶⁶ In addition, Singapore also prioritises human agency and oversight, inclusive growth, societal and environmental well-being in its AI governance framework.⁶⁷ Singapore under its proposed Model Artificial Intelligence Governance Framework require the organizations to provide for an internal governance strategy comprising of AI strategy, governance considerations for procuring AI solutions and a steering committee for AI governance.⁶⁸ These compliance and checkpoints are also likely to strengthen market integrity and secure it from the threats of AI.

VIII. ASSESSING INDIA'S PREPAREDNESS TO SAFEGUARDING MARKET INTEGRITY UNDER THE SEBI (PFUTP) REGULATIONS 2003

Ideally, the SEBI regulation on fraudulent, unfair and manipulative trade practices in the securities market is punitive in nature. The approach towards unfair or manipulative actions is prohibitory and SEBI has adopted a zero-tolerance attitude towards such practices. However, it is not enough to prescribe miniscule penalty for the damage done to the market integrity. The new age challenges posed by technological advancements demand a shift from mere ex-post approach to both ex-ante as well as ex-post approach. The adverse impact which AI enabled algorithms may cause to the market and the investors is now well known and hence, it requires a precautionary or preventive approach rather than merely reactionary approach, as is under the current Prohibition of Fraudulent & Unfair Trade Practices framework of SEBI. Although, the Indian regulator has developed a broad and efficient regulatory framework, it should also adopt some preventive and precautionary ex-ante approaches by developing and institutionalizing an advanced technological architecture to effectively deal with the challenges of AI. Gaps pertaining to enforcement mechanism, algorithm identifiers, risk disclosures and opaque trading patterns need to be

⁶⁶PERS. DATA PROT. COMM'N, SING., *Singapore's Approach to AI Governance* (last visited May 14, 2026), <https://www.pdpc.gov.sg/organisations/resources/guidance-by-topic/singapores-approach-to-ai-governance>.

⁶⁷*Id.*

⁶⁸Office of the Privacy Commissioner for Personal Data, *Model Personal Data Protection Framework*, https://www.pcpd.org.hk/english/resources_centre/publications/files/ai_protection_framework.pdf

immediately filled. A structured algo trading framework based on internationally accepted guiding principles on the AI governance, systemic analysis of risks and threats involved, imposing minimum levels of risk controls with respect to price and quantity, accountability of algo traders, imposing mandatory audit trails and having risk impact assessment in place are required to be prioritized for strengthening market integrity.

The scope and applicability of PFUTP Regulations is broad enough to cover unscrupulous algo and HFT trading which may cause harm to the market or investors. ‘Dealing in securities’ as defined under the regulations is sufficiently covers such acts which may be knowingly designed to influence the decision of investors in securities,⁶⁹ which may cover the act of influencing the decision of investors through algorithms which may be intentionally designed for this purpose. The Regulations also prohibit use of any manipulative or deceptive device or employ any scheme or artifice to defraud the investors, which can well cover AI enabled manipulative devices.⁷⁰ Artificially inflating, depressing, maintaining or causing price fluctuation through any means is also a prohibited and punishable act under the Regulations, which are easily possible through deceptively designed algorithms.⁷¹ Hence, the regulatory structure is well in place to deal with the new age challenges of emerging tech to market integrity. However, the existing framework needs to be supported with proper detection, identification, analysis and enforcement mechanisms. Such AI specific mechanisms should clearly strategize the regulatory approach towards enabling AI systems in the trading, without compromising with investors trust. Towards reinforcing the market integrity, enhancing transparent trading mechanisms based on disclosure in both pre and post trading stages by the investment firms is required. The firms must be asked to mandatorily deploy only such algorithms

⁶⁹Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003, Gazette of India, pt. III sec. 4, Reg. 2(1)(b)(ii) (Ind.).

⁷⁰Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003, Gazette of India, pt. III sec. 4, Regs. 3(b)–(c) (Ind.).

⁷¹Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003, Gazette of India, pt. III sec. 4, Reg. 4(2)(d) (Ind.).

or similar AI systems which are explainable and interpretable by the investors. Overcoming the black box problem should be the most important priority of the regulators as well as the intention of the firms.

Drawing lessons from the MiFiD ii, the liability framework should make the investment firms answerable and accountable primarily in case of any damage caused by the AI. India also needs to understand the role of regulatory-industry partnership model, where both can collaborate & contribute to develop internationally accepted regulatory technical standards for the investments firms. There is also a need to develop adequate infrastructure to leverage the benefits of technology for the growth of the market and enabling retail investors to reap its benefits. Every effort towards this direction will be incomplete, if we fail to develop risk impact assessment system, which should be undertaken from time to time. Real time control mechanisms to mitigate the risks, real time monitoring, pre and post trade reviews, surveillance of trades by a high-powered technical committee and similar other systemic measures to identify, detect and mitigate the risks need to be undertaken by SEBI regularly. SEBI with its existing workload and pending cases may be overburdened to further oversee and monitor the algo-trading transactions.

Creation of a regulatory oversight committee or authority exclusively for the algo trading market will decentralise the monitoring function of SEBI and can lead to better and effective surveillance over such transactions. SEBI should also consider developing a separate grievance redressal mechanism for also investors, which is as speedy as the algo trading itself. And finally, making audit reporting a mandatory compliance for the investment firms will help SEBI get the first-hand information immediately and make a cease & desist order or restrict the firm to cause further harm to the investors or the market. The new age of AI is here to stay, become more complex and multifaceted. All that is needed is to develop mechanisms and strategies, both legal and technical, which makes market integrity uncompromisable.

**CREDITOR CONTROL AND SHAREHOLDER RETURN:
RETHINKING CORPORATE GOVERNANCE ACROSS
INSOLVENCY AND SECURITIES LAW**

Dr. Garima Gupta*

ABSTRACT

*The evolution of India's corporate governance architecture reflects a tension in the interaction between the creditor-driven insolvency regime under the Insolvency and Bankruptcy Code, 2016¹ (“**IBC**”) and the shareholder-centric paradigm embedded in the Companies Act, 2013² (“**2013 Act**”) and securities regulation, particularly the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015³ (“**LODR**”). This paper advances the thesis that Indian corporate governance is characterised by a form of structural circularity, wherein governance authority is first displaced from shareholders to creditors during financial distress, and subsequently reconstituted in favour of shareholders once the firm exits insolvency, without any doctrinal or regulatory reconciliation between these regimes. Under the IBC, the Committee of Creditors (“**COC**”) exercises decisive control over the corporate debtor, effectively displacing both the board of directors and shareholders from governance functions. This creditor primacy is justified on grounds of efficiency, value maximisation, and the need to resolve financial distress in a time-bound manner. However, once a resolution plan is approved and the entity re-enters the domain of securities regulation, it becomes subject to a governance framework that presumes dispersed shareholding, minority protection, and board-centric oversight. The LODR, together with SEBI's evolving framework on related-party transactions (“**RPTs**”), minimum public shareholding (“**MPS**”), and continuous disclosure, operates on normative assumptions that are fundamentally at odds with the realities of insolvency-driven restructuring. This disjunction generates multiple sites of doctrinal conflict which reveal not merely regulatory gaps, but a deeper incoherence in the conceptual foundations of corporate governance in India.*

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¹Insolvency and Bankruptcy Code, No. 31 of 2016 (Ind.).

²Companies Act, No. 18 of 2013 (Ind.).

³Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, Extraordinary, pt. III, sec. 4 (Sept. 2, 2015).

*Creditor Control And Shareholder Return: Rethinking Corporate Governance Across
Insolvency And Securities Law*

This paper argues that India has selectively adopted elements of both creditor-oriented insolvency regimes and shareholder-protective securities frameworks, without adequately harmonising their underlying logics. In response, the paper proposes a ‘distress-contingent’ governance framework that recognises financial distress as a distinct regulatory phase warranting tailored governance norms. Such a framework would recalibrate the application of securities law during and immediately after insolvency, by introducing independent RPT oversight, enhanced disclosure obligations specific to the resolution process, and strengthened structural protections for minority shareholders. By conceptualising governance as dynamic rather than static, the paper seeks to bridge the existing divide between insolvency law and securities regulation, and to offer a more coherent model for aligning India’s domestic complexities with its global regulatory aspirations.

Keywords: Distress-Contingent Governance, Creditor-In-Control Model, Participatory Deficit.

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I. INTRODUCTION

In simple terms, corporate governance is the foundational framework that ensures transparency and accountability throughout the life of a body corporate under company law, securities law, and insolvency law. However, when a listed company undergoes the Corporate Insolvency Resolution Process (“**CIRP**”) under the IBC, the corporate-governance norms applicable to it change abruptly. During CIRP, the ‘creditor-in-control’ model suspends the powers of the Board of Directors (“**BOD**”) of the Corporate Debtor (“**CD**”) and materially displaces the board-shareholder agency relationship; where the IBC conflicts with securities-law requirements, the IBC prevails.⁴ The CoC exercises decisive control over the restructuring process. After NCLT approval of a resolution plan, the moratorium ends under section 31(3) of the IBC. The listed entity then resumes post-resolution operations, while the LODR continues to apply subject to its CIRP-specific exemptions and transition periods.⁵ Consequently, the CD is expected to abide by the norms governing minority-shareholder protection, BOD accountability, transparency, and disclosure obligations under the LODR, without any regulator providing clarity or mediating the transition between governance standards resting on different normative assumptions.

There is an apparent dichotomy between the principles on which control, accountability, risk, and institutional legitimacy are understood under the IBC, company law, and securities law. This tension is exacerbated when a listed company undergoes CIRP, exposing the lack of a coherent account of corporate governance at critical transition points. As is evident, the tension is not merely procedural but also jurisdictional. On the one hand, the IBC focuses on value maximisation, resolution, and preservation of the CD and bestows significant

⁴*Anju Agarwal v. Bombay Stock Exchange & Ors.*, Company Appeal (AT) (Insolvency) No. 734 of 2018 (NCLAT) (Ind.).

⁵Insolvency and Bankruptcy Code, No. 31 of 2016, § 31(3) (Ind.); Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Regs. 15(2A)–(2B), 30 (Ind.).

decision-making power on the financial creditors; on the other hand, securities law facilitates the protection of shareholders' rights and interests through disclosure safeguards and participatory rights. The tension between the governance structures of these two differently oriented legal frameworks leads to the creation of a 'governance circularity' in which authority in the first phase shifts from shareholders to financial creditors of the CD and in the subsequent phase reverts to shareholders. Interestingly, there is no theoretical explanation capable of facilitating this transition in a smooth and coherent manner.

The perils of the absence or underdevelopment of such theories are stark and expose multiple sites of doctrinal conflict. A primary purpose of CIRP is to approve a resolution plan that restructures the CD; where RPTs form part of that plan, the usual shareholder-approval requirement under the LODR does not apply. On a similar note, MPS requirements mandated under the Securities Contracts (Regulation) Act, 1956 ("**SCRA**") read with Securities Contracts (Regulation) Rules, 1957 ("**SCRR**")⁶ are relaxed during CIRP but become subject to a phased restoration timetable after plan approval, even though CIRP itself may produce concentrated ownership structures. On a more fundamental level, CoC meetings are characterised by confidentiality and limited public participation; an aspect that sits uncomfortably with the otherwise disclosure-based regime of Indian securities law. The question is not about the legitimacy of these differences, but about the tensions that arise because of regulatory inconsistencies and an absence of transitional governance norms.

The present scholarship largely examines IBC and securities law in silos given their distinct regulatory domains. The former focuses on the primacy of the CoC's commercial wisdom, efficient resolution, and the limited jurisdiction of tribunals; the latter focuses on disclosure obligations, minority and investor protection, and board accountability. Although these themes are pertinent, the scholarship conspicuously lacks discussion of the interactions and overlaps between the creditor-driven insolvency governance standards and shareholder-

⁶Securities Contracts (Regulation) Rules, 1957, Rule 19A (Ind.); Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 38 (Ind.).

driven governance standards, particularly during the transitional period through which the CD passes after a successful CIRP.

This paper argues that India's corporate governance framework is structurally circular and temporally fragmented. Governance authority is displaced from shareholders to creditors during insolvency and subsequently restored to shareholder-centric regulatory structures after resolution, without any doctrinal or institutional framework reconciling these competing models of governance. The paper contends that Indian corporate law continues to treat governance as a static phenomenon even though financial distress fundamentally alters the distribution of economic risk, control rights, and institutional priorities within the corporation. In response, the paper develops the concept of '*distress-contingent governance*' to argue that governance norms should be calibrated to the financial condition and restructuring stage of the firm rather than uniformly imposed across all phases of corporate existence.

While situating these questions within the broader theme of corporate governance, the paper primarily argues that India has transplanted elements of creditor-oriented insolvency regimes and shareholder-protective securities frameworks from comparative jurisdictions without harmonising their underlying normative assumptions. In consequence, what is apparent is not merely regulatory overlap, but a deeper fragmentation in the governance architecture of distressed corporate entities. The paper proceeds in four parts. *Part I examines the relationship between corporate control and financial distress and discusses the theoretical foundations of a corporate governance framework with the underlying intent of distress-contingent governance. Part II analyses the governance shift during and after the CIRP leading to 'displacement' during CIRP and 'reversion' post-CIRP. Part III examines specific doctrinal conflicts focussing primarily on norms related to RPTs, MPS obligations, and disclosure obligations leading to a 'participatory deficit'. Part IV concludes by proposing a transitional governance model, namely 'distress-contingent governance', capable of reconciling the highlighted friction points during and after the CIRP of a corporate entity.*

II. CORPORATE CONTROL, FINANCIAL DISTRESS, AND THE THEORETICAL FOUNDATIONS OF DISTRESS- CONTINGENT GOVERNANCE

A. CORPORATE GOVERNANCE: A CONVENTIONAL PERSPECTIVE

In accordance with Berle and Means' seminal work,⁷ the separation of ownership and control in large (public) corporations is the structural force behind the theoretical foundations of corporate governance in modern legal systems. Shareholders bear the ultimate economic risk but exercise no direct control over the affairs of the corporate entity, while the BOD is the central authority that makes managerial decisions. This creates an agency concern because directors and managers may act in their own interests under the guise of risk mitigation and may extract private benefits, contrary to the principle of shareholder-value maximisation. In this context,⁸ corporate governance acts as an institutional design to address the 'agency problem'.⁹ The prevalent model of corporate governance is premised on the principle of shareholder primacy, under which the BOD acts as the fiduciary steward of the interests of the shareholders and owes duties to the corporate entity; an idea that rests in equity and is reflected in the statute.¹⁰ In India, under the 2013 Act, while directors do not ordinarily owe fiduciary duties directly to shareholders,¹¹ section 166 imposes duties on directors, including the duty to act in good faith in the best interests of the company, its employees, shareholders, the community, and the environment; section 149 and Schedule IV impose additional obligations on independent directors. More critically, for publicly traded companies, the LODR reinforces corporate-governance norms for listed entities through a mandatory framework.

⁷ADOLF BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

⁸REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* (3d ed. 2017).

⁹*Id.* at 29–32.

¹⁰*Nan Lal Zaver v. Bombay Life Assurance Co. Ltd.*, [1950] SCR 391 (Ind.); Vijay P. Singh, *Directors' Fiduciary Duties to the Company: A Comparative Study of the UK and Indian Companies Act*, 27 *TRUSTS & TRUSTEES* 132, 132–50 (2021).

¹¹*Sangramsinh P. Gaekwad v. Shantidevi P. Gaekwad*, [2005] 1 SCR 624 (Ind.).

Securities laws in India are based on a disclosure-based standard in order to reduce information asymmetry, especially for publicly traded companies.¹² However, the above-mentioned framework is primarily centred around the view that shareholders remain the residual claimants and the primary risk bearers of the corporate entity,¹³ because governance standards must be aligned with the interests of the risk-bearers, namely shareholders.¹⁴ The disclosure-based standards rest on agency-cost economics drawing from the shareholder-centric theories around corporate governance, under which shareholders, as residual claimants, must also receive residual control.¹⁵ Disclosure obligations, as a result, function as mechanisms that enable shareholders to exercise control through voting rights, monitoring, and market responses. However, this assumption can be questioned when a listed entity enters CIRP because shareholders in effect cease to be residual claimants because the CD's economic value may be insufficient to honour creditors' claims. In other words, the residual economic interest in CIRP primarily tilts in favour of creditors because, in such situations, the creditors are the parties most exposed to restructuring consequences.

B. FINANCIAL DISTRESS AND THE DISPLACEMENT OF SHAREHOLDER PRIMACY

As stated briefly above, the assumption underlying the shareholder-primacy model of corporate governance becomes unstable when a CD is undergoing financial distress. This is because the CD's financial position has deteriorated: the asset value of the CD is not only insufficient to cover outstanding debts, but may continue to decline as its equity cushion is progressively eroded. Consequently, the shareholders who in normal circumstances are the residual claimants cease to be so as their claims stand subordinate to creditors and to other outstanding claims, such as CIRP costs and

¹²F. S. MISHKIN & S. G. EAKINS, FINANCIAL MARKETS (2019); JOHN ARMOUR, PRINCIPLES OF FINANCIAL REGULATION (2016).

¹³FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991).

¹⁴Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–09 (1976).

¹⁵*Id.* at 334–37.

workmen's and employees' dues. These parties' economic welfare is directly affected by the proposed resolution.

Jensen and Meckling's agency-cost framework¹⁶ helps explain why the shareholder-primacy model becomes structurally unstable in the 'zone of insolvency' because, during this period, the residual claimants shift from equity holders to debt holders, necessitating a realignment of fiduciary attention. This produces risk asymmetry: equity holders are 'out of the money' and therefore have an incentive to take even higher risks or make speculative bets; if these critical decisions fail, it is the creditors who bear the costs entirely.

Let us assume that a company (CD) has assets worth ₹100 crore but debts of ₹150 crore. In economic terms, the shareholders' equity is already wiped out given that even if the company is liquidated, creditors will still suffer a loss of ₹50 crore. At this stage, shareholders no longer bear the primary residual claim; instead, it is the creditors who bear the risk. However, if shareholders continue to control the company, they may prefer extremely risky projects or speculative transactions. If the gamble succeeds, shareholders may recover value despite being effectively 'out of the money'. But if it fails, the downside falls almost entirely upon creditors, whose recoveries diminish further. This creates a structural risk asymmetry between shareholders and creditors in the vicinity of insolvency. As is evident, a continuing entrenchment of shareholder governance during financial distress may result in pathologies such as shareholders and agents engaging in asset substitution leading to creditor losses; debt overhang caused by underinvestment decisions with respect to positive net-present-value projects; and, in extreme cases, strategic delay in acknowledging insolvency with the underlying intent to preserve the present value of equity at the future expense of reduced creditor recoveries.

In this regard, comparative jurisdictions offer useful guidance. For instance, in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*¹⁷ in the United States, Chancellor Allen opined that when a company is in the

¹⁶*Id.* at 334–37.

¹⁷*Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

‘vicinity of insolvency’, there is a duty upon the directors to protect the interests of the corporate body in its entirety, which in practice means that the interests of the creditors must also be factored in even before insolvency. This idea of ‘community of interests’ was later clarified in the 2007 case of *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*,¹⁸ where the Delaware Supreme Court significantly narrowed the approach suggested by the *Credit Lyonnais* case. It was held that directors do not owe any fiduciary duty directly to creditors during or near-insolvency; creditor protection instead stems from contracts and covenants existing with the corporate entity. It further held that creditors may bring derivative claims on behalf of the corporation once the insolvency is established. Rather than treating the decisions as contradictory, it is more accurate to read Gheewalla as limiting the implications of Credit Lyonnais: both these cases acknowledge that ‘financial distress’ significantly affects the corporate-governance environment of an entity.¹⁹ This question has not been settled even in mature jurisdictions; the UK Supreme Court’s 2022 decision in *BTI 2014 LLC v Sequana SA*,²⁰ discussed in *Part IV* of this paper, reflects a continuing recalibration of when fiduciary attention must shift toward creditors; a debate that remains doctrinally underdeveloped in India. This instability, I argue, demonstrates that existing corporate governance frameworks have often failed to treat financial distress as a relevant variable, leaving courts to struggle to accommodate it within existing doctrinal categories of governance.

C. THE CREDITOR-IN-CONTROL MODEL UNDER IBC, 2016: GOVERNANCE CIRCULARITY AND ITS THEORETICAL INCOHERENCE

The IBC, in effect, promotes a governance structure that is creditor-centric and is premised on the previously discussed economic logic; namely, that during insolvency, it is the financial creditors who wear the hat of ‘residual

¹⁸N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).

¹⁹Larry Ribstein, *The Gheewalla Case: The Delaware Supreme Court Clarifies Directors’ Duties in Bankruptcy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (2007).

²⁰BTI 2014 LLC v. Sequana SA [2022] UKSC 25, [2024] AC 211 (UK).

claimants’.²¹ The CoC exercises substantive governance powers, including approval or rejection of resolution plans; determination of distribution standards and haircuts for various stakeholders within the statutory limits; monitoring and, where permitted, extending the timelines of the resolution process. In other words, during CIRP, shareholders are relegated to the margins as their claims are subordinated,²² they have no statutory vote in the CoC,²³ and their ability to influence the resolution process is nearly eliminated. It can be argued that this does not merely effect a procedural change but a normative re-orientation. The corporate governance standards applicable to the CD do not merely undergo modification; they are displaced by an alternative governance paradigm premised on fundamentally different assumptions about ‘economic risk’ and ‘control’. This transition is temporary by design. Once the NCLT approves a resolution plan, the moratorium ends under section 31(3), and the CD operates under the incoming management where the plan so provides. The approved plan may provide for reconstitution of the BOD. The Companies Act, the LODR, and other applicable securities laws continue to govern the entity, subject to specific CIRP exemptions and the three-month transition period for Regulations 17 to 21. Accordingly, despite the period during which CIRP applies fundamentally different governance standards, the shareholder-primacy model and its disclosure, board-accountability, and minority-protection norms are restored when the successful resolution applicant takes charge, subject to those transition provisions.

Since the present paper focuses on listed companies undergoing CIRP, it is interesting to note that SEBI, as a market-facing and disclosure-oriented regulator, lacks any mandate to assess a listed CD’s post-CIRP governance readiness. This results in a regulatory and governance vacuum at a juncture when the entity is fragile and governance is most critical. The erstwhile CD may

²¹Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 17, 21, 23, 28, 30 (Ind.); *K. Sashidhar v. Indian Overseas Bank*, (2019) 12 SCC 150 (Ind.); *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*, (2020) 8 SCC 531 (Ind.).

²²Insolvency and Bankruptcy Code, No. 31 of 2016, § 30(2) (Ind.); Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Gazette of India, pt. III sec. 4, Reg. 38 (Nov. 30, 2016).

²³Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 21, 24 (Ind.).

emerge with a new, heavily concentrated ownership structure, RPTs embedded in the resolution plan, and obligations under the phased MPS timetable, while simultaneously returning to ordinary market operations and complying with SEBI's disclosure-based regime.²⁴ It is this circularity, the replacement of the shareholder-centric model by a creditor-centric model during CIRP, and its restoration after CIRP without doctrinal or institutional mediation—that is problematic.²⁵ The issue is not merely procedural but a manifestation of a more fundamental theoretical failure which stems from the fact that the framework of Indian corporate law considers corporate governance as a static attribute which is uniformly applicable irrespective of the financial health of the corporate entity. It does not recognise that during financial distress the corporate entity undergoes a different allocation of economic risk that completely alters the position of stakeholders, residual claims, and control, all of which form the normative basis of a sound corporate governance model.

III. GOVERNANCE DURING AND AFTER CIRP: DISPLACEMENT, REVERSION & DOCTRINAL CONFLICT

A. GOVERNANCE DURING CIRP: THE MECHANICS OF DISPLACEMENT

As discussed in Part I, the commencement of CIRP leads to an immediate displacement of the prevalent corporate governance architecture in the listed CD. This is neither incremental nor graduated but instead functions in a statutory binary which commences upon the admission of an application by the National Company Law Tribunal (“**NCLT**”) under section 7, 9, or 10 of the IBC, 2016. As briefly discussed above, admission of a CIRP application by the NCLT leads to immediate anomalies across multiple dimensions of corporate governance operating within the CD. Particularly, for a listed company, the consequences are especially significant. For instance, after imposition of the moratorium under Section 14, the institution or continuation of suits or

²⁴Umakanth Varottil, *India: The Efficacy of India's Legal System as a Tool for Investor Protection*, in GLOBAL SECURITIES LITIGATION AND ENFORCEMENT 813, 813–45 (Pierre-Henri Conac & Martin Gelter eds., 2019).

²⁵*State Bank of India v. Consortium of Murari Lal Jalan & Florian Fritsch*, 2024 SCC OnLine SC 3187 (Ind.).

proceedings against the CD is prohibited, including enforcement of security interests and transfer of, or creation of any encumbrance on assets of the CD. This has significant consequences: on the one hand, its securities on the stock exchanges continue to be traded, while, on the other hand, the CD's capacity to issue securities, deal with assets, or take any other action for value distribution among stakeholders is massively curtailed. Critically, the IBC does not mandate automatic suspension of the CD's listing or of the LODR; an aspect significant from the perspective of corporate governance.

The displacement of governance norms is particularly apparent from the operation of Section 17 under which the Interim Resolution Professional (“**IRP**”) and, eventually, the Resolution Professional (“**RP**”) assume²⁶ management powers while the BOD's powers stand suspended; in simple terms, the CD's former governing organ loses its management authority. The officers of the CD are required to cooperate with the IRP/RP in managing its affairs, and the IRP/RP effectively act in the name of the CD. Hence, the IRP or RP assumes the BOD's operative governance role during CIRP. In *Vijay Kumar Jain v. Standard Chartered Bank & Ors.*,²⁷ the Supreme Court held that once CIRP is initiated, the BOD's powers are suspended. It further clarified that suspended directors lose management authority but retain statutory rights to notice, participation, and relevant documents under the IBC. This position, read with Regulation 15(2A) of the LODR, which provides that the corporate-governance requirements in Regulation 17 of the LODR (regarding BOD composition and independent directors) do not apply to listed entities undergoing CIRP, makes it apparent that this displacement is often under-appreciated through the lens of corporate governance. Under ordinary circumstances, the BOD is the central institution that exercises fiduciary authority and ensures governance, accountability, and transparency in accordance with the statutory framework of the 2013 Act and securities regulations such as LODR. Put simply, displacement of the BOD does not merely affect the position of individual directors; it dismantles the primary architecture through which the shareholder-centric model of corporate governance operates. It also has a consequential effect on

²⁶Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 16–17, 22 (Ind.).

²⁷*Vijay Kumar Jain v. Standard Chartered Bank*, (2019) 9 SCC 436 (Ind.).

the functioning of all board committees, such as the audit committee, nomination and remuneration committee, risk management committee, and similar bodies, because the authority from which they derive their power is itself suspended.

The governance vacuum resulting from this displacement is filled by the CoC,²⁸ which does not represent shareholders and comprises primarily financial creditors with voting shares proportionate to the debt owed to them.²⁹ CoC approval is required before the RP may undertake specified actions analogous to major board decisions, including raising interim finance, creating security interests, changing the ownership or capital structure, and disposing of assets.³⁰ The CoC may approve a resolution plan by at least sixty-six per cent of its voting share and, under³¹ section 33(2), may resolve to liquidate the CD at any time after its constitution and before plan confirmation.³² This demonstrates that the CoC exercises extensive power that may determine the fate of the CD; a point emphatically illustrated by the NCLAT in *Venus India Asset-Finance Pvt. Ltd. v. Suresh Kumar Jain (RP of MK Overseas Pvt. Ltd.)*,³³ wherein it was held that “the Code does not envisage that the adjudicating authority should don the mantle of the CoC and, in second-guessing the commercial wisdom of the Committee of Creditors, approve a resolution plan that the Committee of Creditors has found unacceptable.” The Supreme Court further held in *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta* that³⁴ the commercial wisdom of the CoC is not justiciable on merits, and the powers of the NCLT and National Company Law Appellate Tribunal

²⁸Insolvency and Bankruptcy Code, No. 31 of 2016, § 21 (Ind.).

²⁹Insolvency and Bankruptcy Code, No. 31 of 2016, §§ 21, 24(3)–(4) (Ind.).

³⁰Insolvency and Bankruptcy Code, No. 31 of 2016, § 28 (Ind.).

³¹Insolvency and Bankruptcy Code, No. 31 of 2016, § 30(4) (Ind.).

³²Insolvency and Bankruptcy Code, No. 31 of 2016, § 33 (Ind.).

³³*Venus India Asset-Fin. Pvt. Ltd. v. Suresh Kumar Jain*, Company Appeal (AT) (Ins.) No. 1395 of 2022 (NCLAT) (Ind.).

³⁴*Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*, (2020) 8 SCC 531 (Ind.).

(“NCLAT”) are confined within the limits of section 30(2) of the IBC; a position reinforced in *K. Sashidhar v. Indian Overseas Bank*.³⁵

B. THE MECHANICS OF REVERSION

The moratorium imposed under Section 14 is lifted upon NCLT approval of the CoC-approved resolution plan.³⁶ Consequently, the successful resolution applicant takes control of the CD and reconstitutes the BOD where the approved plan so provides. At this juncture, the securities-law governance framework continues to apply, subject to specific CIRP exemptions and transition periods, the adequacy of which will be discussed later in this work. It must be noted that there is no separate regulatory action by SEBI governing the lifting of the moratorium for a listed CD. After approval under section 31, continuous-disclosure obligations remain applicable, while the entity has three months to comply with Regulations 17 to 21 on board and committee composition. Regulation 17 of LODR requires an optimal combination of executive and non-executive directors, with at least fifty per cent non-executive directors, and mandates the presence of independent directors, including at least one woman director. Regulation 18 requires that two-thirds of the Audit Committee must comprise independent directors to provide oversight on financial reporting and internal controls. Regulation 19 mandates the Nomination and Remuneration Committee to oversee the appointment of directors and matters incidental thereto such as compensation. Regulation 23 requires prior audit-committee approval for RPTs and prior shareholder approval for material RPTs and material modifications, subject to specified exceptions. Regulation 27 requires listed entities to file quarterly corporate-governance compliance reports with the stock exchanges within stipulated timelines. Regulation 30 mandates immediate public disclosure of material events and information in accordance with its materiality framework. In SEBI’s

³⁵*K. Sashidhar v. Indian Overseas Bank*, (2019) 12 SCC 150 (Ind.); *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17 (Ind.).

³⁶Insolvency and Bankruptcy Code, No. 31 of 2016, § 31(3) (Ind.).

final order in the matter of *V.B. Industries Ltd., which was later*³⁷ upheld by Securities Appellate Tribunal (“**SAT**”),³⁸ violations of Regulations 30 and 33 of LODR were found, and the directors were held liable for financial misrepresentations, accounting lapses and misuse of funds. SEBI found violations of the corporate-governance requirements as stipulated in Chapter IV read with Regulation 4 of the LODR. Similarly, in the final order by SEBI in the matter of Trinity Tradelink Ltd., which was later³⁹ upheld by SAT,⁴⁰ serious violations under LODR were found, and the compliance certificates issued by the Chief Financial Officer were declared to be inaccurate and in violation of accountability standards. The investigation identified systemic lapses, including failure to appoint a company secretary or upload annual reports, as well as misrepresentations regarding the use of funds. These responsibilities return to the newly constituted BOD when the RP’s management authority ends, and the shareholder-centric model of governance is at least theoretically reinstated. The Supreme Court’s ‘clean slate’ doctrine in *Ghanashyam Mishra and Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.*,⁴¹ addresses liabilities rather than governance reversion: once the NCLT approves a resolution plan, it binds the CD and its stakeholders, and claims not forming part of the plan stand extinguished. This has sound commercial and legal justifications, without which the successful resolution applicant would stand burdened with obligations that were to be resolved by the CIRP itself. Interestingly, the ‘clean slate’ doctrine remains conspicuously silent about the CD’s governance status, including the applicable institutional framework, the process of transition from a creditor-centric to a shareholder-centric model of governance, and the regulatory support to be extended to the newly constituted BOD to navigate compliances under LODR read with other applicable securities regulations. This gap in the doctrine’s

³⁷Securities and Exchange Board of India, Final Order in the Matter of V.B. Industries Ltd., Order No. WTM/AB/IVD/ID19/12493/2021-22 (Sept. 30, 2021) (Ind.).

³⁸V.B. Indus. Ltd. v. SEBI, Misc. Application No. 1322 of 2021 & Appeal No. 750 of 2021 (SAT) (Ind.).

³⁹Securities and Exchange Board of India, Final Order in the Matter of Trinity Tradelink Ltd., Order No. WTM/AB/IVD/ID19/17487/2022-23 (June 28, 2022) (Ind.).

⁴⁰Trinity Tradelink Ltd. v. SEBI, Appeal No. 637 of 2022 (SAT) (Ind.).

⁴¹Ghanashyam Mishra & Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Co., (2021) 9 SCC 657 (Ind.).

governance implications, it is presently liability, oriented is the central doctrinal problem this Part seeks to expose.

For instance, the reconstitution of the BOD is a complex governance event as the approved resolution plan may determine its composition. The resolution applicant proposes the plan, while the CoC and NCLT approve it; the applicant incurs risk and commits capital to the CD. However, the BOD may effectively have a concentrated structure heavily tilted in favour of the successful resolution applicant's nominees; a governance implication unaddressed by the regulatory framework. The LODR requires at least fifty per cent of the BOD to comprise non-executive directors and at least one woman director. Where the chairperson is a regular non-executive director, at least one-third of the board must be independent; where there is no regular non-executive chairperson, at least half must be independent.⁴² After CIRP, however, the successful resolution applicant as the new controlling shareholder of the listed CD may intend to place its own nominees as executive directors or non-independent directors. In the case of *Yadubir Singh Sajwan & Ors. v. Som Resorts Pvt. Ltd.*,⁴³ the NCLT approved a resolution plan that contained the following clause: "*Clause 5.1.c - Management of the affairs of the Corporate Debtor after approval of the Resolution Plan - powers of the Board of Directors will vest with the Resolution Applicant who will be entitled to appoint its nominees/representatives/assigns as Directors of the Corporate Debtor within 30 days from the Effective Date. The newly constituted Board of Directors shall be vested with the overall control and management of affairs of the Corporate Debtor with effect from the date Resolution Plan becomes effective.*"⁴⁴

It is not that the intersection between proceedings under IBC and obligations under securities laws has gone unnoticed by the regulators.⁴⁵

⁴²Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg. 17 (Sept. 2, 2015).

⁴³*Yadubir Singh Sajwan v. Som Resorts Pvt. Ltd.*, Company Petition No. (IB)-67(ND)/2022 (NCLT) (Ind.).

⁴⁴*Id.* at 19.

⁴⁵Adity Chaudhury, *SEBI Regulations Amended for Companies Undergoing CIRP Under IBC*, ARGUS PARTNERS (June 5, 2018), <https://www.argus-p.com/papers-publications/thought-paper/sebi-regulations-amended-for-companies-undergoing-cirp-under-ibc/>.

Regulation 15(2A) of LODR⁴⁶ is a formal recognition of the fact that specified board and committee requirements under Chapter IV are structurally incompatible with an entity undergoing CIRP. In this light, it disapplies Regulation 17 and Regulations 18 to 21 during CIRP, with the IRP/RP fulfilling the corresponding roles and responsibilities. The second proviso to each of Regulations 15(2A) and 15(2B) requires compliance with Regulations 17 to 21 within three months of approval of a resolution plan under Section 31 of IBC. The IBC also provides that, where implementation of a resolution-plan action would otherwise require shareholder approval under the 2013 Act or another law, that approval is deemed to be given for the effective implementation of the resolution plan.⁴⁷ Similarly, there is no requirement to obtain shareholder approval for material RPTs that form part of the resolution plan, provided relevant disclosures have been made to the stock exchanges within one day of approval of the resolution plan.⁴⁸ The same rule applies for matters such as disposal of shares in a material subsidiary that may lead to a reduction of shareholding to less than or equal to 50%,⁴⁹ cessation of control over the material subsidiary; and any disposal of assets of the material subsidiary that amounts to more than twenty per cent of its total assets, provided⁵⁰ the said matters form a part of the resolution plan and have been disclosed to the stock exchanges within one day of its approval. Regulation 31A, dealing with the reclassification of promoters, provides⁵¹ for exemptions to facilitate smooth implementation of the resolution plan. Ordinarily, such reclassification mandates shareholder approval and compliance with other conditions in relation to shareholding limits, control rights and managerial participation. However, CIRP-driven reclassifications are exempted from such requirements provided that the

⁴⁶Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, regs. 15(2A)–(2B) (Ind.).

⁴⁷MINISTRY OF CORPORATE AFFAIRS, GENERAL CIRCULAR NO. IBC/01/2017 (Oct. 25, 2017).

⁴⁸Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg. 23(4) proviso 2 (Sept. 2, 2015).

⁴⁹Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg. 24(5) (Sept. 2, 2015).

⁵⁰Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg. 24(6) (Sept. 2, 2015).

⁵¹Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2018, Gazette of India, pt. III sec. 4 (Nov. 16, 2018).

erstwhile promoters of the CD cease to have control and the reason for the reclassification is disclosed to the stock exchanges.⁵² Similarly, there are relaxations with respect to schemes of arrangement, for which the ordinary framework requires that the draft scheme must be filed with the stock exchanges before filing it with the NCLT, and must be accompanied by a valuation report and fairness opinion.⁵³ Those requirements do not apply to a restructuring proposal approved as part of a resolution plan under section 31, provided the details are disclosed to the stock exchanges within one day.⁵⁴ It must also be noted that the Insolvency and Bankruptcy Board of India (“IBBI”) and SEBI entered into an MoU in 2019⁵⁵ to facilitate coordinated implementation of the IBC. The MoU provides for information sharing, regulatory coordination, joint capacity building, staff training, and collaborative efforts to strengthen insolvency resolution processes and enhance awareness among financial creditors. It reflects increasing institutional convergence between insolvency regulation and securities regulation in India.

However, the tension that this paper identifies is of a fundamentally different character from the compliance difficulties that amendments to LODR and the SEBI circulars address, as discussed in Part III.

IV. THE DOCTRINAL CONFLICT AND PARTICIPATORY DEFICIT: RPTS, MPS AND DISCLOSURE OBLIGATIONS

In order to expose the depth of the governance problem that this paper has discussed at length, three critical limitations of the existing regulatory structure must be acknowledged. *Firstly*, Regulation 15(2A) of LODR is

⁵²Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg. 31A(9) (Sept. 2, 2015).

⁵³Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Regs. 37, 94 (Ind.); SECURITIES AND EXCHANGE BOARD OF INDIA, SCHEMES OF ARRANGEMENT BY LISTED ENTITIES AND RELAXATION UNDER SUB-RULE (7) OF RULE 19 OF THE SECURITIES CONTRACTS (REGULATION) RULES, 1957, Circular No. CFD/DIL3/CIR/2017/21 (Mar. 10, 2017).

⁵⁴Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg. 37(7) (Sept. 2, 2015).

⁵⁵ Press release, Press Information Bureau, IBBI, SEBI Sign MoU for Better Implementation of IBC (Mar. 19, 2019), <https://www.pib.gov.in/Pressreleaseshare.aspx?PRID=1569075®=3&lang=2>.

primarily concerned with the CIRP period and provides a three-month transition period for Regulations 17 to 21 for compliance. Once a resolution plan is approved under section 31 of the IBC, the ordinary board and committee requirements resume without any mechanism of graduated restoration or any acknowledgement of the disruption in governance structure caused by CIRP. *Secondly*, the continuous disclosures stipulated under Regulation 30 of LODR remain strictly applicable and must be complied with by the RP, meaning⁵⁶ that the governance paradox of a listed CD simultaneously subject to CIRP confidentiality imperatives and transparency obligations under LODR is not resolved by the provision at all. *Thirdly*, and more critically, Regulation 15(2A) of LODR is merely a blunt exemption and cannot be categorised as a calibrated governance framework. To put it simply, it merely defers compliance with certain requirements under LODR without replacing them with an alternative governance standard more suitable for the companies undergoing CIRP. The larger problem is that it leaves multiple questions regarding the nature of governance norms that should protect public shareholders of a listed CD during CIRP completely unanswered, especially when specified board and committee standards under the LODR have been suspended and the CoC model under IBC is not equipped to represent their interests.

Regulation 15(2A) of LODR practically acknowledges the fact that CIRP does result in governance concerns that cannot be accommodated within securities laws. It provides a three-month compliance period without engaging with the deeper governance issues, but this transition period also ceases precisely when governance vulnerabilities become most acute post-CIRP: concentrated ownership, board reconstitution, embedded RPTs and significant information asymmetries. The current framework thus treats the approval of a resolution plan under section 31 of the IBC as the end of governance disruption, while leaving unresolved the broader question of how public shareholders of a listed corporate debtor are to be protected at the most critical phase, namely the post-CIRP period.

⁵⁶Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 30, sch. III, pt. A, para. 16 (Ind.).

The most critical governance problem is institutional rather than substantive because no single regulatory body possesses the mandate and authority to supervise the transition from insolvency governance to securities law governance. This ‘institutional vacuum’ arises from the jurisdictional architecture of the two regulatory regimes. NCLT’s jurisdiction under IBC is resolution-specific and its supervisory role is effectively exhausted after plan approval.⁵⁷ While the NCLT retains jurisdiction over issues relating to implementation of the plan⁵⁸ as recognised in *Ebix Singapore Pvt. Ltd. v. Committee of Creditors of Educomp Solutions Ltd.*, that power⁵⁹ is remedial and not supervisory. The NCLT is neither equipped nor mandated to supervise the ongoing corporate governance of a post-CIRP listed entity. SEBI, conversely, is fully equipped to supervise securities law compliance; however, its regulatory stance towards a CIRP-driven listed company does not actively respond to the evident governance disruption during CIRP. Beyond the targeted relaxations as discussed earlier, there is no formal mechanism for assessing the governance readiness of such an entity or providing a graduated compliance framework. Furthermore, there is no legislative attempt to recognise a formal statutory coordination mechanism among SEBI, the IBBI, and the NCLT for managing the handover of governance supervisory responsibility. The MoU highlighted earlier⁶⁰ does not suffice as it is directed toward the CIRP period rather than the post-CIRP transitional phase. Consequently, post-CIRP, a listed CD receives limited regulatory support while being required to comply with stringent regulatory expectations, leading to doctrinal conflicts as discussed below.

The doctrinal conflicts examined in this Part are not three isolated regulatory failures but manifestations of a single underlying condition: a ‘*participatory deficit*’ in which the formal apparatus of minority shareholder protection under LODR remains technically applicable to a post-CIRP listed entity while being rendered substantively ineffective by the structural

⁵⁷Insolvency and Bankruptcy Code, No. 31 of 2016, § 31 (Ind.).

⁵⁸Insolvency and Bankruptcy Code, No. 31 of 2016, § 60(5) (Ind.).

⁵⁹*Ebix Sing. Pvt. Ltd. v. Comm. of Creditors of Educomp Sols. Ltd.*, (2022) 2 SCC 401 (Ind.).

⁶⁰Press Information Bureau, *Supra* note 55.

consequences of the resolution process itself. Each subsection below traces how this deficit operates within a specific doctrinal area.

Related Party Transactions: RPTs are often embedded in resolution plans during CIRP and are consequently shielded from the scrutiny of securities laws. However, post-CIRP, the LODR framework applies, demanding compliance with the RPT framework although the corporate structure of the CD may have been reconfigured at a fundamental level. Regulation 23 provides an ex ante framework under which all RPTs require prior approval of the audit committee and all material RPTs require approval of shareholders. Although an exemption is provided under the second proviso to Regulation 23(4) with respect to approved resolution plans, it creates a doctrinal inconsistency by treating such approval under section 31 of the IBC as a functional substitute for minority protection. Regulation 23 addresses conflicts of interest through audit-committee scrutiny but CIRP is primarily concerned with maximization of creditor recoveries. The CoC does not represent minority shareholders and therefore cannot perform the fairness function; as a result, the exemption effectively suspends the procedural safeguards without responding to the underlying governance concern. For instance, a resolution-plan clause contemplating a transaction with an entity connected to the resolution applicant may provide for asset transfers, service arrangements, or financial obligations. Since these clauses would be binding on all stakeholders, minority shareholders, who have no vote in CoC meetings, are left with no mechanism to challenge such arrangements. Further, NCLT approval cannot be equated with shareholder approval because, unlike shareholders, the NCLT scrutinises the plan within the limits of Section 30(2) of IBC and does not apply the framework of minority shareholder protection. The implications are even more problematic after CIRP when the resolution applicant often emerges as the controlling shareholder. As a result of the approved resolution plan, certain commercial arrangements between the CD and the resolution applicant or its affiliates may continue but their subsequent renewal, modification, or continuation would trigger LODR restrictions. The point is further exacerbated by sections 43 to 47 of the IBC, which permit the RP to seek relief against preferential and undervalued transactions within the relevant look-back periods. In Anuj Jain

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Insolvency And Securities Law*

Interim Resolution Professional for Jaypee Infratech Ltd. v. Axis Bank Ltd., the Supreme Court⁶¹ explained that the statutory ingredients of section 43 must be established; it did not create a general presumption that every transaction within the look-back period is preferential. An asymmetry is therefore evident: pre-CIRP, there is rigorous retrospective scrutiny while RPTs are embedded in the resolution plan and exempt from the shareholder-approval requirement in Regulation 23(4). The CD thus inherits governance structures and commercial relationships created within a creditor-centric insolvency process, but thereafter becomes subject to a minority-protective securities law framework that neither contemplated nor meaningfully scrutinized their original creation. This is the RPT dimension of the '*participatory deficit*': the formal approval architecture of Regulation 23 remains on the books, but the concentrated post-resolution ownership structure deprives it of any practical check.

Minimum Public Shareholding: The MPS requirements under Rule 19A of the Securities Contracts (Regulation) Rules, 1957 and Regulation 38 of the LODR also expose a doctrinal conflict. The 25% mandate is a structural safeguard to support price discovery, preserve liquidity, and reduce the risks associated with concentrated control. However, a CIRP resolution may leave the successful resolution applicant above the ordinary seventy-five per cent ceiling on non-public shareholding, resulting in a reduced public float, as occurred in cases such as Bhushan Steel and Ruchi Soya Industries Ltd.⁶² SEBI's initial response included case-specific relief.⁶³ Following a 2020 review, the framework was recalibrated:⁶⁴ where public shareholding is below five per cent at plan

⁶¹Anuj Jain v. Axis Bank Ltd., (2020) 8 SCC 401 (Ind.).

⁶²SECURITIES AND EXCHANGE BOARD OF INDIA, CONSULTATION PAPER ON RECALIBRATION OF THRESHOLD FOR MINIMUM PUBLIC SHAREHOLDING NORMS, ENHANCED DISCLOSURES IN CORPORATE INSOLVENCY RESOLUTION PROCESS CASES annex I (Aug. 19, 2020), https://www.sebi.gov.in/reports-and-statistics/reports/aug-2020/recalibration-of-threshold-for-minimum-public-shareholding-norms-enhanced-disclosures-in-corporate-insolvency-resolution-process-cirp-cases_47360.html.

⁶³SEBI, *Supra* note 62, annex I, at 9.

⁶⁴Securities Contracts (Regulation) Rules, 1957, Rule 19A(5) (Ind.); Press release, Securities and Exchange Board of India, Board Meeting, PR No. 61/2020 (Dec. 16, 2020), https://www.sebi.gov.in/media/press-releases/dec-2020/sebi-board-meeting_48451.html. See *Recalibration of Minimum Public Shareholding Norms for Listed Entities Going Through Corporate Insolvency Resolution Process*, at 2.

approval, it must reach at least five per cent before the shares are admitted to dealings on a stock exchange; it must then reach ten per cent within twelve months and twenty-five per cent within three years.

While this calibrated approach is welcome, it still has systemic governance risks. *Restoring even five per cent MPS may be difficult in some cases because a low public float can be a structural consequence of CIRP and may not be corrected* without fundamentally restructuring the economic terms of the resolution. Diluting such concentrated holdings immediately post-CIRP may undermine both the economic assumptions underlying the resolution plan and the stability of the revived CD. More fundamentally, the prolonged MPS breach results in a governance structure in which ownership is concentrated in the successful resolution applicant and public investors remain either dispersed or too few to exert any material influence. Consequently, governance safeguards that formally continue to apply post-CIRP often become structurally ineffective in practice because concentrated promoter control substantially neutralises the monitoring and accountability mechanisms embedded within the securities law framework, including the norms on independent directors, audit committees, and RPT requirements. This is the MPS dimension of the '*participatory deficit*': formal compliance with the public float threshold leaves the underlying concentration of control, and the practical hollowing-out of minority protection, entirely undisturbed.

Disclosure Obligations: The LODR disclosure framework operates on a real-time and continuous basis. Under Regulation 30, material events and information must be disclosed to the stock exchanges in accordance with the prescribed materiality framework. Schedule III provides a non-exhaustive list of such events, including changes in directorships, restructuring, and litigation. But CIRP disrupts this framework, a fact that is not sufficiently acknowledged either under IBC or LODR. CIRP regulations and professional obligations require the RP to preserve the confidentiality of non-public information,⁶⁵ and even the

⁶⁵Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016, Gazette of India, pt. III sec. 4, First Schedule, cl. 21 (Nov. 23, 2016); Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Gazette of India, pt. III sec. 4 (Nov. 30, 2016).

Information Memorandum⁶⁶ issued to prospective applicants is a confidential document shared with registered applicants under non-disclosure safeguards. While necessary in light of the consequences of premature disclosure of the terms of the resolution plan, these obligations stand in direct tension with Regulation 30 of LODR. Events such as developments in the resolution process, changes in prospective resolution applicants, terms of resolution plans, and CoC voting outcomes may constitute material, price-sensitive information. The RP, who exercises the powers of the BOD during CIRP, must navigate this tension by preserving CIRP confidentiality while making the disclosures required to stock exchanges.

Schedule III of LODR in paragraph 16 makes specific provisions for disclosures relating to CIRP such as details regarding filing of the insolvency application, approval of the resolution plan, post-approval disclosure of specific features of the approved resolution plan including pre and post shareholding patterns, details of funds infused, incoming promoter details, and proposed steps for achieving MPS compliance. This represents a meaningful regulatory acknowledgment that CIRP generates disclosure obligations distinct from those of ordinary corporate events and deserves recognition as such. However, paragraph 16 addresses principally the milestone-based architecture of CIRP while leaving the substantive informational core of the resolution process largely outside the disclosure framework. The price-sensitive developments that occur within the confidential proceedings of the CoC, the identity and relative positioning of competing resolution applicants, commercial terms under negotiation between the CoC and the preferred applicant, interim CoC decisions on asset management and financing under Section 28 of the IBC, and the progression of voting on plan terms are not captured by the event-based framework of paragraph 16. Two further structural limitations compound this problem. *Firstly*, the carve-out of ‘commercial secrets’⁶⁷ permits withholding of certain information by the RP and leaves the RP with significant discretion to

⁶⁶Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Gazette of India, pt. III sec. 4, Reg. 36 (Nov. 30, 2016).

⁶⁷Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, sch. III, pt. A, para. 16(l)-(m) (Sept. 2, 2015).

determine what information may be withheld. Without any regulatory definition of commercial secrets in LODR or any SEBI guidance on its application, there is no mechanism through which a minority shareholder may challenge a withholding determination and this creates an accountability gap in relation to categories of information such as RPT arrangements, asset encumbrances, incoming promoter structures and similar matters that may be most material to minority investors' assessment of post-resolution value. Secondly, while paragraph 16 tracks the CIRP process, many of the milestones it enumerates are procedural or also become public through NCLT orders, statutory announcements, creditor lists, and plan-approval orders. Paragraph 16 therefore never pierces the confidential deliberative core of the CoC. For an investor trading in a listed corporate debtor's securities throughout a CIRP period that may extend across multiple years, it provides limited substantive information during the period when the resolution outcome, and therefore the value of their investment, is actually being determined. The result is a systematic and sustained information asymmetry that is not an incidental product of individual non-disclosure but is embedded in the regulatory architecture itself. Post-CIRP, the disclosure problem changes: Regulation 30 continues to apply even though many of these matters were determined through the confidential CoC process and may not have been publicly disclosed during CIRP. The transition from CIRP confidentiality to LODR transparency is therefore sudden and potentially disruptive. This is the disclosure dimension of the *'participatory deficit'*: the milestone-tracking architecture of Schedule III paragraph 16 satisfies the letter of continuous disclosure while leaving investors without the substantive information needed to meaningfully exercise whatever governance rights LODR nominally restores to them.

The preceding discussion shares a common structural aspect, namely, that all these elements under LODR (RPTs, MPS, disclosure obligations) are intended to protect minority shareholders, but each is operationally difficult to maintain in the post-CIRP environment and is weakened by the CIRP process itself. These three conflicts demonstrate a systemic regulatory gap in which, although the formal apparatus of minority-shareholder protection remains

applicable, its substantive efficacy is weakened. This, the paper argues, is the ‘participatory deficit’ in the post-CIRP framework.

The ‘participatory deficit’ originates in the treatment of shareholders during CIRP: shareholders have no statutory right to attend or vote in CoC meetings; suspended directors and qualifying operational-creditor representatives may attend but cannot vote.⁶⁸ This limited attendance right reflects the normative point that shareholders are no longer the residual claimants and hence, during CIRP, the governance structure must yield to a creditor-centric model. The Supreme Court in *Essar Steel*⁶⁹ upheld the centrality of the CoC’s commercial wisdom while recognising the regulatory requirement that a resolution plan consider the interests of all stakeholders. It did not, however, create participatory rights for shareholders in the CoC. This stance says nothing about the post-CIRP governance structure. As *Part I* of this paper discusses, the structure is defensible during CIRP; its continuation post-CIRP is difficult. The ‘participatory deficit’ is thus a condition that the ‘clean slate’ doctrine does not address. Shareholders regain their governance rights upon plan approval but find those rights operating within a structural environment marked by concentrated ownership, embedded RPTs, MPS non-compliance, and information asymmetry, a structure shaped entirely without their participation and often limiting the practical efficacy of their rights. Hence, the post-CIRP governance framework must address not merely the formal restoration of shareholder rights but the structural conditions that determine whether those rights are substantively meaningful. This is the normative challenge that the distress-contingent governance framework, proposed in the next part, is designed to meet.

V. TOWARDS A TRANSITIONAL DISTRESS-CONTINGENT GOVERNANCE FRAMEWORK

This paper has demonstrated a circularity problem of a normative nature in the governance structure of companies that arises from the displacement of the shareholder-centric model by a creditor-centric model during CIRP and the abrupt reversion of the shareholder-centric model post-CIRP without any

⁶⁸Insolvency and Bankruptcy Code, No. 31 of 2016, § 24(4) (Ind.).

⁶⁹*Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*, (2020) 8 SCC 531 (Ind.).

doctrinal framework. It has further argued that, consequently, there is a ‘participatory deficit’ in which the protection of minority shareholders is rendered inconsequential by the CIRP process itself. Hence, the paper argues for a distinct governance framework based on a distress-contingent structure.

A. THE INADEQUACY OF EXISTING RESPONSES: TWILIGHT ZONE SCHOLARSHIP AND UNREFLECTIVE TRANSPLANTATION

Some scholars have sought to address this governance vacuum by invoking the concept of the ‘twilight zone’ to argue that directors’ duties should expand to encompass creditor interests as insolvency approaches.⁷⁰ Such arguments principally rely upon the English approach in *BTI 2014 LLC v. Sequana SA*⁷¹ which held that a duty to consider creditor interests exists as part of the directors’ general duty which requires directors to act in good faith to promote the success of the company for the benefit of its members. The duty is not static: its content intensifies as the company’s financial position worsens. The majority held that it is engaged when directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that insolvent liquidation or administration is probable; a merely ‘real and not remote’ risk is insufficient. Where insolvent liquidation or administration is inevitable, creditors’ interests become paramount. However, such scholarly interventions, while conceptually valuable as a diagnostic tool, are insufficient as a normative response to the governance problem this paper has identified. *Firstly*, the ‘twilight zone’ operates primarily as a retrospective liability framework rather than a prospective governance standard. The avoidance provisions in sections 43, 45, and 66 of the IBC, including the preferential-transaction framework examined by the Supreme Court in *Anuj Jain v. Axis Bank*⁷² operate ex post. As a result, these provisions are silent on the real-time responsibilities of directors, RPs, or regulators regarding what governance standards should apply in real time as distress deepens. *Secondly*, it addresses the pre-CIRP period, the period

⁷⁰Utsav Mitra, Emerging Jurisprudence of Corporate Insolvency: Director Duties in the Twilight Zone (Insolvency & Bankruptcy Board of India 2018), <https://ibbi.gov.in/uploads/engagement/WinnerUtsavMitraNLIUBhopal.pdf>.

⁷¹*BTI 2014 LLC v. Sequana SA*, [2022] UKSC 25, [2024] AC 211.

⁷²*Anuj Jain v. Axis Bank Ltd.*, (2020) 8 SCC 401 (Ind.).

between financial difficulty and formal insolvency commencement, and is silent on the post-CIRP transitional period that this paper has identified as the most acute site of governance failure. Even if Indian law were to develop a fully elaborated ‘twilight zone’ doctrine equivalent to the English position, that doctrine would fail to address the ‘participatory deficit’ which requires an independent normative framework.

Assessing the adequacy of the present governance framework for distressed listed entities requires asking whether it results from a conscious legislative design or an unreflective transplantation. Watson’s theory of legal transplants explains that⁷³ rules transplanted from one jurisdiction may operate differently in another because their original institutional and normative setting does not travel with them. The Bankruptcy Law Reforms Committee drew on comparative insolvency models, including the United Kingdom and United States frameworks, when designing India’s creditor-in-control model. Similarly, the LODR broadly aligns with IOSCO’s⁷⁴ principles of securities regulation and disclosure standards associated with mature capital markets. None of these transplantations underwent a systematic analysis of their interaction within the same corporate entity and therefore did not fully consider whether the institutional framework is sufficient to encompass such interactions. As a result, the doctrinal conflicts discussed in this paper become apparent.

To respond to this inadequacy, the paper proceeds in two steps. *First*, it draws on the EU Restructuring Directive 2019/1023 and Singapore’s disclosure framework under the Securities and Futures Act 2001 and the SGX Listing Rules as international benchmarks demonstrating that the governance problem identified in this paper is institutionally tractable. *Second, drawing on these comparative insights, it proposes* distress-contingent governance resting on three organising principles: (i) staged governance calibration; (ii) institutional mediation; and (iii) structural minority protection.

⁷³ALAN WATSON, *LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW* (2d ed. 1993).

⁷⁴BANKRUPTCY LAW REFORMS COMMITTEE, *THE REPORT OF THE BANKRUPTCY LAW REFORMS COMMITTEE VOLUME I: RATIONALE AND DESIGN* 29–32, 54–55 (2015), https://ibbi.gov.in/BLRCReportVol1_04112015.pdf; INT’L ORG. OF SEC. COMM’NS, *OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION* (2017).

B. INTERNATIONAL BENCHMARKS: CROSS-CLASS PROTECTION AND STAGED DISCLOSURE

The comparative experience of the EU and Singapore, highlighted below, does not supply these principles ready-made but demonstrates that each of them is institutionally achievable. The comparative frameworks most instructive for the Indian context are not those from which the IBC and LODR were said to have been transplanted the UK and US insolvency regimes, but those which have more recently grappled with precisely the interaction problem this paper identifies: how to manage the governance of a listed entity across the continuum from financial distress through resolution and back to ordinary corporate existence. The EU Restructuring Directive 2019/1023⁷⁵ is the most directly relevant in this regard. The Directive treats preventive restructuring as a process with stage-sensitive safeguards rather than as a single discrete event. Its provisions for debtor-in-possession restructuring,⁷⁶ approval through a cross-class cram-down,⁷⁷ and rules addressing equity holders' role in adoption and confirmation collectively reflect a staged governance philosophy that Indian law lacks. Critically, recital 57 and Article 12 seek to protect equity holders' legitimate interests while preventing them from unreasonably obstructing viable restructuring plans,⁷⁸ a requirement that directly confronts the 'participatory deficit' that Indian law leaves structurally unresolved. The cross-class cram-down mechanism under Article 11 of the Directive is particularly instructive as a global best practice that India's framework conspicuously lacks. Under Article 11, a judicial or administrative authority may confirm a plan over dissenting voting classes where the conditions in Articles 10 and 11 are met, including specified class support and priority protections for dissenting classes. Equity holders may be included as affected parties; where a Member State excludes them from Articles 9 to 11, Article 12 instead requires other safeguards against unreasonable obstruction. This is a calibrated mechanism rather than a blanket veto: it binds dissenters where the economic logic of the restructuring justifies it,

⁷⁵Council Directive 2019/1023, 2019 O.J. (L 172) 18 (EU).

⁷⁶*Id.* art. 5.

⁷⁷*Id.* arts. 10–11.

⁷⁸*Id.* art. 12 & recital 57.

while simultaneously ensuring that no class is subordinated beyond what its actual economic position in the priority waterfall requires. The contrast with Section 30(4) of the IBC, 2016 is stark. India's framework resolves the same question through a single supermajority threshold of sixty-six per cent in value within the CoC, a body from which shareholders are entirely excluded, with no class-specific fairness test, and no equivalent class-voting architecture or cross-class fairness test for shareholders. Cross-class cram-down as operationalised under the EU Directive therefore represents a concrete and institutionally achievable mechanism through which India could address the '*participatory deficit*' identified in this paper, namely by replacing the current binary of full shareholder exclusion during CIRP with a structured, judicially supervised fairness framework that gives minority protection substantive rather than merely formal content.

Singapore's approach is also instructive because it addresses, to some extent, the institutional coordination problem that Indian law leaves unresolved. The Insolvency, Restructuring and Dissolution Act 2018 consolidated Singapore's insolvency and restructuring law into a single integrated statute.⁷⁹ For listed issuers, the Securities and Futures Act 2001⁸⁰ and SGX Mainboard Rule 703 operate alongside the SGX RegCo Consultation Paper on Proposed Enhancements to Corporate Restructuring Framework and Trading Resumption Framework; Rule 703 maintains continuous-disclosure obligations while permitting limited confidentiality-based withholding subject to specified conditions.⁸¹ Together, these sources address trading suspensions, disclosure obligations during restructuring, and the conditions for resumption of trading post-restructuring, creating precisely the kind of stage-sensitive disclosure framework that the tension between LODR and CIRP confidentiality in India demonstrates is absent. Critically, the Singapore framework achieves this

⁷⁹Insolvency, Restructuring and Dissolution Act 2018, No. 40 of 2018 (Sing.).

⁸⁰Securities and Futures Act 2001, (2020 Rev. Ed.) (Sing.).

⁸¹SINGAPORE EXCHANGE REGULATION, CONSULTATION PAPER ON PROPOSED ENHANCEMENTS TO CORPORATE RESTRUCTURING FRAMEWORK AND TRADING RESUMPTION FRAMEWORK (2024), https://api2.sgx.com/sites/default/files/2024-02/Restructuring%20Consultation%20Paper%20%28final%29_0.pdf; SINGAPORE EXCHANGE, MAINBOARD RULES r. 703.

through a calibrated framework that distinguishes between information that must be disclosed immediately, information that may be deferred on confidentiality grounds subject to regulatory oversight, and information that triggers mandatory disclosure upon the occurrence of specific restructuring milestones. These frameworks should not be transplanted directly; they demonstrate that the governance problem this paper identifies is tractable and that its resolution is a legislative design choice rather than an institutional impossibility.

C. DISTRESS-CONTINGENT GOVERNANCE: THE PROPOSED FRAMEWORK

Drawing on the institutional benchmarks examined above, this paper now turns to its proposal for distress-contingent governance as an indigenous normative framework capable of reconciling the governance circularity, the '*participatory deficit*', and the doctrinal conflicts that the preceding Parts of this paper have identified as structural features of India's current legal architecture. The framework operates through three organising principles, each addressing a distinct layer of the governance failure this paper has identified: the first correcting the absence of phase-sensitivity in the applicable regulatory obligations, the second addressing the institutional vacuum at the moment of transition, and the third targeting the structural conditions that render formally restored shareholder rights substantively hollow.

Staged governance calibration: This requires LODR to formally recognise three distinct governance phases: the ordinary phase, in which the full shareholder-centric model applies without qualification; the CIRP phase, in which Regulations 15(2A) and 15(2B) exemptions operate but are supplemented by baseline minority protection obligations including a mandatory disclosure standard for price-sensitive CIRP developments that does not compromise CoC confidentiality but addresses the informational asymmetry identified in Part III; and the transitional post-CIRP phase, which should be defined as a period of twelve to twenty-four months from plan approval, during which graduated compliance restoration obligations apply in place of immediate full LODR compliance, and during which specific structural protections such as independent RPT oversight, enhanced monitoring and enforcement of the

existing MPS compliance timetable, and enhanced disclosure of resolution plan consequences operate as a dedicated regulatory regime.

Institutional mediation: Transitions between governance phases require active regulatory oversight rather than automatic statutory reversion. This requires a joint supervisory mechanism between SEBI and the IBBI for the post-CIRP transitional period, with defined and non-overlapping responsibilities and a clear jurisdictional allocation for governance disputes arising during the transition. The existing SEBI-IBBI MoU⁸² provides the institutional foundation for such a mechanism but requires substantive legislative development, ideally through amendments to both the IBC and LODR, to discharge this function with regulatory authority rather than merely coordinative effect.

Structural minority protection: The post-CIRP regulatory framework must address not merely the formal restoration of shareholder rights but the structural conditions determining whether those rights are substantively meaningful. This requires, concretely: clear monitoring and enforcement of the existing timetable under Rule 19A(5) of the SCRR, supported by reasoned and transparent criteria for any case-specific relief; that the commercial secrets carve-out in Schedule III paragraph 16 be defined by regulation to prevent its operation as a general withholding mechanism for material investor-relevant information; and that RPT arrangements embedded in approved resolution plans be subject to post-approval independent review by the audit committee within the transitional period, with disclosure to minority shareholders of any material deviation from arm's-length terms.

VI. CONCLUSION

Indian corporate law has reached a point at which the governance adequacy of its framework for distressed listed entities can no longer be assessed by reference to the IBC or LODR in isolation. The governance circularity this paper has demonstrated, displacement during CIRP, abrupt reversion post-CIRP, and 'participatory deficit' that the reversion produces, is a systemic condition that neither creditor-driven insolvency law nor shareholder-centric

⁸²Press Information Bureau, *Supra* note 55.

securities law, operating within their respective silos, is equipped to resolve. The ‘twilight zone’ scholarship has identified part of the problem but addressed only the pre-CIRP dimension through retrospective liability rather than prospective governance design. The transplanted frameworks from which India’s current architecture derives offer no answer because they were never interrogated for their interaction effects. What is needed is a governance framework that treats financial distress not as an interruption of normal corporate existence but as a distinct phase of it, warranting its own normative logic, its own institutional architecture, and its own calibrated regulatory obligations. The proposed ‘distress-contingent governance’ is neither a rejection of the creditor-centric model of the IBC nor the shareholder-protective model of LODR, but a reconciliation of them through the recognition that both are contextually appropriate responses to the governance demands of different phases of corporate existence, and that the task of a coherent corporate law framework is to manage the transitions between those phases with the doctrinal rigour and institutional support that Indian law does not currently provide.

**FROM PRUDENTIAL RESTRAINT TO CALIBRATED
LIBERALISATION: INDIA'S ACQUISITION FINANCE
FRAMEWORK IN THE GLOBAL GOVERNANCE MATRIX**

*Vedansh Goyal & Jhalak Bhatia**

ABSTRACT

*This paper examines the implications of the 2026 acquisition financing reforms introduced by the Reserve Bank of India (“**RBI**”), which allow commercial banks to fund corporate acquisitions. Historically, Indian banks were largely restricted from participating in acquisition finance due to concerns over related risks. As a result, corporate acquisitions in India were primarily financed through Alternative Investment Funds (“**AIFs**”) and Non-Banking Financial Companies (“**NBFCs**”), which often involved higher borrowing costs and governance concerns. The 2026 reform marks a significant shift in policy by permitting banks to extend credit for acquisition transactions under a structured regulatory framework. The paper evaluates whether this framework effectively establishes a genuine Leveraged Buyouts (“**LBO**”) regime or merely introduces a prudentially constrained form of acquisition finance. It analyses key regulatory features including eligibility requirements for acquiring firms, leverage caps, collateral structures, and restrictions on financing. A comparative perspective with the United Kingdom and the United States highlights how India’s model differs from mature leveraged finance markets that rely on flexible capital structures and deep credit markets.*

The study concludes that the RBI’s framework represents a cautious but important step toward developing a domestic acquisition finance ecosystem. While it enables banks to participate in corporate control transactions, its prudential safeguards limit the emergence of highly leveraged sponsor-driven buyouts, favouring strategically motivated corporate acquisitions instead.

Keywords: Acquisition Finance, Leverage Buyout, Reserve Bank of India.

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I. INTRODUCTION

On 13th February 2026, RBI released its RBI (Commercial Banks - Credit Facilities) Amendment Directions, 2026, thereby permitting bank financing of corporate acquisitions. It marked a shift from RBI's historic aversion to acquisition finance, as seen in its 2014 directions, where Indian banks were only allowed to fund acquisitions in very limited circumstances.¹

A reason behind this historic aversion was that bank's money is public money, and RBI was unwilling to risk it in high-risk speculative acquisition.²

¹RBI, Master Circular – Loans And Advances – Statutory And Other Restrictions (Jul. 1, 2014), <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9024&Mode=0>.

²*Turning point: Acquisition Finance permitted by RBI for Indian banks for the first time- game changing or over cautious?* KHAITAN & CO. (Nov. 6, 2025) <https://www.khaitanco.com/sites/default/files/2025-11/ERGO%20-%20RBI%20-%20Draft%20Directions%20-%20206%20November%202025.pdf>

Furthermore, there were also fears of asset-liability mismatches and rising concentration risk.³

In the absence of bank financing, India Inc.'s need for capital was satisfied by AIFs and NBFCs.⁴ Reliance on them was however problematic in nature. Investor finance raised concerns of control over the firms, resulting in regulatory changes in India's competition framework.⁵ NBFCs, which could have been a meaningful alternative, however, suffer from the problem of high lending cost.⁶ Due to this, with acquisition finance continues to be dominated by AIFs.⁷

In an effort to keep up with evolving global practices, and to provide Indian banks with new avenues for corporate lending,⁸ RBI therefore chose to allow Indian banks to fund corporate acquisitions. With the availability of bank debt, it not only solves the aforementioned problems, but also brings a lot of benefits to the system.

Firstly, financing by bank debt allows firms to trade-off deadweight costs of financial distress and bankruptcy with incentives of tax benefits of debt.⁹ Under Indian law, interest paid on the debt can be deducted from taxes as a business expense under Section 36(1)(iii) of the Income Tax Act, 1961.¹⁰

³Debashree Dutta, *Why RBI's Acquisition Financing Reform Marks a Structural Shift in Indian Banking*, NDTV PROFIT (Nov. 13, 2025) <https://www.ndtvprofit.com/business/economy-reserve-bank-of-india-rbi-acquisition-financing-reform-structural-shift-banking-9526419>

⁴Rajat et al., *Financing M&A Transactions in India: An Overview*, S&R ASSOCIATES (Aug. 8, 2025), <https://www.snrlaw.in/financing-ma-transactions-in-india-an-overview/> [hereinafter Rajat et al.].

⁵Himanshu K. Mishra, *The Debt Shift: How the RBI is Quietly Reshaping India's M&A and Competition Landscape*, INDIA CORPLAW (Oct. 22, 2025) <https://indiacorplaw.in/2025/10/22/the-debt-shift-how-the-rbi-is-quietly-reshaping-indias-ma-and-competition-landscape/>

⁶*Why are gold loans from banks preferred over NBFCs?* TIMES OF INDIA (Jun. 18, 2020) <https://timesofindia.indiatimes.com/spotlight/why-are-gold-loans-from-banks-a-safer-investment-option-over-nbfc/articleshow/76391741.cms>

⁷*Financing M&A Transactions in India: An Overview*, S&R ASSOCIATES, *Supra* note 4.

⁸*RBI Allows Indian Lenders to Fund Acquisitions of Indian Corporates*, BUS. STANDARD, (Oct. 1, 2025) https://www.business-standard.com/industry/banking/rbi-allows-indian-banks-to-fund-corporate-acquisitions-125100101038_1.html.

⁹Alan Kraus & Robert H. Litzenberger, *A State-Preference Model of Optimal Financial Leverage*, 28 J. FIN. 911, 911 (1973).

¹⁰Income Tax Act, No. 43 of 1961, §36(1)(iii) (Ind.).

Second, firms are unwilling to utilize their equity unless a particular threshold or correct market conditions have arrived.¹¹ Bank financing therefore provides firms with appropriate options to fund their acquisition without indulging in distress sale of equity. Third, bank financed acquisitions are known to perform well in the long term because of bank monitoring post-acquisition.¹²

While RBI's acquisition finance framework is indeed revolutionary, there are questions on whether RBI's framework represents a true LBO. The current paper therefore seeks to evaluate RBI's acquisition financing framework and its implications for the development of leveraged acquisition markets in India.

And for this purpose, the paper answers the following research questions: **(1)** Is the RBI's acquisition financing framework a genuine LBO framework? **(2)** Does the RBI's acquisition finance framework enables acquisition finance, and can it be improved? **(3)** How does India's acquisition financing framework compare with leveraged acquisition regimes in developed markets such as the United States, and what lessons can be drawn for future regulatory reforms?

Through these questions, the paper aims to contribute to the emerging scholarship on acquisition finance regulation in India. It seeks to ultimately assess whether the RBI's policy shift represents a more sophisticated leveraged acquisition financing ecosystem or merely a cautious step toward liberalization.

II. THE 2026 REFORM: TEXTUAL ARCHITECTURE AND DESIGN

RBI's new credit directions, while revolutionary, permit acquisition finance within a set mechanism. Firstly, it prescribes limits on who can acquire. The acquiring company must be a non-financial company valued at a minimum

¹¹H. KENT BAKER & GERALD S. MARTIN, CAPITAL STRUCTURE AND CORPORATE FINANCING DECISIONS: THEORY, EVIDENCE, AND PRACTICE 20-21 (2011).

¹²Mario Fischer, *The Source of Financing in Mergers and Acquisitions*, 65 Q. REV. ECON. & FIN. 227, 228 (2017).

net worth of Rs. 500 crore and be profitable for the past 3 financial years.¹³ Furthermore, if unlisted, an additional requirement of a grade BBB- investment certificate from a recognized credit rating agency is required.¹⁴

RBI's framework restricts acquisition finance only to non-financial acquiring companies despite their being substantial acquisition activities common in the financial sector.¹⁵ For the companies that are allowed as acquiring companies, the criteria of profitability over the past 3 years excludes Unicorns that may not have such a long history of finances. This effectively makes them reliant on NBFCs and AIFs, and now increasingly foreign firms after external commercial borrowings ("**ECB**"),¹⁶ thereby going against the goal of increasing bank participation in corporate lending. Furthermore, for unlisted companies, the reliance on the Credit Agency framework instead of a more nuanced framework is fraught with the possibilities of bias of Credit Agencies that were also responsible for the IL&FS crisis.¹⁷

The framework furthermore requires that the acquisition must be a 'strategic investment' for the purpose of 'long term value creation'.¹⁸ And in cases of refinancing the debt of the target company, the acquisition finance must be 'integral' to the acquisition finance.¹⁹ These terms are vague in nature. It provides no measurable quantities for what constitutes as strategic, long term or integral. With vague standards like this, companies and investors cannot confidently determine whether their transactions comply with the requirements

¹³RBI (Commercial Banks – Credit Facilities) Directions, 2025, §170D (1) (Ind.) https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=13156 [hereinafter RBI Directions].

¹⁴*Id.*

¹⁵*Refinitiv report : India I-banking fees decreased by 25% in H1CY2022 despite record M&A and IPO profits*, IIFL CAPITAL (<https://www.indiainfoline.com/news/ipo/refinitiv-report-india-i-banking-fees-decreased-by-25-in-h1cy2022-despite-record-m-a-and-ipo-profits>).

¹⁶Dhananjaya et al., *India's ECB overhaul: A new era for cross border financing*, HERBERT SMITH FREEHILLS KRAMER (Feb. 19, 2026) <https://www.hsfkramer.com/insights/2026-02/indias-ecb-overhaul-a-new-era-for-cross-border-financing>

¹⁷*Strengthening Credit Framework in the Country: Standing Committee Report*, PRS INDIA (last visted Mar. 10, 2026) <https://prsindia.org/policy/report-summaries/strengthening-of-the-credit-rating-framework-in-the-country>.

¹⁸RBI Directions, §170D (1) (Ind.).

¹⁹RBI Directions, §3(1)(iii) (ia) (Ind.).

leading to legal uncertainty. Banks would interpret these terms differently on a case-by-case basis, giving them broad discretionary power and creating the risk of inconsistent or arbitrary decisions. This uncertainty may also increase compliance costs and delay transactions. Furthermore, this can on the contrary may end up discouraging bank led acquisition financing, as lenders and investors may hesitate to participate in deals that could later be challenged by authorities.

The framework further provides that such acquisitions must result in the acquirer acquiring 'control' over the target firm.²⁰ While the term 'control' has not been defined in the act, but as per Securities and Exchange Board of India ("SEBI") Substantial Acquisition of Shares and Takeovers Regulations, 2011 as well the Companies Act, 2013 'control' essentially means the power to appoint a majority of the board of directors or control the management or policy decisions.²¹ This test known as the 'Brightline test', was proposed to be revised by SEBI, but has so far remained unchanged.²² In this regard *Subhkam Ventures v. SEBI*,²³ offers great help. It was held that 'control' can only include only positive control, where an investor can actively determine outcomes as distinguished from negative control, which is the power to prevent certain events from occurring.

The framework further provides that in case the acquirer already has 'control' over the target firm, acquisition finance is permitted if further acquisition is done to additional stake that crosses a substantial threshold of 26%, 51%, 75%, 90% of voting rights thereby conferring materially enhanced governance or control rights under applicable law.²⁴ It is hard to understand RBI's rationale behind making firms justify the utility of their acquisitions when the framework on the other hand permits loans for margin trading by stock

²⁰RBI Directions, §170A (Ind.).

²¹Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, r. 2(1)(e) (Ind.); Companies Act, No. 18 of 2013, §2(27) (Ind.) [hereinafter SEBI Regulations 2011].

²²SECURITIES & EXCH. BD. OF INDIA, DISCUSSION PAPER ON BRIGHTLINE TESTS FOR ACQUISITION OF 'CONTROL' UNDER SEBI TAKEOVER REGULATIONS (Mar. 14, 2016), https://www.sebi.gov.in/reports/reports/mar-2016/discussion-paper-on-brightline-tests-for-acquisition-of-control-under-sebi-takeover-regulations_31883.html.

²³*Subhkam Ventures (I) (P.) Ltd. v. SEBI*, (2010) 99 SCL 159 (Ind.).

²⁴RBI Directions, §170A (Ind.).

brokers without no such justifications.²⁵ Since margin trading is generally considered far more riskier and more prone to abuse and as such this difference in regimes is hard to justify.

Furthermore, the criteria of ‘control’ or the above-mentioned thresholds would trigger Regulations 3 and 4 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. This would mean that a public offer for acquisition of shares to the tune of 26% must be made,²⁶ for a price equivalent to the maximum price paid per share for the acquisition.²⁷ The open offer must be backed by an escrow account where if cumulative value of the open offer is up to Rs.500 crore, 25% of the amount must be deposited and if the value is more, 10% of the balance amount must additionally be deposited.²⁸ This along with the actual cost of acquiring the stocks received by the open offer, constitutes a significant cost borne during acquisition. Despite being an obvious cost, no provision of financing the same is provided in the regulations. Firms are therefore once again forced to depend on alternatives to bank led financing. It is recommended that the banks could finance the above costs as well, maybe via an unsecured loan with high interest rates to balance the associated risks.

Even to those costs that banks are supposed to finance under these Regulations, a limit of 75% is placed.²⁹ The rest, 25% is to be financed by the acquiring company on its own. The act makes an exception and allows banks to provide bridge financing for the remaining amount to listed companies.³⁰ The bridge finance is to be refinanced in a period of 12 months. This is too rigid and arbitrary. It is not always possible to raise equity due to market volatility. Furthermore, large acquisitions often require significant time for post-acquisition integration and financial restructuring, and imposing a strict 12-month deadline may pressure companies to prioritise refinancing over stabilising

²⁵RBI (Commercial Banks- Credit Facilities) Directions, 2025 § 219W, 219ZB (Ind.).

²⁶SEBI Regulations, 2011, r. 7 (Ind.).

²⁷SEBI Regulations, 2011, r. 8 (Ind.).

²⁸SEBI Regulations, 2011, r. 17 (Ind.).

²⁹RBI Directions, §170E (Ind.).

³⁰RBI Directions, §170I (Ind.).

the business. Also, the figure of 75% representing the maximum percentage that banks can finance operates in a 20% bank limit out of an overall limit of 40% allocated for the securities market. All of this raises serious doubts on the extent and effectiveness of bank financing of acquisitions.

It must be noted that in all cases, the loan must be a secured loan.³¹ The equity shares or compulsorily convertible debentures (“CCDs”) of the target company along with additional assets of the target and acquired company as well as promoter’s personal guarantee may operate as collateral. However, this is subject to the exception that in case the target company is a public company, its assets cannot be used as collateral.³² It must also be noted that as per the Banking Regulations Act, a maximum 30% of the shares of a company could be held by a bank.³³ It is suggested by the author that the above limit must either be done with or revised to allow better utilization of the shares of the target company.

Lastly, post-acquisition, the acquirer company’s debt to equity ratio is to be kept at a maximum 3:1 on a continuous basis.³⁴ The limit is rigid and no logical reason is provided behind the ratio chosen. In fact, a uniform leverage cap does not account for differences across industries, business models, or the financial strength and cash-flow stability of the acquiring company, which are important factors in determining sustainable debt levels.

III. WHETHER THESE NEW RULES CONSTITUTE A GENUINE LBO REGIME?

The above question can be best answered by separating the doctrinal features that define an LBO from the precise mechanics and regulations the RBI set out in 2026. Classic LBO does not refer to a single mechanism but it is the combination of structural attributes like very high debt equity, cash-flow centric repayment, security interests focused on target assets, and transactions driven by

³¹RBI Directions, §170J (Ind.).

³²Companies Act, No. 18 of 2013, §67(2) (Ind.).

³³Banking Regulation Act, No. 10 of 1949, §19(2) (Ind.).

³⁴RBI Directions, §170H (Ind.).

financial sponsors (mostly private equity).³⁵ Therefore, the question arises with respect to the conceptual test that whether the RBI framework replicate those attributes in substance, or does it permit acquisition finance only in a narrow, prudentially constrained form?

A classic LBO consists of various features that together create a distinctive risk profile. First, one of the most important characteristics of an LBO is that it involves very high debt-to-equity ratios and deals with financing often ranging from 70 to 90% debt.³⁶ This produces leverage multiples commonly in excess of 4–5x (or debt: equity ratios of 4:1–5:1 and above). Second, the debt is mostly secured not only by shares but also by the target's operating assets. This constructional preservation helps funnel target cash flows to service debt (cash-flow based repayment). Third, these deals are generally structured by financial sponsors, such as private equity funds, whose business model is to use high leverage to multiply returns and consequently exit via sale or IPO in a few definite years.³⁷ Finally, covenants and intercreditor arrangements in LBOs are negotiated to the core and thus are flexible in practice (e.g., payment-in-kind, covenant lite structures). This allows for operational and exit strategies which can be adjusted by the sponsors accordingly. These characteristics create a financing product that is high risk, high return, and in many jurisdictions supported by specialized support markets (e.g., syndication, mezzanine debt, high-yield bonds).

Conversely, the 2026 RBI framework introduces acquisition finance which are subject to a set of clear prudential brakes and eligibility constraints that blur several hallmark features of classic LBOs. The most headline-grabbing rule in the Directions is that banks would be able to finance a large share of an acquisition (up to 70–75% of deal value in eligible cases), but this is accompanied by binding ceilings and rules with respect to the collateral. The Directions call for the acquisition finance to be secured primarily by the acquired equity of the target and permit additional collateral and corporate guarantees.

³⁵ISABELLE CHAMBOST, *ECOLOGICAL MONEY AND FINANCE: EXPLORING SUSTAINABLE MONETARY AND FINANCIAL SYSTEMS* (Thomas Lagoarde-Segot eds., 2023).

³⁶Paolo et al., *Leverage and Pricing of Debt in LBOs*, 18 J. CORP. FIN. 124, 126 (2012).

³⁷Daniel Pindur, *VALUE CREATION IN SUCCESSFUL LBOs* (2009).

This implies that the primary remedy would be those acquired securities only leaving the other assets, like operating plant, receivables, etc. of the target safe. This is what essentially differentiates the framework from a conventional LBO security package.³⁸

Further, the 2026 framework imposes an explicit post-acquisition debt-equity cap (about 3:1), and thus the banks must limit aggregate exposures to acquisition finance within the limit prescribed. The given consolidated ceiling is actually quite lower than the leverage multiples that are typically higher for an LBO (frequently exceed 4:1–5:1). Thus, the framework strongly reduces the scope for highly leveraged, more risky transactions. This is something that is not spotted under pure LBO logic, especially in budding years.³⁹

Finally, the covenant design and supervisory regime under the RBI framework are prudentially oriented rather than the transaction-market oriented. The Directions talk about strict supervision, standardized risk-weighting and structured caps, and direct bank governance obligations to limit the overall risk. Where LBOs in market economies often rely on tailoring the directions to sponsor's advent;⁴⁰ the Indian approach reduces borrowers' and lenders' freedom to craft aggressive covenant structures. The resulting product is thus less flexible but more stable and thus allows banks to participate in acquisition finance comparatively safely.

Taken together, these differences clearly portray that the RBI's 2026 Directions do not represent merely an LBO market in the typical sense. Instead, it is a deliberate acquisition-finance regime created in such a way that permits banks to fund control-acquiring transactions under carefully prescribed limits and collateral rules while also protecting the banking system from the tail risks associated with sponsor-led, highly leveraged deals. Thus, the policy balances

³⁸Peter A. Magowan, *The Case for LBOs: The Safeway Experience*, 32 CALIF. MGMT. REV. 9, 14 (1989).

³⁹JOSHUA ROSENBAUM & JOSHUA PEARL, INVESTMENT BANKING: VALUATION, LBOs, M&A, AND IPOs (2022).

⁴⁰Tim Jenkinson & Rüdiger Stucke, *Who Benefits from the Leverage in LBOs?* (Saïd Bus. Sch., Univ. of Oxford, 2011), <https://ora.ox.ac.uk/objects/uuid:40b251ff-fded-4426-8627-e0587211702c> (last visited Aug. 31, 2026).

two competing aims: firstly, correcting the competitive distortion that disadvantaged domestic banks in M&A financing, and secondly, preserving banking stability through various leverage ceilings, caps and rules.

IV. COMPARATIVE PERSPECTIVES FROM THE UK AND USA

A. UNITED KINGDOM

United Kingdom has one of the most advanced regimes when it comes to acquisition finance. It is supported by the flexibility of corporate laws, banking laws, and capital markets regulations. The system for controlling acquisition finance is largely through the prudential control exercised by the Prudential Regulation Authority (“**PRA**”) and the conduct control exercised by the Financial Conduct Authority (“**FCA**”), both of which are the results of the Financial Services Act 2012.⁴¹

According to the jurisprudence of company law, acquisition finance is largely subject to the Companies Act, 2006.⁴² The UK has traditionally had restrictions on leveraged acquisitions through the rule on financial assistance⁴³. This prohibited companies from providing financial assistance for the purchase of their own shares. These restrictions were largely removed by the Companies Act 2006 amendments that came into force in 2008, abolishing the prohibition on private companies.

As of now, restrictions on financial assistance have been preserved in public companies under sections 678⁴⁴ to 683⁴⁵ of Companies Act, 2006, but private companies can provide financial aid in the form of guarantees, security, and upstream financial assistance in acquisition structures. This change has been significant in allowing modern LBO structures, which allow financial backers to secure debts against the target company’s assets.

⁴¹Financial Services Act 2012, c. 21 (UK).

⁴²Companies Act 2006, c. 46 (UK)

⁴³Kees Hooft, *The Financial Assistance Prohibition: Origins, Evolution, and Future*, 8 EUR. CO. L. 157, 158 (2011).

⁴⁴Companies Act 2006, c. 46, §678 (UK).

⁴⁵Companies Act 2006, c. 46, §683 (UK).

From Prudential Restraint To Calibrated Liberalisation: India's Acquisition Finance Framework In The Global Governance Matrix

For the bankers who provide acquisition finance; those have to comply with prudential requirements based on international Basel requirements⁴⁶ and are reflected in the UK's prudential rulebook following Brexit. These are regulated under the PRA Rulebook, which regulates credit risk exposure limits, leverage ratio requirements, capital requirements, etc.

Further, Financial Services and Markets Act, 2000 (“**FSMA**”)⁴⁷ is the most important prudential statute, which forms the basis of bank regulation. For regulated banks, it is mandatory by FSMA that the bank must maintain adequate capital and look into risk management prior to commencement of leveraged lending activity.

Additional supervisory guidance on the same has been issued in the under the Prudential Assessment of Acquisitions and Increases in Control, 2024, which sets out the prudential review process for those regulated bodies which gain or grow control in financial institutions. This ensures the stability of the financial system in general as well.

In addition, unlike some countries (such as India), the UK does not impose direct statutory constraints on LBOs, and the risks are managed through prudential supervision and capital regulation.

Large leveraged loans are typically handled by multiple banks and financial institutions. Moreover, banks facilitate risk distribution by providing for collateralized loan obligations (“**CLO**”) and private credit markets. According to the 2023 International Organization of Securities Commissions (“**IOSCO**”) Report on Leveraged Loans and CLO Markets,⁴⁸ the international organizations such as the IOSCO provide significant regulatory guidelines that influence market practices and investor protection tools.

⁴⁶Basel III: International Regulatory Framework for Banks, BANK FOR INT'L SETTLEMENTS (last visited Mar. 12, 2026), <https://www.bis.org/bcbs/basel3.htm>

⁴⁷Financial Services and Markets Act 2000, c. 8 (UK).

⁴⁸IOSCO Publishes Final Report on Leveraged Loans and CLOs Good Practices for Consideration, INT'L ORG. OF SEC. COMM'NS (Jun. 3, 2024), <https://www.iosco.org/news/pdf/IOSCONEWS736.pdf>

Thus, it can be safely concluded that The UK's current regulatory framework has led to the development of a deep and sophisticated leveraged finance market. On the whole, the regulatory approach by UK has been one where it is majorly inclined towards market facilitation and prudential supervision, as opposed to restriction. This has enabled the UK to remain one of the largest leveraged finance centres in the world. While the UK has had a liberal approach, India has historically had strict prudential restrictions on bank-funded acquisitions. However, with the issuance of RBI (Commercial Banks-Credit Facilities) Amendment Directions, 2026 in February, 2026,⁴⁹ acquisition finance has become much more liberal.

As a result, whereas in the UK there has been established a liberal environment that accommodates significant LBO finance instruments with bank backing, in India there is a nascent attempt to establish a controlled environment to facilitate such transactions. Accordingly, the RBI's framework is gradual liberalization attempt that strikes a balance between developing India's fin-Corp markets and protecting its banking industry.

B. UNITED STATES OF AMERICA

Just like the UK, the USA also has a well-developed financial market with both bank and non-bank led creditors available. Acquisition financing in the United States generally consists of a combination of equity and multiple layers of debt instruments. These different sources of funding are structured together to create a capital structure that balances risk, cost of capital, and repayment capacity.

Senior secured loans constitute the most common form of debt used in acquisition financing in the United States.⁵⁰ These loans hold priority repayment rights over other forms of financing and are typically secured against the assets

⁴⁹RBI Directions (Ind.).

⁵⁰Nicholas et al., *Chambers Global Practice Guides (2021): Acquisition Finance*, CRAVATH (2021) <https://www.cravath.com/a/web/9bn5jNMFqDLpMjpTyb6Lgr/2LPb5f/chambers-usa-acquisition-finance-guide.pdf>

of both the borrower and the target company.⁵¹ It is considered relatively less risky compared to subordinated debt.

A typical debt package also includes revolving credit facilities, that allows the borrower to draw funds as needed up to a predetermined limit, repay the borrowed amount, and redraw funds during the loan tenure.⁵² These facilities are typically used to support working capital requirements, provide operational liquidity, and finance costs associated with the post-acquisition integration of the target company. The structure of revolving facilities is similar to working capital facilities and term loan arrangements provided by Indian banks. However, revolving facilities in the United States are generally more flexible than India in terms of drawdown and repayment mechanisms.

Subordinated or mezzanine financing represents another important layer within acquisition financing structures. It occupies an intermediate position between senior secured debt and equity in the capital structure.⁵³ Because it carries greater risk than senior loans, mezzanine debt has higher interest rates. Furthermore, it may include additional features such as equity warrants or conversion rights that provide lenders with a chance to profit from the company's growth.⁵⁴ It allows the acquiring entity to increase the overall leverage used in the transaction without significantly diluting the ownership interests of the equity sponsors. Although mezzanine financing structures are present in India, they are relatively less common due to regulatory limitations.⁵⁵ In contrast,

⁵¹Pascal Rohner, *Understanding the Structure of Senior Secured Loans: Key Insights for Investors*, KATCH INVESTMENT GROUP (Jan. 28, 2026) <https://katchinvest.com/understanding-the-structure-of-senior-secured-loans-key-insights-for-investors/>

⁵²*Revolving Credit Loan: Glossary USA*, THOMSON REUTERS PRACTICAL LAW (last visited Mar. 11, 2026) [https://ca.practicallaw.thomsonreuters.com/9-3823774?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://ca.practicallaw.thomsonreuters.com/9-3823774?transitionType=Default&contextData=(sc.Default)&firstPage=true)

⁵³Arthur et al., *Mezzanine Finance: Overview*, SIMSPON THATCHER & BARTLETT (2013) <https://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1580.pdf>.

⁵⁴*How Does Mezzanine Debt Work: Structure, Interest, and Tax*, LEGAL CLARITY (Mar. 6, 2026) <https://legalclarity.org/how-does-mezzanine-debt-work-structure-interest-and-tax/>.

⁵⁵Kumud Das, *Will Mezzanine Financing Be Next Big Thing for FDI In India?* BIZZ BUZZ (Nov. 9, 2024) <https://www.bizzbuzz.news/markets/will-mezzanine-financing-be-next-big-thing-for-fdi-in-india-1341688?>

mezzanine debt forms a significant component of leveraged acquisitions in the United States.

Another major source of acquisition financing in the United States is the issuance of high-yield bonds, often referred to as ‘junk bond’. These bonds are typically issued in the capital markets to raise large amounts of funding for acquisition transactions, particularly in LBOs involving sizable target companies.⁵⁶ High-yield bonds generally carry higher interest rates due to their greater credit risk and usually have longer maturities, typically ranging from seven to ten years.⁵⁷ They may be unsecured or structured as second-lien secured obligations, ranking behind senior secured loans in the repayment hierarchy. The high-yield bond market provides access to a large pool of institutional investors, thereby enabling companies to raise substantial amounts of capital beyond what traditional bank lending alone can provide. In comparison, India’s corporate bond market remains relatively less developed,⁵⁸ which limits the widespread use of high-yield bonds in acquisition financing transactions.

As compared to India, the overall market for LBO is well developed in the USA. In India, what RBI has created is a prudentially controlled finance model and not a high-leverage acquisition finance system. The overall goal of the US regulatory framework has been unlike India, to facilitate and not restrict acquisition finance which reflects in the way acquisition finance is carried out in both the countries.

V. IMPLICATIONS FOR CORPORATE CONTROL IN INDIA

The 2026 RBI framework introduced by the RBI will play an important role in the architecture of corporate control transactions in India. Historically, banks in India were restricted from financing acquisitions directly due to prudential concerns. The 2026 framework, however, represents a careful departure from the archaic approach. The goal of the regulations is to

⁵⁶BYRON ET AL., DEBT MARKET AND INVESTMENTS 599 (H. Kent Baker et al. eds., 2009).

⁵⁷*Id.* at 601.

⁵⁸A. Nadaf & Shivappa, *Corporate Bond Market in India: A Review of Factors Limiting the Development*, 2 MLAC J. ARTS, COM. & SCI. 33 (2024)

encourage competent acquisitions while maintaining the financial health of the banking sector, not to foster a high-leverage takeover environment.

A. PUBLIC COMPANY TAKEOVERS

The most direct impact will be seen in takeovers of the publicly listed companies. Under Indian takeover code,⁵⁹ it is very clearly mentioned that acquisition of control in a listed company triggers mandatory obligations requiring the acquirer to offer to purchase at least 26% of the public shareholding. Earlier, financing these posed a big challenge for bidders, because a lot of those that lacked sufficient liquidity which is necessary to fund both the initial purchase and the open-offer simultaneously. The availability of financing from banks will now change the mechanics of such transactions.

The availability of acquisition financing from channels like bank may also accelerates timelines in listed takeovers. In the past, bidders had to negotiate complex financing arrangements due to paucity of funds as well as non-availability of internal channel to help; which could delay announcements and/or weaken bidding positions in competitive situations.⁶⁰ Now, with the Indian banks able to provide acquisition facilities within the framework; listed acquirers can move more quickly to secure financing commitments prior to announcing the acquisitions. This will particularly help the mid-cap listed companies, where timing and financing credibility are a determining factor in the success of bids.

Another likely outcome is accelerated consolidation, especially among the listed mid-cap companies. Many Indian industries (For e.g. specialty chemicals, auto components, engineering goods, and industrial manufacturing) are currently characterized by multiple listed companies which are operating at sub-scale levels. Acquisition financing by banks will enable stronger listed players to acquire controlling stakes in smaller listed competitors without immediately diluting their own shareholders through issuing of the equities. This will, in the

⁵⁹SEBI Regulations, 2011 (Ind.).

⁶⁰*Supra* note at 11.

long run, help achieve economies of scale, improve supply chain efficiency, and enhance the market.

More importantly, the prudential constraints that are included in the RBI framework will prevent excessively leveraged public-market takeovers. The consolidated leverage cap will help keep a check that acquirers cannot load disproportionate debt onto the combined entity following acquisition. Thus, as a result, public company takeovers financed through bank are will be primarily strategic in nature rather than those which are designed to extract just short-term returns through leverage.

B. PRIVATE COMPANY ACQUISITIONS

The framework will affect the private companies more than those listed acquirers. Many sectors in India consist of few and large listed companies competing with several privately held regional players. Prior to 2026, acquisitions of such private companies often required the acquirer to deploy significant capital from various unsuited sources. Bank-financed acquisition facilities will provide an apt and better option. This structure will help listed companies to undertake acquisitions that which otherwise have been constrained by balance-sheet limitations.

However, acquisitions of private companies do come with its own complexities. First, the valuation becomes significantly more contested. This is because private firms do not have transparent market pricing, and sellers often need to rely on negotiated methodologies to calculate the valuation such as EBITDA, discounted cash-flow projections, etc. However, once banks will step up for financing; these acquisitions will require a thorough, vigilant and independent valuations to ensure that the acquisition price reflects realistic enterprise values which will help the other stakeholder to study the same too.

Second, the enforcement of security might be more complex when the acquired company is privately held. This is because the shares of unlisted companies are less liquid and may be difficult for lenders to exchange for money in case of a distress scenario. For this reason, banks will be required additional safeguards in private acquisitions, including corporate guarantees from the

acquiring company, pledges over additional assets, or stricter covenants governing dividend distribution and cash-flow management within the acquired entity.

Due to these structural constraints, bank-financed acquisitions of private enterprises would tend to prioritize transactions involving financially stable targets with predictable cash flows over speculative acquisitions of early-stage or highly indebted businesses.

C. SHIFT IN BARGAINING POWER

Once the framework is implemented properly and the banks start executing the same; it will also lead to achievement of a very important objective of altering the balance of bargaining power between buyers and sellers in control transactions. Buyers (particularly the listed corporate groups) will now enjoy a much better financial flexibility because they can access leverage from domestic banks itself which will be cheaper and easier.⁶¹ This enhances their ability to make credible acquisition offers quickly and to pursue multiple opportunities simultaneously.

For a seller; the presence of an institution like bank being financing the seller reduces the risk of failure due to funding uncertainty. Sellers of both all kinds of companies may therefore encounter buyers capable of executing transactions on proper timelines without delay. In competitive sale processes, buyers with confirmed bank financing may gain an advantage over bidders relying on slower equity fundraising processes.

Financial sponsors often bring operational expertise and flexible deal structures that banks may not support under the prudential constraints imposed by RBI. As a result, while bank financing strengthens the negotiating position of domestic corporate acquirers, it does not eliminate competition from alternative sources of capital.

⁶¹Sara B. Moeller & Frederik P. Schlingemann, *Global Diversification and Bidder Gains: A Comparison Between Cross-Border and Domestic Acquisitions*, 29 J. BANKING & FIN. 533, 560 (2005).

D. SECTORAL IMPLICATIONS: MANUFACTURING CONSOLIDATION

The 2026 RBI framework has impacted many sectors; manufacturing sector is particularly well in position to experience a heavy and good impact of consolidation under the new acquisition-finance framework. This is so because many manufacturing segments are highly fragmented, consisting of a few large listed companies and several privately held regional firms. And as discussed in the above sub section; that the ability of listed manufacturers to finance acquisitions through bank credit can lead to a better horizontal and vertical integration.

Such consolidation will also help in yielding several economic benefits. Integrated manufacturing entities can help achieve economies of scale, improve R and D for the entire sector, and strengthen global competitiveness. But it is also important to consider that, consolidation may raise competition law considerations where acquisitions significantly increase market concentration within particular industrial segments.⁶²

Lastly, from a regulatory perspective, the prudential structure of the RBI framework will serve the primary purpose of ensuring that manufacturing consolidation occurs primarily through financially suitable and sustainable transactions. The leverage ceiling and collateral requirements might discourage large-scale acquisitions while allowing strategically motivated consolidation to proceed. Consequently, the likely outcome will be a gradual but meaningful restructuring of manufacturing sectors in which stronger listed companies absorb smaller competitors or suppliers.

E. STRUCTURAL PREFERENCE FOR STRATEGIC CORPORATE BUYERS

The acquisition-financing framework introduced by the RBI favours strategic corporate acquirers over financial sponsors such as private equity funds. Traditional LBOs rely on highly leveraged capital structures, flexible covenant packages, and sponsor-led deal structuring designed to maximise equity returns. The 2026 framework, however, restricts these features through prudential

⁶²Robert L.D. Colby & Erik R. Sirri, *Consolidation and Competition in the U.S. Equity Markets*, 5 CAP. MKTS. L.J. 169, 180 (2010).

safeguards including a consolidated leverage ceiling of approximately 3:1 and limitations on borrower eligibility and capital market exposure. These constraints significantly reduce the viability of highly leveraged sponsor-led transactions. Consequently, the regime is most naturally suited to operating companies- particularly listed corporates with established cash flows- that seek acquisitions for strategic expansion rather than purely financial engineering. In effect, the framework creates what may be termed “strategic leverage,” allowing corporations to use moderate levels of debt to fund acquisitions while preventing the emergence of a classic private-equity-driven LBO market within the Indian banking system.

VI. SUGGESTIONS

While the RBI's 2026 Directions represent a significant step toward modernising India's acquisition finance framework, certain refinements could make the regime more effective without undermining prudential safeguards:

- (i) First, eligibility criteria for acquirers should be broadened. The current requirement of being a non-financial company with three years of profits excludes lots of innovative and high growth firms.
- (ii) Second, the regulatory standards should be clarified. Terms such as ‘strategic investment’, ‘long-term value creation’, and ‘integral refinancing’ remain undefined and introduce significant legal uncertainty. RBI could issue interpretative guidelines or quantitative indicators such as minimum holding periods, operational integration requirements, or financial thresholds to ensure consistent application across banks and reduce transaction delays.
- (iii) Third, the framework should allow greater flexibility. The current directions of 3:1 debt to equity may not reflect commercial realities and diverse situations in various industries.
- (iv) Fourth, the regime should recognize ancillary financing requirements in takeover transactions. Requirements like open offer under the SEBI takeover framework creates substantial upfront liquidity requirements that are not covered in the framework. Allowing banks to finance such

regulatory costs, subject to appropriate risk-weighting would make acquisition financing more practical and reduce reliance on alternative funding sources.

VII. CONCLUSION

The RBI's Commercial Banks (Credit Facilities Amendment Directions), 2026 represent a revolutionary development in India's corporate finance landscape. By permitting banks to participate in acquisition financing, the RBI has begun to address a long-standing gap in the domestic financial system that had previously forced Indian corporations to rely heavily on alternative sources such as AIFs and NBFCs. Although the framework does not copy the highly LBO models prevalent in jurisdictions such as the United States and the United Kingdom. It nevertheless marks an important transition from strict prohibition to a much more liberalized system that allows banks to provide acquisition finance under prudent safeguards.

These directions should not be interpreted merely as a partial liberalization, but as the foundation for the gradual development of a modern acquisition financing ecosystem in India. If supported by incremental reforms then RBI's policy shift has the potential to significantly enhance the efficiency of corporate control transactions and contribute to the long-term development of India's financial and corporate sector.

THE BUSINESS JUDGMENT RULE AND MFW: RETHINKING JUDICIAL DEFERENCE IN CONTROLLER TRANSACTIONS

*Siya Sharma & Kartikey Tripathi**

ABSTRACT

The Business Judgment Rule (“BJR”) shields directors from liability for informed, good-faith decisions, presuming they prioritize corporate interests. However, its application falters in controller transactions, where a dominant shareholder’s influence risks minority prejudice. Delaware’s MFW framework addresses this by conditioning BJR protection on rigorous procedural safeguards: an independent special committee, fully empowered to negotiate or reject the deal from the outset, and informed majority-of-minority shareholder approval. The focus is simple; if a company undergoing a controller transaction is to enjoy the perks of BJR, it must sieve the transaction through the test in MFW. Recent rulings, like those rejecting BJR for Elon Musk’s Tesla compensation due to MFW noncompliance, underscore its limits while highlighting judicial wariness of unchecked control.

India possesses a promoter-heavy corporate landscape that amplifies the risk of sabotage due to controller transactions, yet it lacks MFW equivalents. Further, the developing notion of corporate control, that is, one beyond substantial shareholding and power to appoint key managerial personnel, presents a unique yet untested opportunity to reform India’s corporate governance of controller transactions. Existing tools like Audit Committees and Nomination and Remuneration Committees under the Companies Act, 2013 and various SEBI regulations enforce disclosures and approvals but fall short; they are standing bodies, not transaction-specific, lacking true bargaining autonomy or ab initio conditioning.

This paper critiques MFW’s evolution, procedural pitfalls, and India’s fragmented regime. It then proposes calibrated reforms that include a materiality-triggered, transaction-specific independent committee with advisor selection rights, mandatory minority approval via enhanced disclosures, and BJR as a reward for compliance. Drawing from Hong Kong and Singapore models, these fill gaps without rigidity, fostering procedural fairness, curbing judicial overreach, and bolstering shareholder safeguards in India’s control-centric governance.

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Keywords: Business Judgment Rule, Controller Transactions, MFW Framework, Judicial Deference, Minority Shareholder Protection, Procedural Fairness.

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I. INTRODUCTION

The Business Judgement Rule (“***BJR***”) is a legal principle protecting company directors from liability for business decisions, presuming they acted in good faith, with due care, and in the company’s best interest. It allows taking actions in the course of a company’s business without fear of lawsuits unless bad faith, fraud, or conflict of interest is proven. The principle is a judge-made law, finding its roots in Delaware, United States (“***US***”).¹ Courts generally extend the BJR to all board decisions taken with due care, but they first apply stricter

¹Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

scrutiny when a transaction involves someone who exercises control over the company.

Controller Transactions are transactions where a shareholder with significant exercisable power in the company (“**Controller**”) is a part of a transaction between themselves and the company.² These transactions make room for the possibility of the company’s interest being subdued by the controller’s ambitions and a threat to the best interests of other shareholders. This happens when the directors tasked to vote and decide are influenced by the directions of the controller. Recognising this risk, Delaware courts have conditioned the application of BJR in controller transactions on compliance with procedural safeguards articulated in *Kahn v M & F Worldwide Corporation*, called the ‘**MFW**’ requirements, which include the approval of the transaction by a special committee and the majority-of-minority shareholders.³ Because BJR acts as a safeguard against court scrutiny, MFW requirements ensure that transactions involving controlling shareholders are approved by independent and fair decision-making processes, guaranteeing the same presumption of fairness before judicial scrutiny.

The significance of the MFW framework came into focus in December 2024, when the Delaware Court of Chancery refused twice to apply BJR to the approval of Tesla founder Elon Musk’s \$56 billion compensation package.⁴ The suit opposing the package was filed by Tesla’s minority shareholder, claiming breach of due care by its directors who approved it. When Tesla sought the protection of the BJR, the court declined the same, as the transaction did not meet the threshold approved under the MFW framework, leading to an examination of the fairness of the pay package on the merits. The decision sparked debate on the limit of judicial deference in transactions involving controlling shareholders.

In India, the adoption of the BJR has been through judicial interpretation; it is not found in the Companies Act, 2013 (“**Act**”). When it

²Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110, 1113 (Del. 1994); Guth v. Loft, Inc., 5 A.2d 503, 506 (Del. 1939).

³Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

⁴Tornetta v. Musk, 310 A.3d 430 (Del. Ch. 2024).

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comes to the adoption of MFW, the courts are far behind, even when the backdrop exists. Control remains a defining feature of Indian corporate ownership. As of June 2025, promoters held roughly 40.6 per cent of shareholding in Indian corporates,⁵ while Related Party Transactions (“**RPT**”) in top listed companies exceeded ₹21 trillion in FY23, representing over nine per cent of total assets.⁶ More critically, promoters exercised nearly 79 per cent of voting power in NIFTY 500 companies in 2024, despite holding just over half of the equity.⁷ This concentration of economic and voting power complicates the application of judicial deference under the BJR, particularly in transactions involving controllers, making a strong case for the need for enhanced procedural safeguards such as the MFW framework. When controller transactions are undertaken, the MFW exists as a gateway that would prevent their judicial examination as a consequence of procedurally guaranteed fairness.

This paper examines the limits of the BJR in transactions involving controlling shareholders and assesses the relevance of the MFW framework in the context of Indian corporate governance. **Part II** introduces controller transactions as a distinct category of decision-making processes influenced by the exercise of control and its implications for other shareholders. **Part III** analyses the BJR and explains why its presumption becomes difficult to apply in transactions influenced by the controlling shareholders. **Part IV** traces the evolution of the MFW framework in Delaware, outlining its six prerequisites and its impact on judicial review. **Part V** critically evaluates the limitations and critiques of the MFW framework. **Part VI** examines India’s existing legal and regulatory framework governing the controller and promoter transactions, discussing disclosure and committee-based safeguards. Finally, **Part VII**

⁵Press Trust of India, *India Inc Promoters Holding Slumps to 8-Yr Low in June Qtr: Report*, THE ECONOMIC TIMES (Aug. 4, 2025), <https://economictimes.indiatimes.com/news/company/corporate-trends/india-inc-promoters-holding-slumps-to-8-yr-low-in-june-qtr-report/articleshow/123091435.cms>.

⁶Sachin P. Mampatta, *Top Companies Account for Trillions in Related-Party Transactions*, BUSINESS STANDARD (May 27, 2024), https://www.business-standard.com/markets/news/top-companies-account-for-trillions-in-related-party-transactions-124052701171_1.html.

⁷Neha Vyas, *Majority Promoter Stake in Most Firms Influences Voting Outcomes*, THE INDIAN EXPRESS (June 2, 2025), <https://indianexpress.com/article/business/majority-promoter-stake-in-most-firms-influences-voting-outcomes-10042769/>.

proposes calibrated reforms focused on adapting MFW-style procedural safeguards in the Indian governance context.

II. UNDERSTANDING CONTROLLER TRANSACTIONS AND THE NATURE OF CONTROL

Controller Transactions raise significant governance concerns because they involve decision-making by controllers. Essentially, the person wielding control and the company sit on the two sides of the table, raising a logical presumption that the transaction might benefit the controller more than it is supposed to benefit the company. When such transactions are entered into, value may be diverted from the company to the controller through unfair pricing, favourable terms, or hidden benefits, to the detriment of both minority shareholders and the corporate enterprise.⁸ A company's transaction with a controller, whether motivated or not, does not involve a neutral consideration as any transaction with a third party would. This is due to the interest of the controller, who seeks to benefit from either end. In companies where the biggest shareholder is also a director, past promoter, or other Key Managerial Personnel, the possibility of influencing the Board of Directors ("**BoD**") as well as the shareholders to one's favour to get a gratuitous transaction approved is very real.

Notably, while control has originally been associated with the voting power and sway over the decision-making in the company, Delaware corporate law is increasingly becoming susceptible to a 'new' control.⁹ Now, the definition of control is not only confined to economic or asset-based power, but also to the power to influence a transaction.¹⁰ The power may vary from being based on

⁸Zipora Cohen, *Fiduciary Duties of Controlling Shareholders: A Comparative View*, 12 U. PA. J. INT'L L. 379 (1991).

⁹Jill E. Fisch & Steven Davidoff Solomon, *Control and Its Discontents*, 173 U. PA. L. REV. 641 (2025) [hereinafter Fisch & Solomon]; Ben Potts, Andrew Blumberg & Tom James, *Delaware Corporate Law Myth-Busting: "The Expanding Definition" of Controlling Stockholder*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 21, 2025), <https://corpgov.law.harvard.edu/2025/02/21/delaware-corporate-law-myth-busting-the-expanding-definition-of-controlling-stockholder/>.

¹⁰Stephen M. Bainbridge, *A Course Correction for Conflicted Controller Transactions*, CLS BLUE SKY BLOG (Nov. 26, 2024), <https://clsbluesky.law.columbia.edu/2024/11/26/a-course-correction-for-conflicted-controller-transactions/>.

the classic large-shareholding control or the control of other investors and shareholders in terms of the business they bring into the company.¹¹ This makes the presence of control in controller transactions not as absolute as in the corporation but relative to the transaction in question.¹² Consequently, while a controller might appear synonymous with the majority shareholder, a minority shareholder can also be a controller with respect to transactions that they can influence in their favour. The Tesla-SolarCity transaction illustrates this dynamic. Tesla's founder, Elon Musk, used his position as co-owner, despite holding only a 12.8% shareholding, to influence the company to acquire SolarCity, demonstrating that control can exist independently of numerical ownership.¹³

India's present corporate landscape does not share the 'controller' terminology with Delaware. Comparing the scope of such transactions, transactions entered into by Promoters in India come the closest to controller transactions. This is so owing to the control wielded by promoters, which has been recognised in law by the Securities and Exchange Board of India ("**SEBI**") SEBI (Substantial Acquisition of Shares and Takeovers) Regulations ("**Takeover Code**")¹⁴ and SEBI (Issue of Capital and Disclosure Requirements) Regulations ("**ICDR**").¹⁵ However, the formal definition of promoter in these regulations is absolute, while a controller can exercise control relevant to transactions without being a promoter. A controller may or may not have a connection with the setting up of the company or a figure having sizable control over shareholding, like a promoter. Therefore, the definition of promoter followed in India is narrower than that of a controller in Delaware.

Controller transactions also overlap with RPT, but the two are not the same. An RPT is characterised by the presence of an existing relationship between the company and the party transacted with, even in the absence of

¹¹Robbins & Co. v. A.C. Israel Enterprises Inc., 1985 WL 149627, at 5 (Del. Ch. 1985).

¹²Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110, 1113 (Del. 1994).

¹³In re Tesla Motors, Inc. Stockholder Litigation, 298 A.3d 667 (Del. Ch. 2023).

¹⁴Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Gazette of India, pt. III, sec. 4 (Sept. 23, 2011).

¹⁵Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Gazette of India, pt. III, sec. 4 (Sept. 11, 2018).

formal or relative control over the decision. By contrast, a controller transaction is characterised by the ability to sway the outcome of a decision, either directly or indirectly.¹⁶

Accordingly, the Indian regulatory framework governing RPTs and promoter dealings does not fully capture transactions shaped by indirect, situational, or transaction-specific control. Controller transactions operate on a broader plane; they are defined not by formal status, pre-existing relationships, or absolute shareholding thresholds, but by the capacity to influence the initiation, structuring, negotiation, or approval of a transaction.¹⁷ In this sense, controller transactions form a conceptual superset within which promoter transactions and RPTs are subsets. Where a controller exerts sway over both corporate decision-making and the approval architecture, conventional assumptions of arm's-length bargaining and independent oversight become untenable. For instance, when a controlling shareholder negotiates a transaction with the company while exercising influence over the board, even if the transaction is formally approved, the influence weakens confidence in the fairness of the process. This fragility necessitates heightened judicial scrutiny of such transactions and justifies conditioning deference to BJR on the existence of robust procedural safeguards designed to neutralise the distortive effects of control.

When the scope of Indian regulations on promoters and RPTs is revisited through judicial developments, it is inferred that India does not envision something similar to Delaware's 'new' control. In *Subhkam Ventures (I) Pvt. Ltd. v. SEBI*, the Securities Appellate Tribunal ("**SAT**") held that affirmative veto rights alone do not constitute "control" under Regulation 2(1)(e) of the Takeover Code¹⁸ absent positive direction of management,¹⁹ a threshold the

¹⁶Umesh S. Mahtani, *Related Party Transactions in India and Their Impact on Reported Earnings*, 53 J. Developing Areas 165 (2019).

¹⁷Yu-Hsin Lin, *Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control*, COLUM. BUS. L. REV. 453, 483 (2017).

¹⁸Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Gazette of India, pt. III, sec. 4, Reg. 2(1)(e) (Sept. 23, 2011).

¹⁹*Subhkam Ventures (I) Private Ltd. v. Securities & Exchange Board of India*, 2010 SCC OnLine SAT 35 (India.).

Supreme Court of India (“SC”) left intact by disposing of the appeal without a substantive ruling and explicitly disclaiming SAT’s order as precedent.²⁰ This positive control test was indirectly reaffirmed in both by the SC²¹ and SAT later,²² where contractual rights and relationships did not trigger control without evidence of actual management direction. Therefore, it did not broaden the concept to include mere sway or board ties, thus missing the opportunity to adopt ‘new’ control. The Takeover Code’s “direct management” test under Regulation 2(1)(e) similarly demands actual entitlement to appoint directors or dictate policy, not latent influence.²³

This strict definition neither provides the shareholders with a guarantee of fairness from transaction-specific ‘new’ control nor companies a standard of regulatory scrutiny that would constitute due care. Such a regulatory void reinforces the need for setting a standard, which, when followed by companies during controller transactions, would afford them the right to rebut the allegations of unfairness.

III. THE BJR AND THE PROBLEM OF CONTROLLER TRANSACTIONS

The BJR reflects the principle of judicial restraint that courts will not interfere in the decision of boards as long as the directors acted in good faith, on an informed basis, and in the honest belief that the decision was for the benefit of the company.

In India, although the BJR is not explicitly codified, the principle is reflected inversely in the provisions of the Act. Section 166 of the Act outlines the duties of the directors, focusing on acting in good faith and exercising reasonable care and diligence.²⁴ Further, Section 463 of the Act relieves directors from liability for negligence, breach of duty, or similar issues if they prove that

²⁰Securities & Exchange Board of India v. Subhkam Ventures (I) Pvt. Ltd., 2011 SCC OnLine SC 37 (India.).

²¹ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1 (India.).

²²Vishvapradhan Commercial (P) Ltd. v. Securities & Exchange Board of India, 2022 SCC OnLine SAT 1128 (India).

²³Supra note 18.

²⁴ Companies Act, No. 18 of 2013, § 166 (India.).

they are performing their actions honestly and reasonably.²⁵ Therefore, a combined reading of the two provisions prescribes the director's duties and provides protection as a positive consequence of such duty when undertaken, as opposed to a legal presumption under BJR.

However, the Indian courts have extended this protection in the form of a safeguard that saves transactions from being vitiated by judicial scrutiny. In *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, for example, the SC refrained from interfering in decisions based on directors' commercial prudence unless vitiated by mala fide intentions, influence, or gross mismanagement.²⁶

As far as the effect is concerned, when utilised in both Delaware and India in its original form, the assumption underlying BJR weakens in the case of controller transactions. Where a controlling shareholder influenced a transaction on both sides, such a deal undermines the presumption of independence and disinterest in decision-making. Recognising these concerns, Delaware courts strictly applied the entire fairness standard in such dealings, requiring both fair process and fair price.²⁷

The strict application of the entire fairness standard in controller transactions often resulted in intrusive judicial review even when transactions were procedurally fair.²⁸ The MFW framework evolved as a calibrated response to this judicial review in lieu of pursuing procedural safeguards such as independent committee approval and informed majority-of-minority shareholders' approval. In doing so, the MFW framework repositions judicial deference not as an automatic assumption but as an outcome of demonstrable procedural fairness.

²⁵Companies Act, No. 18 of 2013, § 463 (India.).

²⁶*Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, (1997) 1 SCC 579 (India.).

²⁷Edward B. Micheletti, Peyton V. Carper & Emily A. Nowlan, *Skadden Discusses Delaware Decisions on Controller Transactions, Standards of Review, and Disclosure Obligations*, CLS BLUE SKY BLOG (July 10, 2024), <https://clsbluesky.law.columbia.edu/2024/07/10/skadden-discusses-delaware-decisions-on-controller-transactions-standards-of-review-and-disclosure-obligations/>.

²⁸Daniel Wilson, *Desirable Resistance: Kahn v. M&F Worldwide and the Fight for the Business Judgment Rule in Going-Private Mergers*, 17 U. PA. J. BUS. L. 644 (2015).

IV. THE MFW FRAMEWORK: EVOLUTION, PRECONDITIONS, AND JUDICIAL IMPACT IN DELAWARE

The MFW has been subject to continuous judicial development in Delaware. Born in the case of *Kahn v M & F Worldwide Corporation* in 2014, the requirements were a direct outcome of judicial economy in providing the protection of BJR.²⁹ Before the development of MFW, the general norm was to place strong emphasis on the transactional history to determine whether all safeguards were in place to protect the minority shareholder at the time of a controller transaction.³⁰

The entire fairness standard, which occupies a central position in testing such a transaction, requires both procedural and substantive (economic) review of the transaction. Aspects like coercion, bias, and the interest of decision-makers, as well as the commercial interest of the company, are tested to determine if the transaction is to the detriment of the minority. The entire fairness standard is the highest level of judicial scrutiny for corporate transactions involving a director or a controller having a conflict of interest due to being on both ends, shifting the burden to the controller to prove the deal was both a fair price (substantive fairness) and fair dealing (procedural fairness) to the company and minority shareholders.³¹

With MFW, the position changed as the Delaware Supreme Court (“DSC”) recognised that the BJR could be substituted as the standard for controller transactions if the company followed two broad prongs. *Firstly*, the transaction must have been passed by a special committee that reserved the power and mandate to reject it. *Secondly*, the transaction must have been approved by the majority of the minority shareholders. The Court opined that when these two prerequisites were duly followed by the directors, there would

²⁹Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

³⁰Alex Lindsey, *Expanding MFW: Delaware Law Should Offer a Business Judgment Rule Safe Harbor for All Conflicted Controller Transactions*, 29 FORDHAM J. CORP. & FIN. L. 339 (2023).

³¹Andrew Beck & Ben Potts, *Delaware Supreme Court Holds Entire Fairness Applicable to All Conflicted Controller Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 8, 2024), <https://corpgov.law.harvard.edu/2024/04/08/delaware-supreme-court-holds-entire-fairness-applicable-to-all-conflicted-controller-transactions/>.

remain no need to examine the pith of the transaction under the entire fairness standard.

The two prongs have been further based on six requirements; to get the benefit of the BJR, (i) the controlling shareholder must condition the completion of the transaction on these two measures from the very outset of the transaction negotiations; (ii) the special committee must be independent; (iii) the committee must be empowered to freely select its own advisors and to say no to the transaction definitively; (iv) the committee must meet its duty of care; (v) the vote of the minority must be informed; and (vi) there must be no coercion of the minority. These requirements make sure that the minority continues to hold the best end of the bargain.

A special committee can be considered to be any committee designated to review or permit controlling-shareholder transactions. Conditioning the transaction on a special committee, so separated as to be empowered to reject any offer, ensures that the offer so accepted is the most beneficial. Further, the majority-of-minority requirement essentially makes room for the say of those who would have to eventually exit the company but can do so in a manner that is better suited to their economic prospects.³² In addition to this, subjecting the acceptance of a transaction to the duty of care requires directors to review whatever is presented to support the transaction thoroughly. When promoters or groups with substantial shareholding are considered, the concept of minority shareholding retains its original meaning based on numerical minority. When the concept of 'new' control is considered, unaffected by the numerical majority, the voting includes all shareholders other than the controller in the transaction. Delaware conceptualises all the minority voting under this prong to be 'disinterested', with no disclosed benefit arising to them from the transaction.³³ This ensures the welfare of those shareholders who personally stand to gain nothing from the transaction.

³²Brian M. Rostocki et al., Delaware Supreme Court Clarifies the Scope and Application of MFW's Procedural Protections, REED SMITH (May 8, 2024), <https://www.reedsmith.com/our-insights/blogs/viewpoints/102j70p/delaware-supreme-court-clarifies-the-scope-and-application-of-mfws-procedural-pr/>.

³³Itai Fiegenbaum, *The Geography of MFW-Land*, 41 DEL. J. CORP. L. 763 (2017).

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It is essential to note the stress on ‘from the outset’ or *ab initio* conditioning of the deal. Any transactional negotiations between the controller and the special committee must begin only after the committee has been independently established.³⁴ This *ab initio* position has also been subject to judicial rigmarole, settling on the rule that the negotiations must contain as a prerequisite the two obligations of the special committee and a majority-of-minority vote before the committee and controller sit to discuss the deal.³⁵

Originally, the benefit of the BJR after following MFW was limited to freezeout/squeeze out mergers (mergers forcing minority shareholders out of the company).³⁶ However, the DSC in *In re Match Group, Inc. Derivative Litigation* has formally extended the application of MFW to seek BJR review to all transactions where the controlling shareholder seeks to receive a non-ratable benefit through the transaction’s outcome.³⁷ Non-ratable benefits are any outcomes that benefit some (or one) shareholder over others, even though the company is involved as a whole.³⁸ Squeeze-out mergers also come in the category of transactions providing non-ratable benefits, as in this case, the company’s ownership is given completely to one shareholding group. Thus, the extension of MFW to all controller transactions is a cue to protect the interests of shareholders regardless of the stature of the transaction.

V. STRUCTURAL AND PROCEDURAL LIMITATIONS OF THE MFW FRAMEWORK

Although the MFW framework promises significant benefits, it requires both approval from an independent special committee and the support of a

³⁴Roger Cooper et al., *Clarifying MFW’s Ab Initio Condition*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 3, 2018), <https://corpgov.law.harvard.edu/2018/11/03/clarifying-mfw-ab-initio-condition/> [hereinafter Roger Cooper].

³⁵*Id.*

³⁶William T. Allen, Jack B. Jacobs & Leo E. Strine Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 882 (2001).

³⁷*In re Match Group, Inc. Derivative Litigation*, 315 A.3d 446 (Del. 2024).

³⁸Jody C. Barillare, Michael D. Blanchard & Brian Loughnane, *Delaware Supreme Court Holds MFW Doctrine Applies to Any Controlling Stockholder Transaction Resulting in Non-Ratable Benefit*, MORGAN LEWIS LAWFLASH (Apr. 5, 2024), <https://www.morganlewis.com/pubs/2024/04/delaware-supreme-court-holds-mfw-doctrine-applies-to-any-controlling-stockholder-transaction-resulting-in-non-ratable-benefit>.

majority of minority shareholders to balance the controller's power with minority shareholders' interests. In practice, the MFW framework has proven to be procedurally and structurally demanding. An MFW compliant process is both expensive and time-consuming.³⁹ Procedurally, a company must set up an independent special committee, which in turn requires engaging its own legal and financial advisors. Additionally, conducting an informed vote of minority shareholders increases transaction costs and prolongs deal timelines, often reducing deal certainty.⁴⁰

Moreover, in the MFW framework, litigation risk is not diminished; it merely transforms it. Delaware courts apply a strict approach when examining compliance with procedural requirements, particularly with respect to director independence and disclosure. *In re Match Group, Inc. Derivative Litigation*, one member of the special committee had prolonged personal and professional ties with the controlling shareholders. The DSC held that even the lack of independence of one committee member is sufficient to refuse the MFW protection due to strict compliance with the framework.⁴¹ Similarly, in *Brookfield Asset Management (TerraForm)*, although a special committee was constituted, the committee's legal and financial advisers had prior relationships with the controlling shareholders, including equity interests that were not disclosed to minority shareholders. The DSC held that such non-disclosure vitiated informed majority-of-minority approval, resulting in the denial of MFW protection, and the transaction was subject to an entire fairness review.⁴² These cases demonstrate that even technical deficiencies related to independence and disclosures can defeat MFW protection.

³⁹Christopher B. Chuff et al., *MFW Pitfalls: Bypassing the Special Committee and Pursuing Detrimental Alternatives*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 30, 2020), <https://corpgov.law.harvard.edu/2020/06/>.

⁴⁰Nathaniel J. Stuhlmiller & Brian T. M. Mammarella, "MFW" Just Turned 10, but Is It Worth the Candle?, DEL. BUS. CT. INSIDER (July 3, 2024) <https://www.rlf.com/wp-content/uploads/2024/07/MFW-Just-Turned-10.pdf>.

⁴¹*In re Match Group, Inc. Derivative Litigation*, 315 A.3d 446 (Del. 2024).

⁴²*City of Dearborn Police & Fire Revised Retirement System v. Brookfield Asset Management Inc.*, 311 A.3d 395 (Del. 2024).

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One of the vital concerns in the MFW framework is the uncertainty of its standard of director independence. Since the measure of an independent committee requires transparency and absence of bias, the state of directors' independence is a question of fact. In the *Trade Desk* case, despite the formal constitution of a special committee and minority shareholder approval, the Delaware Court of Chancery denied MFW protection on the ground that one of the directors from the special committee had been associated with the promoter for a long time. From being hired by the controller to being made the Chief Technology Officer of the company, the Court analysed the history and personal ties of association that were present.⁴³ It is inferred that the extent to which courts trying MFW compliance consider the past relationships between the controller and special committee members makes the determination of fairness in controller transactions lengthy and expensive.

Further, the absence of a numeric provision for directors also weakens how far independence is actually present. The presence of a single-director committee, for example, may be independent in name, but the same may still be acceptable under MFW. In addition to these shortcomings, the psychological pressure that the committee's director may feel, even if not directly under the influence of the controller, cannot be ignored.⁴⁴ For example, a director, however independent they may be, would have to consider the possibility of bearing the consequences of denying the controller the requisite approval for the transaction, especially when the controller is a promoter. The probable cost that the director may associate with the rejection of the transaction can extend to losing his position on the board, striking at his independence. The question thus boils down to how independent the committee is. For a committee to actually protect vulnerable shareholders, it must look ahead of formal compliance.

As a result, the MFW framework has not always achieved the predictability, efficiency, and litigation-reducing advantages that it was intended to achieve. In essence, any framework in line with MFW is intended to replace

⁴³City Pension Fund for Firefighters & Police Officers in Miami v. The Trade Desk, Inc., 2022 WL 3009959 (Del. Ch. 2022).

⁴⁴Fisch & Solomon, *Supra* note 9.

scrutiny at the courts with true fairness at the internal level of the company. Such a framework must therefore also replace increased costs in implementation and avoid detailed character assessment at courts so as not to become redundant, but actually a guarantee for shareholders.⁴⁵

VI. INDIA'S CURRENT FRAMEWORK FOR CONTROLLER TRANSACTIONS

India does not have a consolidated framework for regulating controller transactions. Instead, such transactions are *de facto* regulated by a mix of regulations concerning both RPTs in general and promoters specifically. Further, this framework addresses disclosure and approval requirements but does not mandate transaction-specific procedural safeguards, such as conditioning approval on an independent special committee. As a result, the framework falls short of the process-centric protection that was provided in the MFW framework.

Under the Act, controller transactions are primarily addressed through the framework for RPTs. Section 2 (76) of the Act provides a broad definition of the “related party” that includes directors, key managerial personnel, and entities with significant shareholding or influence, bringing promoters and their actions under its purview.⁴⁶ Further, Section 188 of the Act outlines a wide range of RPTs, including the sale or purchase of goods or property, appointment to office or place of profit, and underwriting of securities. These transactions require the consent of the Board or approval by a resolution; if not ratified by the Board, in many cases, prior approval from the shareholders by a resolution is also required.⁴⁷ Section 188(2) sets forth that related parties shall abstain from voting on such resolutions to mitigate direct conflicts of interest at the approval stage.⁴⁸ The framework mandates that if transactions between related parties happen, they must be conducted on an arm’s-length basis, which means they have to be treated as if they are unrelated to avoid conflict and must be properly

⁴⁵Zohar Goshen, Assaf Hamdani & Dorothy S. Lund, *Fixing MFW*, CLS BLUE SKY BLOG (Feb. 11, 2025), <https://clsbluesky.law.columbia.edu/2025/02/11/fixing-mfw/>.

⁴⁶Companies Act, No. 18 of 2013, § 2(76) (India.).

⁴⁷Companies Act, No. 18 of 2013, § 188 (India.).

⁴⁸Companies Act, No. 18 of 2013, § 188(2) (India.).

disclosed. Adherence to the provision may serve as a presumption of the purity of such transactions. These provisions, however, condition the transaction on the consent of the BoD and not on the approval of the shareholders, therefore negating the involvement of shareholders other than the controller. Consequently, the direct representation of shareholders other than the controller is absent under RPTs.

With regard to the processes of transactions, certain committees play a determinative role in regulating controller transactions that enjoy statutory recognition and mandatory compliance obligations. In particular, the Audit Committee and the Nomination and Remuneration Committee (“**NRC**”) perform oversight functions that resemble certain elements of the MFW framework. However, as discussed in the subsequent sub-section, their structure and scope of authority limit their capacity to deliver the level of transactional independence that lies at the core of the MFW framework.

A. AUDIT COMMITTEE AND ITS LIMITS IN CONTROLLER TRANSACTIONS

Section 177 of the Act mandates the constitution of an Audit Committee, consisting of a minimum of three directors, with a majority of independent directors.⁴⁹ The audit committee plays a significant role in recommending the appointment, remuneration, and reviewing the independence of auditors. In the context of controller transactions, the audit committee is tasked with reviewing, approving, and modifying RPTs under both the Act and SEBI (Listing Obligations and Disclosure Requirements) Regulations (“**LODR**”).⁵⁰

Regulation 23 of the LODR requires prior approval of the Audit Committee for all RPTs and their subsequent material modifications.⁵¹ The approval of these transactions by the Audit Committee ensures impartiality and mitigates influence. The recent 5th amendment to the LODR, SEBI emphasises

⁴⁹ Companies Act, No. 18 of 2013, § 177 (India).

⁵⁰ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III, sec. 4 (Sept. 2, 2015).

⁵¹ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III, sec. 4, Reg. 23 (Sept. 2, 2015).

procedural oversight and transparency by enhancing disclosure requirements, materiality thresholds, and reinforcing the role of the Audit Committee.⁵²

However, despite these amendments, the Audit Committee remains a standing body with a broad mandate. It deals with financial statements, audit processes, and omnibus approvals for the routine or recurring RPTs to continue regular business operations. While omnibus approvals are necessary, they reduce the committee's ability to engage in transaction-specific scrutiny, particularly high-conflict transactions. The committee focuses more on regulatory compliance rather than actively checking in conflicted deals.⁵³

This limitation becomes apparent when contrasted with the MFW framework. Under MFW, a special committee approves and reviews the related party transactions, which are truly independent, selects its own advisors, negotiates, and even rejects the transaction. As opposed to MFW, the audit committee is not equipped with the same autonomy and negotiating power to review the transactions. The Audit Committee performs duties to review the financial statements before the BoD and related issues, with the auditors and management not solely tasked with safeguarding the minority interests in a particular transaction.

Accordingly, the Audit Committee has formal elements related to procedural fairness, such as independence and prior approval, but it does not replicate the independence and authority of a special committee as required under MFW. Even after the recent amendment of the LODR, the Audit Committee remained focused on the compliance mechanism rather than a transaction-specific safeguard involving material controller transactions.

⁵²Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2025, Gazette of India, pt. III, sec. 4 (Nov. 19, 2025).

⁵³Mustafa Rajkotwala, *SEBI's 2025 Related Party Transactions' Overhaul: Balancing Ease of Doing Business and Investor Protection*, INDIA CORPLAW (Aug. 27, 2025), <https://indiacorplaw.in/2025/08/27/sebi-2025-related-party-transactions-overhaul-balancing-ease-of-doing-business-and-investor-protection/>.

B. NRC: STRUCTURAL CONSTRAINTS AND INDEPENDENCE CONCERNS

The NRC becomes relevant to establish an uncoerced yet empowered environment of decision-making within a company where controlling shareholders have influence, particularly in board composition and executive remuneration. Since the MFW is centred around unbiased management that decides the fate of transactions, that too *ab initio*, it is essential to conceptualise the agency responsible for the same.

Section 178 of the Act mandates the constitution of NRC in specified companies to ensure proper appointment of directors, formulate criteria for board appointment, and determine remuneration policies.⁵⁴ These are NRC's central functions that frequently arise in the context of controller transactions, especially where remuneration to directors or Key Managerial Personnel (“KMP”) is concerned. Regulation 19 of the LODR mandates that the appointment of directors and KMPs must be done through the evaluation policy framed by the NRC, which must be constituted with at least two-thirds of independent directors, along with the remuneration and performance review policy.⁵⁵

Despite this, the NRC has been critiqued for being independent only in name and remains structurally constrained. The constituency and independence of the NRC are determined by the BoD, which is generally oriented towards the Promoter. Thus, the independence of NRC raises the question of good faith and its extent so as to influence the NRC's control over Controller Transactions.⁵⁶

Unlike the MFW special committee, which is constituted solely for controller transactions and derives its legitimacy from transactional and bargaining autonomy, the NRC functions as a standing committee with a broad

⁵⁴Companies Act, No. 18 of 2013, § 463 (India.).

⁵⁵Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III, sec. 4, Reg. 19 (Sept. 2, 2015).

⁵⁶Prithvi Haldea, *Myth of Independent Directors: They Can Only Be Effective if They Are Independent of Promoters*, THE FINANCIAL EXPRESS (Oct. 14, 2020), <https://www.financialexpress.com/opinion/myth-of-independent-directors-they-can-only-be-effective-if-they-are-independent-of-promoters/2104809/>.

governance mandate. It neither operates at the transaction level nor has the authority to restructure or negotiate decisions influenced by controller shareholders. NRC plays a significant role at the start by providing for the role of independent directors, but does not provide procedural safeguards against the controller's influence in high-conflict transactions.

C. PROMOTER-SPECIFIC REGULATORY SAFEGUARDS

Apart from the committee-based structural requirements, transactions involving promoters have their own requisites to be met under the law. The Takeover Code, which regulates acquisitions and takeovers in India, prescribes thresholds that, if triggered, mandate an enhanced level of authorisation. These regulations are not in a directive nature towards the BoD or committees, but a safeguard to be respected by the acquirer. Regardless, such legal requirements may serve as a presumption of the *bona fide* nature of the transactions.

Under Regulation 3, when a promoter or persons acting in concert with him seek to acquire more than twenty-five per cent shareholding in the company, a public offer must be mandatorily made so that existing shareholders get to exit at a fair, predetermined price of their holding.⁵⁷ Moreover, Regulation 4 reinforces protection independent of shareholding threshold by mandating a public offer whenever any acquisition renders the acquirer in control, which includes indirect control.⁵⁸ These provisions ensure minority shareholders have an opportunity to exit at a regulated and predetermined price, mitigating the risk of coercive acquisitions.

While the Takeover Code framework provides protection to minority shareholders, it does not address the internal decision-making process through which controller transactions are approved. Therefore, it provides market-level

⁵⁷Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Gazette of India, pt. III, sec. 4, Reg. 3 (Sept. 23, 2011).

⁵⁸Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Gazette of India, pt. III, sec. 4, Reg. 4 (Sept. 23, 2011).

obligations but fails to provide procedural safeguards and transaction-specific oversight that lie at the core of the MFW framework.⁵⁹

Taken together, the Audit Committee, the NRC, and promoter-specific regulatory safeguards constitute the core of India's framework governing controller transactions, which focuses more on disclosure, approval thresholds, and formal compliance, but does not provide procedural safeguards for specific transactions capable of being influenced by controlling shareholders at the decision-making level. Consequently, the existing framework falls short of the process-centric model of procedural fairness that lies at the core of the MFW framework. These limitations underscore the need for a calibrated reform approach that adapts the core logic of the MFW framework to India's ownership structure and governance realities.

VII. PROPOSED REFORMS: ADAPTING MFW-STYLE SAFEGUARDS TO INDIA

India's framework of regulating controller transactions puts a greater emphasis on transactions being sound with respect to the extant regulations. However, the role of committees to foresee, review, and decide remains limited and restrained due to a lesser focus on their role in regulating internally. Arguably, the intent of the law to regulate transactions on the side of the controller/ promoter might not be misplaced when committee processes are reduced to mere formality. However, this leads to the inference that the MFW may not be fulfilled on a table where deals transacted are out of the purview of these regulations, and the committees also do not feel duty-bound to act due to their *de facto* bias. For instance, the lack of regulation of the material aspects of remuneration to promoters gives room for something similar to Musk's case to happen in India. The adoption of a parallel in India would require assimilation of MFW in a manner that also addresses shortcomings in Delaware while harmonising with the existing regulatory framework and filling gaps therein. Therefore, both the limitations of MFW and the shortcomings of the extant Indian framework are considered before advocating reform proposals.

⁵⁹Bhavya Nahar, *Reviewing the Ambit of "Control" Apropos to the Objective of "Mandatory Bids": An Analysis under the Takeover Regulations*, 11 NUJS L. REV. 1 (2018).

A. TRANSACTION-SPECIFIC INDEPENDENT COMMITTEES

To address the risks involved in material controller transactions, this paper proposes introducing a transaction-specific independent committee as a relative improvement over reliance on existing committees. This approach finds support in comparable jurisdictions. In Hong Kong, the Hong Kong Stock Exchange Listing Rules treat such dealings as connected transactions and require the formation of the Independent Board Committees composed of independent non-executive directors. In addition, companies are required to appoint an independent financial adviser to assess the fairness and reasonableness of the transaction.⁶⁰ Similarly, in Singapore, the Singapore Exchange Limited listing rules governing Interested Person Transactions mandate an independent evaluation when a transaction involving controlling shareholders crosses a specific threshold and exclude the interested shareholders from voting for the approval process.⁶¹

These frameworks are neither burdensome nor exceptional, but rather represent a measured regulatory response to risks inherent in controller transactions.⁶² Drawing from these approaches, India does not need to create a new governance structure, but should adopt a calibrated mechanism aimed at strengthening minority protection without undermining board autonomy. There, the adoption of a transaction-specific independent committee constituted solely for controller transactions is proposed. One of the main concerns is that the special committee is still constituted by biased boards and may therefore suffer from influence and structural dependence of the MFW framework is acknowledged in this paper. The proposal of the transaction-specific independent committee is not premised on an assumption of perfect

⁶⁰Hong Kong Exchanges and Clearing Limited Listing Rules, ch. 14A, *Connected Transactions*, THE STOCK EXCHANGE OF HONG KONG LTD., <https://en-rules.hkex.com.hk/rulebook/chapter-14a-connected-transactions>.

⁶¹Singapore Exchange Regulation Listing Manual, ch. 9, *Interested Person Transactions*, SINGAPORE EXCHANGE REGULATION, <https://rulebook.sgx.com/rulebook/chapter-9-interested-person-transactions>.

⁶²Christopher Chen & Wai Yee Wan, *Transnational Corporate Governance Codes: Lessons from Regulating Related Party Transactions in Hong Kong and Singapore*, SINGAPORE MANAGEMENT UNIV., FACULTY OF LAW RESEARCH PAPER, 2019, https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=4921&context=sol_research.

independence, but on improving relative independence in controller transactions.

The transaction-specific independent committee should be constituted at the stage when the board first considers a controller transaction, not after substantial negotiations have commenced, similar to the *ab initio* requirement in the original MFW framework.⁶³ Therefore, the committee must be constituted at the emergence of a material controller transaction, ensuring the sole mandate to evaluate that transaction rather than managing routine compliance. The word ‘materiality’ may be defined by reference to existing LODR thresholds or where the transaction exceeds a prescribed percentage of a company’s assets or turnover.⁶⁴ The committee should consist exclusively of independent directors, constituted for the transaction, who have no prior involvement in the transaction, and be empowered to freely appoint its own legal and financial advisers. The committee should possess the authority to negotiate, recommend modifications, or reject the transaction outright. The Act may be suitably amended by the Parliament to incorporate a committee similar to the provisions for the Audit Committee. The same threshold used for the Audit Committee would adequately cover the companies that would best benefit from the framework suggested.

B. MAJORITY-OF-MINORITY SHAREHOLDER APPROVAL AS A PROCEDURAL SAFEGUARD

To complement committee-level safeguards, this paper proposes the introduction of the majority-of-minority shareholder approval requirement for material controller transactions. Such a mechanism would allow the representation of the interests of the minority shareholders directly by making the BJR protection contingent on their consent.

Regulations should ensure the uncoerced and informed nature of the voters, supported by enhanced disclosures, including the committee’s independent evaluation and fairness opinions. The mandate of disinterested

⁶³Roger Cooper, *Supra* note 34.

⁶⁴Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2025, Gazette of India, pt. III, sec. 4 (Nov. 19, 2025).

voters may also be implemented as a consequence of an audit of the disclosures made under the extant RPT framework, that is, the implementation of Section 188(1)⁶⁵ and Regulation 23 (4) & (9) of LODR.⁶⁶ For listed companies, promoters/promoter group and shareholders holding less than ten per cent of the company must be identified via disclosures under these regulations. The audit of the same would disclose the interest before any significant minority shareholder appears to trump the approval in disguise.

Both the transaction-specific independent committee approval and majority-of-minority consent are obtained, creating a strong presumption of procedural fairness. This mechanism directly addresses concerns of those shareholders whose economic interests are most vulnerable in controller transactions. This presumption justifies extending BJR protection to controller transactions in India; while codification remains a gradual and complex process, such reform offers a realistic pathway.

C. CONDITIONAL APPLICATION OF BJR IN CONTROLLER TRANSACTIONS

The above proposed safeguards are not framed to eliminate judicial scrutiny in controller transactions, but to justify a measured level of deference when fair procedures are followed. Where a material controller transaction is negotiated by a transaction-specific independent committee and approved by a majority of minority shareholders, the court focuses on shifting from substantive reassessment to procedural oversight.

In such a context, BJR does not operate as a standalone rule or automatic presumption but follows from a fair decision-making process. The court would still examine whether the required safeguards were followed, but once the procedural fairness is established, it would avoid reassessing the commercial merit of the transaction.⁶⁷ This approach reflects the core idea of

⁶⁵Companies Act, No. 18 of 2013, § 188(1) (India.).

⁶⁶Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III, sec. 4, Reg. 23(4), (9) (Sept. 2, 2015).

⁶⁷D. Gordon Smith, *The Modern Business Judgment Rule*, CLS BLUE SKY BLOG (Aug. 6, 2015), <https://clsbluesky.law.columbia.edu/2015/08/06/the-modern-business-judgment-rule/>.

the MFW framework; it preserves accountability in controller transactions while providing protection to directors and KMPs.

Taken together, the above-discussed reforms seek to preserve the core idea of the MFW framework while avoiding the rigidity and litigation-based structure that has limited effectiveness in practice. This paper does not propose the transaction-specific independent committee as a standalone solution. Instead, confining safeguards to material controller transactions, relying on transaction-specific independent committees combined with majority-of-minority approval and enhanced disclosure, improves the decision-making process. The framework reduces cost and delay while offering a realistic way for extending BJR protection to controller transactions in India.

VIII. CONCLUSION

Controller transactions are inherently difficult and complex in nature, where the same shareholder has the ability to influence both the substance and approval of the transaction. In such cases, the ordinary confidence placed in board decision-making is weakened. Delaware courts have responded to this concern by shifting the focus of judicial review from protecting outcomes to ensuring the independence and fairness of the transaction. The MFW framework represents this shift by treating judicial deference not as an assumption but as a result of procedural integrity.

In India, corporate governance continues to rely on the existing framework of disclosure-based- based regulations and committee oversight. The Audit Committee, NRC, and shareholder approval requirements are still significant; they remain standing bodies with broad mandates and limited autonomy. They are not designed to address high-conflicted controller transactions and do not provide the level of independence and bargaining power contemplated under the MFW framework.

This paper does not argue for the exact adoption of the MFW framework, but proposes a more practical adaptation of its core logic, informed by the critiques of the framework itself. By confining enhanced safeguards to material controller transactions, constituting transaction-specific independent

committees, and supplementing them with informed majority-of-minority approval, the proposed approach seeks to balance managerial discretion with minority protection. Such an approach makes judicial deference under BJR more justified through process rather than presumed by default.

In doing so, India can move toward a more calibrated, process-based framework that offers a middle path that avoids excessive judicial intervention and unchecked control, while remaining consistent with principles of judicial restraint, procedural integrity, and minority shareholder protection.

EQUITY WITHOUT BORDERS: LEGAL BLUEPRINT FOR INDIA'S CROSS-BORDER SHARE SWAPS

*Shivangi Nawalkha**

ABSTRACT

In cross-border transactions, cash is no longer the only currency of deal making. Share for Share swaps where equity instruments are exchanged instead of money are increasingly used to facilitate private equity exits, stock for stock mergers and strategic realignments. These structures enable companies to pursue restructuring without immediate cash outlay while still complying with India's foreign investment framework.

However, until recently, India's Foreign Exchange Management Act, 1999 regime did not distinguish share for share swaps from outright cash acquisitions creating uncertainty over whether Reserve Bank of India's approval was required.

The 2024 amendments to the Foreign Exchange Management Act (Non-Debt Instruments) Rules, 2019 and the RBI's updated Master Directions on Foreign investment in India offer the long-awaited clarity by expressly permitting the cross-border share swaps under the automatic route i.e. without the RBI's approval, provided they follow standard valuation, pricing, and sectoral cap conditions.

Yet despite these welcome reforms, numerous practical questions remain. This article answers these by providing a practitioner's roadmap for navigating India's complex compliance landscape in cross-border share for share swaps under the new regime. It distils five core compliance pillars from fair-value valuation and time bound RBI filings to repatriation classification, corporate approvals and tax obligations. Additionally, it highlights three traps that may break the deal if overlooked i.e. indirect investment cap breaches, FOCC/IOCC misclassification and deferred payment tranche reporting.

By following this roadmap, practitioners can confidently anticipate and address each compliance requirement transforming regulatory complexity into a structured and risk mitigated process that delivers seamless and enforceable cross border equity swaps.

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Keywords: Cross-Border Share Swaps, FEMA NDI Rules 2024, Foreign Direct Investment (FDI), Overseas Direct Investment (ODI), Automatic Route, Corporate Compliance.

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I. INTRODUCTION

On 23 July 2025, Aurum PropTech Ltd. completed the acquisition of PropTiger Marketing Services India, the Indian subsidiary of News Corp Australia-backed REA India through a 100% all-stock strategic equity swap. The transaction valued at approximately USD 10.5 million marked the first ever share-swap based acquisition in India entirely sidestepping cash outlays and currency headwinds.¹ Yet, until recently, dealmakers in Mumbai and beyond operated in a fog – the Foreign Exchange Management Act, 1999 (“**FEMA**”) and its 2019 Non-Debt Instruments Rules (“**NDI Rules**”) never explicitly addressed cross border equity for equity swaps.

¹*Aurum PropTech acquires home brokerage platform PropTiger for ₹86.45 crore from REA India*, HINDUSTAN TIMES, (July 23, 2025), <https://www.hindustantimes.com/real-estate/aurum-proptech-acquires-home-brokerage-platform-proptiger-for-rs-86-45-crore-from-australia-s-rea-group-101753271325637.html>.

That all changed when the Reserve Bank of India's 2024 amendments to the NDI Rules and its accompanying Master Directions on Foreign Investment ("**Master Directions**")² finally carved out an automatic-route regime for cross-border equity share swaps³ ("**Cross Border Swap**") (A share swap is a transaction in which one party exchanges its equity instruments such as shares, convertible securities etc.⁴ for those of another party instead of a cash consideration. In cross-border swaps, entities can exchange equity across jurisdictions while provided they comply with the applicable rules).⁵

Almost overnight, India's non-cash toolkit went from a regulatory grey zone to a conditional green light coinciding with a 14 percent year-on-year jump in the total Foreign Direct Investment ("**FDI**") inflows (from USD 71.28 billion in FY 2023-24 to a provisional USD 81.04 billion in FY 2024-25).⁶

While the regulatory framework has evolved, cross-border share swaps continue to present complex compliance challenges from structuring multi-jurisdictional layers to managing repatriation rules and tax deferral risks.

This article categorizes the different types of cross-border equity swaps, outlines the applicable FEMA and tax compliance requirements, identifies common regulatory pitfalls, and distils key strategic considerations for both inbound and outbound investors.

²RESERVE BANK OF INDIA, MASTER DIRECTION – FOREIGN INVESTMENT IN INDIA, 2018 (as updated Jan. 20, 2025), https://www.rbi.org.in/scripts/bs_viewmasdirections.aspx?id=112200[hereinafter RBI MASTER DIRECTIONS].

³*Updated Master Direction on Foreign Investment in India: Clarifications to the Regulatory Framework*, S&R ASSOCIATES (May 15, 2024), <https://www.snrlaw.in/updated-master-direction-on-foreign-investment-in-india-clarifications-to-the-regulatory-framework/>;

⁴Ritika Agarwal, *Permissibility of Cross-Border Share Swap under Fourth Amendment to NDI Rules*, SCC ONLINE BLOG (Nov. 23, 2024), <https://www.scconline.com/blog/post/2024/11/23/permissibility-of-cross-border-share-swap-under-fourth-amendment-ndi-rules>.

⁵*Cross Border Share Swaps – Made Easier!*, NISHITH DESAI ASSOCIATES, (Aug. 2023), <https://nishithdesai.com/NewsDetails/15121>.

⁶PRESS RELEASE, PRESS INFORMATION BUREAU, FDI Inflows Increased by 14% in 2023–24 Despite Global Slowdown (June 28, 2024), <https://www.pib.gov.in/PressNoteDetails.aspx?ModuleId=3&NoteId=154840&cid=154840>.

II. 2024 FEMA & NDI REFORMS: AUTOMATIC-ROUTE SWAP REGIME

The revised 2024 regime permits an Indian company to issue new shares or transfer existing shares to a foreign investor for equity in the investor's overseas entity without any cash component. This automatic route swap applies provided transactions follow RBI's valuation norms, pricing guidelines and sectoral caps, unlocking a more efficient cross-border deal structure.⁷

A. RULE 9A CASH-FREE SHARE-SWAP MECHANISM

Under Rule 9A of the recently amended FEMA NDI Rules⁸ and the revised Schedule I of FEMA,⁹ Indian companies may swap equity instruments (e.g., shares, convertible debentures etc.)¹⁰ with foreign investors via the automatic FDI route instead of using cash.

All of these amendments have been consolidated in paragraph 7.14 of the Master Directions¹¹ which provides a single, unified text reflecting every change to FEMA and its allied rules. It states:

“The transfer of equity instruments of an Indian company between a person resident in India and a person resident outside India may be by way of—

1) *swap of equity instruments, in compliance with the rules prescribed by the Central Government and the regulations specified by the Reserve Bank from time to time;*

2) *swap of equity capital of a foreign company in compliance with the rules prescribed by the Central Government including the Foreign Exchange Management, (Overseas Investment) Rules, 2022, and the regulations specified by the Reserve Bank from time to time.”¹²*

⁷RBI MASTER DIRECTIONS, *Supra* note 2.

⁸Foreign Exchange Management (Non-Debt instruments) Rules, 2019, Gazette of India, pt. II sec.3(ii), rule 9A (Oct. 17, 2019) [hereinafter FEMA (NON-DEBT INSTRUMENTS) RULES].

⁹Foreign Exchange Management Act, No. 42 of 1999, sch. I (Ind.).

¹⁰FEMA (NON-DEBT INSTRUMENTS) RULES, *Supra* note 8 at r. 2(k).

¹¹RBI MASTER DIRECTIONS, *Supra* note 2.

¹²*Id.*, para 7.14.

In essence, paragraph 7.14¹³ brings both inbound and outbound equity swaps under one roof wherein clause (a) authorises inbound share swaps under the FEMA NDI Rules via the automatic FDI route while clause (b) governs outbound equity swaps under the FEMA (Overseas Investment) Rules, 2022 (“OI Rules”). Both of them subject to the RBI rules and regulations.

B. MANDATORY FDI COMPLIANCE PARAMETERS FOR EQUITY SWAPS

Although no cash changes hands, share for share swaps are governed by the same foreign investment rules under FEMA. To qualify under the automatic FDI route, every transaction must satisfy the following; a) Both the Indian target and the overseas counter-party must operate under the same FDI entry route since a swap cannot be used to “upgrade” into a more favourable sectoral policy;¹⁴ b) the foreign shareholding in the Indian company after accounting for the newly issued or transferred shares must not exceed the sectoral cap specified in the FDI policy;¹⁵ c) Swap ratios must be based on an independent fair-market valuation method prescribed in the Master Directions;¹⁶ d) when the share swap itself creates an indirect foreign investment into another Indian company (for example if the foreign country already holds equity in an Indian subsidiary), that component is treated as a downstream investment under the FEMA (NDI) Rules;¹⁷ e) the filing of the FC-GPR to report the issuance/allotment of shares arising from the swap within 30 days of allotment,¹⁸ the FC-TRS to report transfers of exiting equity instruments within 60 days of the transaction¹⁹ and the Downstream Investment form (DI) to report any kind of downstream investment as soon as the commitment is made.²⁰

¹³*Id.*

¹⁴FEMA (NON-DEBT INSTRUMENTS) RULES, *Supra* note 8, sch. I.

¹⁵RBI MASTER DIRECTIONS, *Supra* note 2, para 5.2.

¹⁶*Id.*, para 8.4.

¹⁷*Id.*, para 9.

¹⁸Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, Gazette of India, pt. II sec. 3(i), Reg. 4(1) (Oct. 17, 2019) [hereinafter FEMA (REPORTING) REGULATIONS].

¹⁹*Id.*, reg. 4(3).

²⁰*Id.*, reg. 4(11).

C. INDEPENDENT VALUATION PROTOCOL UNDER PARA 8.4 OF THE MD

To safeguard fairness and prevent value-shifting, every equity swap transaction must be backed by an independent valuation. Paragraph 8.4 of the Master Directions mandates that regardless of the deal size, the valuation must be conducted by either a SEBI-registered Merchant Banker in India or an Investment Banker registered with the appropriate regulator in the host country.²¹

This report must specify the valuation methodology used (e.g., Discounted Cash Flow, Comparable Company Analysis or the Net Asset Value method), the swap ratio derived therefrom and certify that the transaction was carried out through arms-length. This assists the RBI in verifying that the swap ratio reflects the fair market value.²²

D. REPATRIATION FRAMEWORK & REPORTING OBLIGATIONS

The shares issued under a cross-border share swap are designated as non-repatriable if all the dividends and sale proceeds remain in India. In such cases, the investment is treated as domestic under the FEMA (NDI) Rules. Since there is no inflow of foreign exchange and the transaction does not constitute foreign investment on a repatriable basis, no FC-GPR filing is required. Instead, an FC-TRS must be filed to report the transfer.²³

E. IMPACT OF CROSS-BORDER SWAPS ON FOCC/IOCC STATUS

A cross-border share swap can alter the ownership or control structure of the Indian company involved. This is because under Section 2(27) of the Companies Act, 2013, a company is said to be under “control” if a party has the power to appoint the majority if its directors or influence management and policy decisions.²⁴

²¹RBI MASTER DIRECTIONS, *Supra* note 2, para 5.2.

²²*The importance of adopting the correct approach for share valuation in India*, MAJMUDAR & PARTNERS (Mar. 14, 2023), <https://www.majmudarindia.com/the-importance-of-adopting-the-correct-approach-for-share-valuation-in-india/>.

²³FEMA (REPORTING) REGULATIONS, *Supra* note 18, reg. 4(3).

²⁴The Companies Act, No. 18 of 2013, §2(27) (Ind.).

Concurrently, as per the FEMA (NDI) Rules, if a non-resident acquires more than 50% of the equity or the right to appoint the majority of directors whether directly or through a swap, the entity becomes a Foreign Owned and Controlled Company (“**FOCC**”).²⁵ However, if the foreign ownership/control falls below this threshold due to the swap, the company may continue being an Indian Owned and Controlled Company (“**IOCC**”).²⁶

This analysis matters because FOCC’s making downstream investments are considered as channels of indirect foreign investment which demands an additional filing of the Form DI.²⁷ Also, to avoid unintended reclassification and compliance burdens, parties can structure their shareholders’ agreements to retain the control with either the foreign or the domestic party preserving the intended FOCC or IOCC status post-transaction.

III. KINDS OF CROSS-BORDER SWAPS

Cross-border equity swaps fall into four broad categories defined by (a) whether equity is exchanged on a primary (new-issue) or secondary (existing shares) basis and (b) whether each leg involves Indian or foreign equity under the NDI or the Overseas Investment (“**OI**”) regime.

A. DOMESTIC RESIDENT – NON-RESIDENT SWAP (INBOUND SHARE SWAP)

In the simplest form, a resident Indian shareholder and a non-resident shareholder of two Indian companies can swap existing shares for example Rahul (resident) can exchange his 10 percent stake in TechCo. India for Priya’s (Non-resident) 15 percent holding in PharmaCo. India. This transaction will be governed by the FEMA (NDI) Rules and will qualify under the automatic route (Rule 9A) without RBI approval unless it touches sensitive sectors or land border restrictions. Additionally, the parties must obtain a fair-market valuation from a SEBI registered merchant banker or an equivalent valuer, secure broad

²⁵FEMA (NON-DEBT INSTRUMENTS) RULES, *Supra* note 8, r. 23.

²⁶*Id.*

²⁷FEMA (REPORTING) REGULATIONS, *Supra* note 18, reg. 4(11).

approvals as required under the Companies Act, and file an FC-TRS²⁸ (to report the share transfer) along with the foreign liabilities/assets return (“**FLA**”).²⁹

An example of such a swap is the acquisition of PropTiger by Aurum PropTech, where REA India (non-resident) received shares in Aurum in exchange for its stake in the Indian entity.³⁰

B. FDI-ODI SWAP (OUTBOUND SHARE SWAP)

Under the NDI Rules’ Schedule I(d),³¹ FDI-ODI swaps encompass both primary and secondary issue structures in which Indian and foreign equity are exchanged simultaneously.

In a primary issue or a reverse flip variant here, an Indian company may issue new shares to a foreign investor in exchange for that investor’s equity in a foreign entity.³² For example, IndiaTech Ltd. could issue one million new shares to Global Investment Co. in return for Global Investment’s 20% stake in Germany’s Software GmbH. This primary-issue structure would require board resolutions, fair market valuation, swap-ratio certification and an FC-GPR filing within 30 days³³ since there will be a fresh issuance of shares. Simultaneously, the outbound leg is treated as an outbound direct investment (“**ODI**”) by the foreign investor and must meet bona-fide purpose, pricing and reporting requirements under the OI framework.

On the other hand, in the secondary share variant, an Indian resident swaps shares in an Indian company for equity in an overseas company.³⁴ For instance, Rahul (Resident) may transfer his 8% stake in AutoIndia Ltd. to Maria

²⁸*Id.*, reg. 4(3).

²⁹*Id.*, reg. 4(2).

³⁰Ankit Sharma, *Aurum PropTech acquires 100% stake in PropTiger from REA India in ₹86.45 crore equity swap deal*, ET REALTY (Jul. 23, 2025), <https://realty.economictimes.indiatimes.com/news/allied-industries/aurum-proptech-acquires-proptiger-with-8645-crore-equity-swap/122857613>

³¹Foreign Exchange Management Act, No. 42 of 1999, sch. I (Ind.).

³²*JSA Prism – M&A January 2025: Share Swap*, J SAGAR ASSOCIATES, (Jan. 2025), <https://www.jsalaw.com/wp-content/uploads/2025/01/JSA-Prism-MA-January-2025-Share-Swap.Final43.pdf>.

³³FEMA (REPORTING) REGULATIONS, *Supra* note 18, reg. 4(1).

³⁴J. Sagar Associates, *Supra* note 32

(Non-Resident) in exchange for her 5% interest in United States based Auto World Inc. The Indian equity leg in this transaction will be classified as an NDI transaction while the foreign equity leg falls under the India's OI rules. Importantly, the Indian company must ensure it remains within 100% FDI limits or secure government approval if not.³⁵ Lastly, the Indian leg needs to comply with the arms-length valuation and file the FC-TRS while the resident investor must report its outbound investment under the OI reporting norms.

A classic example of such a swap are first; the 2024 merger of Bharti Airtel Lanka with Dialog Axiata where the latter's Sri Lankan arm acquired 100% of Airtel Lanka and issued 10.355% of its shares to Bharti Airtel in return, The deal involved Airtel receiving foreign equity making it an outbound investment under the ODI rules. Simultaneously, Dialog's acquisition of Airtel Lanka qualified as inbound FDI, subject to local valuation and regulatory compliance.³⁶

Second; EaseMyTrip's pledge and Planet deals where EaseMyTrip issued fresh Indian equity to non-resident shareholders (inbound FDI) in exchange for acquiring equity in foreign companies (outbound ODI).³⁷

C. ODI-ODI SWAP (OUTBOUND SHARE SWAP)

Under Schedule I of the OI Rules, an Indian company may undertake outbound investment by way of a swap of securities when it trades its existing equity capital in foreign entity for equity capital in another.³⁸ Although the rules do not expressly use the term "swap of equity capital", a purposive interpretation of "securities" has been endorsed to facilitate such structures.³⁹ For example, an Indian parent (Company A) holding shares in Foreign Co. X

³⁵RBI MASTER DIRECTIONS, *Supra* note 2, para 3.

³⁶Reuters, *Dialog Axiata to buy Bharti Airtel's telecom operations in Sri Lanka*, REUTERS (Apr. 18, 2024), <https://www.reuters.com/business/media-telecom/dialog-axiata-buy-bharti-airtels-telecom-operations-sri-lanka-2024-04-18/>.

³⁷*EaseMyTrip will acquire 49% stake in the Dubai-based Pflge Home Healthcare*, NDTV PROFIT (Sept. 17, 2024), <https://www.ndtvprofit.com/business/easemytrip-to-acquire-49-stake-in-pflege-home-healthcare-30-in-rollins-international>.

³⁸Foreign Exchange Management (Overseas Investment) Regulations, 2022, Gazette of India, pt. III sec. 4, sch. I (Aug. 22, 2022).

³⁹J. Sagar Associates, *Supra* note 32.

can transfer that equity to Foreign Co. Y as consideration for the newly issued shares in Foreign Co. Y.

Similarly, Company A can similarly transfer its equity in Foreign Co. X to acquire newly issued shares in another overseas affiliate or subsidiary as long as the proposed swap remains within the prescribed sectoral ceilings and overall ODI limits.

Each of these transactions must be authorised by a board resolution supported by an independent fair-valuation⁴⁰ and reported to the RBI via the requisite ODI filing.

D. THREE-PARTY MULTILATERAL SWAP (INBOUND AND OUTBOUND SHARE SWAP)

Multilateral swaps where three or more parties exchange equity in a single circular transaction are not explicitly provided for in FEMA. These deals are implemented as a series of back to back bilateral swaps.⁴¹ Suppose Company A (India) wants B's (non-resident) foreign shares via an intermediary Resident C, each of these swaps (A ↔ C and C ↔ B) must independently comply with the relevant NDI and OI rules, secure valuations, observe sectoral caps and complete the requisite RBI filings. Due to the added complexity, three-party structures are rare and demand careful co-ordination of all legs to avoid inadvertent non-compliance.

Despite the regulatory clarity under the 2024 NDI and ODI rule amendments, there has not yet been a publicly disclosed deal of an Indian company executing a pure ODI-ODI swap or a Multilateral swap.

IV. REGULATORY AND TRANSACTIONAL COMPLIANCE FOR CROSS-BORDER SWAPS UNDER FEMA AND NDI

Cross-border share for share swap trigger multiple overlapping compliance regimes in India. Practitioners are required to juggle FEMA rules, RBI reporting, corporate law approvals, taxation and sectoral restrictions. The

⁴⁰RBI MASTER DIRECTIONS, *Supra* note 2, para 8.4.

⁴¹Nishith Desai Associates, *Supra* note 5.

following section organises these requirements into key “compliance pillars” to guide swaps involving Indian companies and foreign investors. Each pillar below outlines the critical rules and procedures.

A. FAIR-VALUE VALUATION

Under the Master Directions, any issue or transfer of equity to a person resident abroad must be at an arm’s length price (not less than the fair market value).⁴² For listed issuers, the issue price must meet SEBI’s pricing formulae⁴³ while for unlisted companies, the fair value is determined by discounted cash-flow or other accepted methods.⁴⁴ Lastly, the transaction price must be certified by a SEBI-registered Category I merchant banker or for smaller deals, a chartered or cost accountant to preclude unwarranted regulatory scrutiny and allegations of round-tripping.⁴⁵ For instance, EaseMyTrip’s 2025 share swap with Pledge Home (Dubai) was structured at ₹19.83 crore for existing shares and ₹10 crore for new issuance based on a Category I banker’s valuation.⁴⁶

B. RBI FILINGS AND DEADLINES

All inward equity investments and transfers are reported via RBI’s FIRMS portal under the Single Master Form regime. Fresh issuances require Form FC-GPR to be filed within 30 days of the share allotment within 30 days⁴⁷ while share transfers both repatriable or non-repatriable require Form FC-TRS to be filed in 60 days of the remittance and transaction respectively.⁴⁸ Downstream Investments by Indian entities must be furnished via Form DI within 30 days of the allotment.⁴⁹ Finally, all entities should file an annual FLA return by July 15, failure of which would attract compounding penalties.⁵⁰

⁴²RBI MASTER DIRECTIONS, *Supra* note 2, para 8.4.

⁴³*Id.*, para 8.1.1.

⁴⁴*Id.*

⁴⁵*Id.*, para 8.2(c).

⁴⁶NDTV Profit, *Supra* note 37.

⁴⁷FEMA (REPORTING) REGULATIONS, *Supra* note 18, reg. 4(1).

⁴⁸*Id.*, reg. 4(3).

⁴⁹*Id.*, reg. 4(11).

⁵⁰*Id.*, reg. 4(2).

C. REPATRIATION AND FOREX TREATMENT

RBI categorises foreign investments as either repatriable or non-repatriable. The former carries full rights to remit sale proceeds and dividends abroad and is counted as FDI for reporting. By contrast, issues to NRIs/OCIs on a non-repatriable basis are treated on par with domestic capital and not as foreign investment for the purposes of FEMA. This distinction affects compliance because converting an NRI's non-repatriable holding into a repatriable one triggers an FC-TRS⁵¹ filing since it effectively turns what was treated as domestic funds into foreign capital. Hence, shares issued on a non-repatriable basis need not be reported as FDI in the FLA form⁵² while shares on a repatriable basis need to be. Moreover it is the choice of the parties to denominate the shares in a transaction as repatriable to treat it as a FDI and others as non-repatriable to use the domestic treatment.⁵³

D. CORPORATE APPROVALS AND DISCLOSURES

Alongside FEMA filings, standard Indian corporate law procedures would also apply. Indian corporate law mandates board and shareholder approvals for any equity issuance or transfer. The board first sanctions the proposed share swap or capital increase, if authorized capital must be raised, an Extraordinary General Meeting is convened and shareholders pass ordinary or special resolutions under Sections 62⁵⁴ and 14⁵⁵ of the Companies Act, 2013. Following shareholder sanction, the board approves allotment and the company is required to file the following e-forms: MGT-14 to record special resolutions and SH-7 to register capital increases (both within 30 days), and PAS-3 to report the allotment (within 30 days for public offers or 15 days for private placements).⁵⁶

⁵¹*Id.*, reg. 4(3).

⁵²*Id.*, reg. 4(2).

⁵³*Cross-Border Share Swaps: Amendments to Regulatory Framework*, S&R ASSOCIATES (Sept. 12, 2024), <https://www.snrlaw.in/cross-border-share-swaps-amendments-to-regulatory-framework/>.

⁵⁴The Companies Act, No. 18 of 2013, §62 (Ind.).

⁵⁵*Id.*, §14.

⁵⁶S&R Associates, *Supra* note 53.

E. TAX AND STRUCTURING IMPLICATIONS

Cross-border swaps trigger tax considerations such as 56(2)(vii)(b) of the Income tax Act taxes any share premium received by an unlisted Indian company above the fair market value of shares.⁵⁷ This is even from non-resident investors. On the other hand, if the shares are transferred for below the fair market value, section 50CA can deem the sale price to be the fair market value for computing the capital gains.⁵⁸ Long-term capital gains on listed equity are taxed at 10% (above a ₹1 lakh exemption)⁵⁹ and on unlisted equity at 20%,⁶⁰ while short-term equity gains are taxed at 15% (if STT is paid) or 30% otherwise.⁶¹

Lastly, the swap can create cross border tax events such as EaseMyTrip's transactions (49.03% Pflge and 49% Planet) involved overseas sellers in Dubai and Australia disposing of shares in-kind which created local capital gains obligations in those jurisdictions.⁶²

V. DEAL BREAKER PITFALLS

India's FEMA and NDI regulatory frameworks provide clear pathways for structuring cross-border share swaps however practical implementation often reveals critical compliance pitfalls that can derail a transaction. These issues frequently arise from operational oversights in classification, structuring or reporting. Specifically, there are three key deal-breakers; breaches of indirect foreign investment caps through downstream acquisitions, misidentification of an Indian entity's ownership or control status (FOCC v. IOCC) and failure to correctly handle deferred consideration structures such as earn-outs and escrows. Each of these can trigger regulatory violations invalidating the swap.

⁵⁷Income-tax Act, No. 43 of 1961, §56(2)(vii)(b) (Ind.).

⁵⁸*Id.*, §50CA.

⁵⁹*Id.*, §112A.

⁶⁰*Id.*, §112(1)(c).

⁶¹*Id.*, §111A.

⁶²NDTV Profit, *Supra* note 37.

A. INDIRECT INVESTMENT CAP BREACH

A downstream share-swap can unintentionally push a group's cumulative foreign equity beyond the sectoral limits violating the FEMA and FDI caps. The guiding principle of the Master Directions that is “what cannot be done directly shall not be done indirectly” would bar a transaction from going through if these sectoral limits are breached.⁶³

B. MISREADING THE CONTROL THRESHOLD

Another pitfall is misclassifying the investee company as an IOCC⁶⁴ or a FOCC⁶⁵ because this may create multiple compliance issues for example, an FOCC must follow the indirect investment rules i.e. report through Form DI⁶⁶ upon status change whereas an IOCC would follow the standard NDI rules. It is important to note that if foreign investors effectively control the board or own a majority stake, it as an FOCC, otherwise it will be classified as an IOCC.⁶⁷ A misread 50% test (covering both share capital and director-appointment right) can lead to the wrong filings (e.g. FC-GPR vs. FC-TRS, Form DI, etc.) and regulatory route.

C. DEFERRED PAYMENT TRANCHING

Deferred considerations such as earn outs, escrows, milestone payments must be treated as separate investment tranches under FEMA.⁶⁸ While RBI's 18-25 rule allows up to 25% of downstream investment to be paid over 18 months,⁶⁹ each release of held-back funds is deemed as a fresh equity allotment or transfer.⁷⁰ Consequently, the investee must obtain a new fair-value

⁶³*FAQs on Downstream Investment*, NISHITH DESAI ASSOCIATES, (Nov. 2024), https://www.nishithdesai.com/fileadmin/user_upload/pdfs/research_Papers/FAQs-on-Downstream-Investment.pdf.

⁶⁴FEMA (NON-DEBT INSTRUMENTS) RULES, *Supra* note 8, r. 23.

⁶⁵*Id.*

⁶⁶FEMA (REPORTING) REGULATIONS, *Supra* note 18, reg. 4(11).

⁶⁷FEMA (NON-DEBT INSTRUMENTS) RULES, *Supra* note 8, r. 23.

⁶⁸S&R Associates, *Supra* note 53.

⁶⁹RBI MASTER DIRECTIONS, *Supra* note 2, para 7.12.

⁷⁰FEMA (NON-DEBT INSTRUMENTS) RULES, *Supra* note 8, r. 9A(7).

certification and file the appropriate FC-GPR⁷¹ or FC-TRS⁷² for each drawdown. Failure to re-value or re-file for every instalment can breach pricing and reporting norms, stripping away the deferral exemption and exposing the parties to penalties.

VI. POLICY RECOMMENDATIONS

Cross-border share swaps can turn out to be multi layered giving rise to a number of obligations and so legal advisors should conduct a rigorous end to end mapping of FOCC v. IOCC status, control thresholds and downstream investment ceilings at the very outset. There should also be processes in place for aggregating primary and secondary foreign equity and co-ordinating FC-GPR and FC-TRS filings within the statutory timelines.

Additionally, there should also be a dedicated share-swap FAQ or annexure to the Master Directions with scenario-based examples to guide investors and practitioners through structuring challenges.

Lastly, from a corporate governance perspective, the RBI could append to its Master Directions a model board resolution approving cross-border swaps alongside a sample shareholders' agreement clause that addresses valuation certification, control-threshold definitions and downstream investment limits.

VII. CONCLUSION

The 2024 amendments to the FEMA (NDI) Rules and the Master Directions now expressly permit cross-border share for share swaps under the automatic FDI route. Companies may exchange equity whether through new issue “reverse flips” or secondary transfers without any upfront cash provided they secure board and shareholder approvals under the Companies Act, an independent arm's length valuation (Master Directions rule 8.4) and classify shares correctly as repatriable or non-repatriable to trigger the appropriate FC-GPR or the FC-TRS filing respectively.

⁷¹FEMA (REPORTING) REGULATIONS, *Supra* note 18, reg. 4(1).

⁷²*Id.*, reg. 4(3).

Importantly, a thorough post-swap review of control thresholds is essential to avoid an unintended FOCC/IOCC status change or any downstream obligations that may arise.

By structuring these transactions around five key compliance pillars i.e. fair valuation, RBI filings, forex treatment, corporate approvals and tax obligations and by guarding against cap breaches, control-threshold errors and earn out tranching risks, practitioners can execute fully compliant and cost-effective equity swaps.

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