



COMPETITIVE NEUTRALITY IN CORPORATE GOVERNANCE NORMS FOR CPSEs

CORPORATE GOVERNANCE DIRECTORS EXEMPTIONS
RELATED PARTY TRANSACTIONS CPSES GOVERNMENT COMPANIES CPSES
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Acknowledgements

This Report is an independent, non-commissioned piece of academic work.

The authors would like to thank Sumit Bose, Former Finance Secretary, Government of India, Dr. Umakanth Varottil, Associate Professor of Law at National University of Singapore, J. N. Gupta, Founder and Managing Director of Stakeholder Empowerment Services, Mumbai, Suyash Rai, Senior Consultant, National Institute of Public Finance and Policy, New Delhi, and Shehnaz Ahmed, Senior Research Fellow at Vidhi Centre for Legal Policy, New Delhi for their comments on an earlier draft of this Report. The authors are also thankful to Vidhi interns - Yash Maheshwari, Siddharth Sonkar and Mansvini Jain for their assistance.

Errors, if any, are the authors' alone.

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Executive Summary

Globally, State Owned Enterprises (“SOEs”) are important because their activities are significant in diverse ways to their domestic economies. However, despite their considerable clout, the governance of SOEs is often fraught with distinct challenges due to the dual role of the State as the policy maker as well as owner. Not surprisingly, State ownership in SOEs gives rise to multiple corporate governance issues. This Report focuses on one such corporate governance issue - the lack of competitive neutrality between SOEs and their private sector counterparts.

There are several forms in which the lack of competitive neutrality manifests in SOEs, such as subsidies, easier access to credit, etc.; however, this Report focuses on ‘statutory exemptions’ from corporate governance provisions granted to government companies¹ (as defined in the Companies Act, 2013 (“Companies Act”)) where the direct holding of the Central Government or of other Central Public Sector Enterprises (“CPSEs”) is 51% or more,² as an indicator for the lack of competitive neutrality.

An analysis of the legal and regulatory framework applicable to CPSEs in India *vis-à-vis* the principle of competitive neutrality reveals that considerable exemptions have been granted to CPSEs in terms of company law, securities regulation and competition law. A detailed legal matrix highlighting this is provided in **Annexure A** to this Report. In some situations, an alternative framework is prescribed by the State for CPSEs; however, as discussed in **Annexure A**, enforcement of the alternative framework remains far from desirable. In this backdrop, this Report also discusses a few case studies, conducted using publicly available sources, to demonstrate a correlation between the statutory exemptions granted to CPSEs and the reported lapses in corporate governance in such CPSEs.

Having highlighted the problem, Chapter V of the Report attempts to present possible solutions by discussing the regulatory framework for SOE governance in selected jurisdictions such as Norway, Singapore and Brazil. Best practices from these jurisdictions are discussed in order to enable the formulation of alternative regulatory frameworks, where competitive neutrality plays a vital role in enabling CPSEs to achieve excellence and set standards of good corporate governance.

The Report concludes with suggested Next Steps which pave the way forward for enhancing corporate governance standards in CPSEs. We hope that the Report and its recommendations will provide policy-makers with a greater understanding of what ails CPSEs and help in arriving at a distinctive Indian model of SOE governance in the future, which by being competitively neutral, will help CPSEs unleash their true potential. The ultimate beneficiaries of ensuring compliance with robust corporate governance norms by CPSEs shall be Indian taxpayers as well as direct stakeholders of the CPSEs such as its shareholders, employees and directors. This holds true even in light of the disinvestment plan of the government, since one of the keys to securing a good valuation for the State's stake in CPSEs is to make the CPSE a lucrative and promising buy for the next owner.

¹ A government company is defined in Section 2(45) of the Companies Act to mean ‘any company in which not less than 51% of the paid up share is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such company’.

² Department of Public Enterprises, Ministry of Heavy Industries and Public Enterprises, Government of India, ‘The Public Enterprises Survey 2016-17: Annual Report on the performances of Central Public Sector Enterprises’ pg. 1, <<https://dpe.gov.in/sites/default/files/PE%20ENG%20Volume-1%20FINAL%20web.pdf>>, accessed on 19 May 2018. This Report also confines itself to the said definition of CPSEs.

I. Introduction

Historically, the State has been '*in the business of business*' for a long time. Some people believe that the financial crisis in 2008 marked the '*return of the State*' in business.³ Business ventures undertaken by the State are globally referred to as SOEs. A 2016 study by the Organisation for Economic Co-operation and Development ("OECD") states that an estimated 22% of the world's largest 100 companies are effectively under State control.⁴ They are spread across various sectors of the economy and their performance is generally of great importance to broad segments of the population. The rationale for the existence of SOEs stems from a complex mix of social, economic and political factors which this Report does not aim to delve into.



Figure 1: The role of SOEs in world economy⁵

In terms of governance, SOEs face distinct challenges. If the State is a passive owner, then managerial agency problems will prevail and SOEs may endure managerial slack and tunnelling (theft of corporate assets). If the State is an actively engaged shareholder, managerial agency problems may reduce; however, the costs of reducing potential abuse by the controlling shareholder may rise.⁶ Moreover, corporate governance problems become more severe in case of

³ The French President, Nicolas Sarkozy in 2010 had argued that a distinguishing feature of the 2008 financial crisis was the '*return of the State, the end of the ideology of public powerlessness*'. See, 'Leviathan stirs again', (*The Economist*, 21 January 2010), <<https://www.economist.com/node/15328727>>, accessed on 21 February 2018.

⁴ OECD, State-owned Enterprises as Global Competitors – A Challenge or an Opportunity, (2016), pg. 13, <https://read.oecd-ilibrary.org/finance-and-investment/state-owned-enterprises-as-global-competitors_9789264262096-en#page1>, accessed on 21 February 2018.

⁵ OECD, The Size and Sectoral Distribution of State-owned enterprises, (2017). <https://read.oecd-ilibrary.org/governance/the-size-and-sectoral-distribution-of-state-owned-enterprises_9789264280663-en#page1>, accessed on 27 May 2018.

⁶ Curtis J. Milhaupt & Mariana Pargendler, 'Governance challenges of Listed State-owned Enterprises around the World: National Experiences and a framework for Reform', (2017) European Corporate Governance Institute, Law Working Paper N° 352/2017, pg. 05-06, <http://www.ecgi.global/sites/default/files/working_papers/documents/3522017.pdf>, accessed on 21 January 2018.

SOEs due to an absence of market check on managerial agency costs owing to (a) the lack of operation of the market for corporate control through hostile takeovers; and (b) the implicit sovereign guarantee that undermines the threat of insolvency.⁷

The State may also obtain a disproportionate share of SOE returns at the cost of minority shareholders by way of corruption and cronyism, often referred to as '*pecuniary private benefits of control*'.⁸ But with respect to SOEs, the greater threat is that the State may exert '*non-pecuniary private benefits of control*' or '*political*' private benefits of control by using SOEs to further its public policy objectives.⁹ Examples of exercise of non-pecuniary private benefits of control include cases such as that of Coal India Limited ("**Coal India**"), a SOE in India which supplied coal below market prices, becoming the subject of a campaign by a UK hedge fund, which was its second largest shareholder¹⁰ and Oil & Natural Gas Corporation ("**ONGC**"), an Indian SOE operating in the petroleum sector, wherein 90% of its cash reserves were eroded due to certain government decisions imposed on ONGC, including the direction to purchase a majority stake,¹¹ in Hindustan Petroleum Corporation Limited ("**HPCL**"), from the Central Government.

Moreover, the role of the State as a market player as well as the regulator could potentially create a problem of duality, which is undesirable from a perception standpoint. This is especially so if the State prescribes laxer norms for its own enterprises compared to private firms when in fact, the State must set an example by requiring SOEs to comply with higher order norms, which private firms would then aspire to adhere to.

In this backdrop, it becomes imperative to adopt a framework that is competitively neutral and includes robust corporate governance laws and strong legal and political institutions to implement them. Such a framework is one of the primary mechanisms to mitigate agency costs and the inherent conflict of interest in SOE governance.¹² While aspects of SOE corporate governance such as the composition of the board of directors, ownership structure, protection of minority shareholders, etc. are often discussed, the importance of competitive neutrality as a key corporate governance contributory for SOEs is often neglected. Competitive neutrality denotes the importance for the State to maintain a non-discriminatory legal and regulatory policy in order to allow the private sector to mature in an economy. Recognising the importance of competitive neutrality, the OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 (the "**OECD Guidelines**") state that "*consistent with the rationale for state ownership, the legal and*

⁷ *Ibid.*

⁸ *Ibid.*

⁹ Curtis J. Milhaupt & Mariana Pargendler, 'RPTs in SOEs: Tunnelling, Propping, and Policy Channelling', (2018) European Corporate Governance Institute, Law Working Paper N° 386/2018, pg. 05, <http://www.ecgi.global/sites/default/files/working_papers/documents/finalmilhauptpargendler.pdf> accessed on 28 May 2018.

¹⁰ James Crabtree & Sam Jones, 'TCI Threat Against Coal India', (*Financial Times*, 13 March, 2012), <<https://www.ft.com/content/7e70ca02-6d12-11e1-ab1a-00144feab49a>>, accessed on 30 May 2018. Quoting a senior official of the UK hedge fund TCI: "We believe they [Coal India] are destroying value. When you list a company you can't treat it like a government body."

¹¹ Saket Sundaria & Debjit Chakraborty, 'India's ONGC is bleeding cash', (*Bloomberg Quint*, 11 June 2018), <<https://www.bloombergquint.com/markets/2018/06/11/once-cash-rich-india-s-demands-erode-90-of-ongc-s-warchest>>, accessed on 12 June 2018.

¹² *Governance challenges of Listed State-owned Enterprises*, (n. 06).

regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities".¹³

Some of the obvious benefits of introducing competitive neutrality in the legal framework applicable to SOEs and their private sector counterparts are as follows:

- (a) reduction in agency costs between the majority shareholder (the State) and minority shareholders (particularly in case of listed SOEs) and adequate protection of minority shareholder rights;¹⁴
- (b) raising the governance standards applicable to SOEs and ensuring due enforcement of these standards which in turn will improve their competitiveness and enable them to achieve higher levels of transparency and accountability;¹⁵
- (c) creating a market-driven model of governance for SOEs shall unlock value and assist Central Government in its disinvestment goals¹⁶ (more importantly, in case of partial disinvestment);
- (d) weeding out archaic exemptions which serve no purpose;
- (e) generating a positive signalling effect for the government as it will hold companies owned by it to the same standards as privately held companies. This in turn may have several consequential advantages such as increased flow of foreign as well as domestic investment in SOEs; and
- (f) with increased adherence to corporate governance norms (including enhanced disclosures, penalties, etc.) the liability of the government as an owner will become less onerous.

This Report begins by analysing the legal and regulatory framework applicable to CPSEs in India vis-à-vis the principle of competitive neutrality under the OECD Guidelines. A detailed analysis of the key exemptions available to CPSEs and the resultant regulatory lapses and violations has been captured in **Annexure A** to this Report. In this backdrop, the Report also discusses certain case studies that demonstrate the negative consequences of continuing with *status quo*. In the latter part, the Report discusses international experience in countries like Singapore, Norway and Brazil and the distinct features of their legal regime governing SOEs. The Report culminates by providing suggested Next Steps to improve corporate governance in CPSEs from a competitive neutrality standpoint.

¹³ OECD Guidelines On Corporate Governance of State Owned Enterprises (2015), pg. 20, <https://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en>,accessed on 30 March 2018.

¹⁴ *Governance challenges of Listed State-owned Enterprises*, (n. 06).

¹⁵ Lalitha Som, 'Corporate Governance of Public Sector Enterprises in India', (2013), Money & Finance, ICRA Bulletin,<https://www.researchgate.net/publication/319482540_Corporate_Governance_of_Public_Sector_Enterprises_in_India>, accessed on 09 June 2018.

¹⁶ Bhargavi Zaveri, 'The State in Business and the Business of Regulation', (July 2016), Economic & Political Weekly, pg. 19-21. See also, Bhargavi Zaveri, 'The State in Business and the Business of Regulation', IndiaCorpLaw Blog, 31 July 2016, <<https://indiacorplaw.in/2016/07/the-state-in-business-and-business-of.html>>, accessed on 28 May 2018.

II. Legal and Regulatory Framework governing CPSEs in India

The government owns entities across various sectors of the Indian economy. These entities are owned by the Central Government and/ or the State Government/s. As a starting point for discussion, this Report only focuses on entities owned by the Central Government i.e. CPSEs. However, it must be emphasized that several government companies owned by State Government/s are also significant players in the market and a similar study may be undertaken for them in the future.

CPSEs have been at the heart of India's mixed-economy model and industrialisation policy.¹⁷ A recent OECD study (2017) states that India has 270 CPSEs with a combined enterprise value of USD 338.5 billion.¹⁸ These 270 CPSEs can be classified as majority-owned listed entities (68), majority owned unlisted entities (198) and statutory corporations (4).¹⁹ A majority of these CPSEs are engaged in the manufacturing and finance sector. While we briefly touch upon Public Sector Banks ("PSBs") and their legal framework, this Report does not delve into details regarding CPSEs engaged in the financial sector including such PSBs and Public Sector Insurance Companies ("PBICs") among others since they operate with a distinct purpose and have unique corporate governance concerns.²⁰

Broadly, CPSEs in India are regulated by their respective administrative ministries, which enters into a Memorandum of Understanding ("MoU") with the CPSE to exercise control on behalf of the Central Government. Additionally, the Department of Public Enterprises, Ministry of Heavy Industries and Public Enterprises, Government of India ("DPE") has also issued certain guidelines in relation to the '*coordination of matters of general policy affecting all CPSEs, evaluation and monitoring the performance of CPSEs, including the MoU mechanism*'.²¹

CPSEs are organised as separate legal entities, either incorporated under the Companies Act or under a special statute. Thus, the Companies Act which applies to all companies in India, is also generally applicable to CPSEs, albeit with certain alterations.²² For example, DPE, being the nodal ministry for developing a '*general policy*' for CPSEs has issued separate guidelines in relation to various corporate governance aspects in the form of Guidelines on Corporate Governance of Public Sector Enterprises ("Guidelines")²³ for CPSEs. The Guidelines cover issues such as the composition of the board of directors ("Board"), their appointment and remuneration, MoUs to be entered into by CPSEs with their respective administrative ministries, performance evaluation of CPSEs and so on. In addition, the securities market regulator, Securities and Exchange Board of

¹⁷ Rajesh Chakrabarti, William L. Megginson, and Pradeep K. Yadav, 'Corporate Governance in India', (2008) 20 Journal of Applied Corporate Finance 1, pg. 59-72, <<https://ssrn.com/abstract=1115534>>, accessed on 20 May 2018.

¹⁸ OECD, *The Size and Sectoral Distribution of State-owned enterprises*, (2017), (n.05).

¹⁹ *Ibid.*

²⁰ Lalita Som, 'Corporate Governance in Public Sector Banks', (2016), Money & Finance, ICRA Bulletin, pg. 60, <https://www.researchgate.net/publication/313105401_Corporate_Governance_of_Public_Sector_Banks_in_India>, accessed on 25 May 2018.

²¹ 'About Department of Public Enterprises', <<https://dpe.gov.in/about-us/about-department>>, accessed on 25 May 2018.

²² Section 1(4) of the Companies Act.

²³ Guidelines on Corporate Governance for CPSEs, 2010, <<https://dpe.gov.in/publications/guidelines-corporate-governance-cpses-2010>>, accessed on 05 June 2018; Guidelines were issued in June 2007 on an experimental basis and was earlier voluntary in nature, however, DPE made it mandatory for CPSEs to adhere to the Guidelines on 14 May 2010. Please note CPSEs have not been defined by virtue of a statute or the Guidelines. However, for the purposes of our analysis we aim to cover all CPSEs i.e. companies where the direct holding of the Central Government or of other CPSEs is 51% or more (Source: www.bsepsu.com) which fall within the ambit of the Guidelines, excluding PSBs and PBICs.

India (“**SEBI**”) has issued several regulations which apply to listed CPSEs. Further, decisions of CPSEs that have a potential anti-trust impact are governed by provisions of the Competition Act, 2002 (“**Competition Act**”).

We have set forth a legal matrix in **Annexure A** that tabulates, the various laws applicable to companies in India and highlights the exemption from these laws provided to CPSEs. In certain cases, DPE provides an alternate framework in the form of the Guidelines but accountability under such framework is questionable. The underlying aim of the legal matrix in **Annexure A** is to drive home the lack of competitive neutrality in the corporate governance framework applicable to CPSEs vis-à-vis non-government owned companies. Illustrations of the negative impact of exemptions have also been provided, wherever available.

III. Exemptions to CPSEs: Disquieting the level-playing field

A study of **Annexure A** reveals that while *prima-facie* the regulatory framework applicable to CPSEs is the same as that applicable to non-government companies, there are certain key dispensations provided to CPSEs including important exemptions under company law, securities law and competition law. Thus, the lack of a competitively neutral corporate governance framework for CPSEs is not moot.

By way of a snapshot of our findings in **Annexure A**, the key exemptions to CPSEs under the company law framework include exemption from the following:²⁴

- (a) disclosure of the company's policy on appointment and remuneration of directors;
- (b) disclosure of a statement indicating the manner of annual performance evaluation of individual directors;
- (c) determination of '*relevant experience and expertise*' in relation to the appointment of Independent Directors;
- (d) disqualification of directors for non-submission of financial statements or annual returns for a continuous period of three financial years or failure to repay deposits, redeem debentures or pay dividend declared by the company for a period of over one year;
- (e) providing loans and guarantees or security to certain persons;
- (f) seeking shareholder approval in case of related party transactions between two government companies; and
- (g) appointment process of key managerial personnel.

CPSEs are also exempt from key securities law requirements including:²⁵

- (a) the minimum 25% public shareholding requirement by way of differing the application of this rule; and
- (b) listed CPSEs have been exempted, on a case to case basis, from the open offer requirement in case of substantial share acquisition.

Additionally, the general power to exempt entities under the Competition Act has been exercised to exempt CPSEs engaged in the oil and gas sector and the financial sector.²⁶

Please refer to **Annexure A** for details of the legal landscape applicable to CPSEs, the nature and source of exemptions and the alternative legal landscape applicable to CPSEs. In the remarks

²⁴ Please refer to Table 1 in Annexure A for a detailed analysis regarding exemptions to CPSEs under the company law framework.

²⁵ Please refer to Table 1 in Annexure A for a detailed analysis regarding exemptions to CPSEs under securities law.

²⁶ Please refer to Table 1 in Annexure A for a detailed analysis regarding exemptions to CPSEs under the Competition Act. Please note that the exemptions under the Competition Act do not strictly pertain to corporate governance, however, these have been included in Annexure A to illustrate the broader lack of competitive neutrality in compliance requirements for CPSEs and non-CPSEs.

section of **Annexure A**, we discuss how these exemptions affect the overall corporate governance framework for CPSEs. This section also highlights examples of non-compliance with the applicable alternative framework by CPSEs.

Recognizing the pitfalls of the lack of competitive neutrality in the governance framework for SOEs, the OECD Guidelines have advocated that '*as a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations*' and '*laws and regulations should not unduly discriminate between SOEs and their market competitors*'.²⁷ The OECD Guidelines also state that there are nations which provide exemptions to SOEs from the application of certain laws and regulations, which '*generally must be avoided*' and where they exist, they should be '*limited and transparent*'.²⁸ Further, the OECD Guidelines recommend that SOEs, to the extent possible, should '*adhere to the policies underpinning those laws and regulations*'.²⁹

Thus, if these exemptions exist, it is important to understand the rationale behind such exemptions. An OECD Paper provides the plausible rationale for instances when the State may depart from the principle of competitive neutrality as follows:

- (a) when SOEs are engaged in maintaining public service obligations such as postal services or telecommunications services in outlying areas, providing essential services at affordable cost, etc.;
- (b) when SOEs are assumed to be key drivers of the industrial policy i.e. they are assigned a pro-active role in the economy in order to develop certain capabilities or pursue knowledge and technologies in the broader national interest;
- (c) when profits from SOEs would be providing significant fiscal support to the State exchequer; and
- (d) when the political economy behind SOEs due to which various interest groups or general public may pressurise the State to put in place protectionist policies to protect their vested interests, for e.g. closure of loss-making SOEs may not be viewed positively since SOEs contribute towards employment.³⁰

Importantly, the OECD Paper concludes by stating that "*if the SOEs are engaging in purely commercial activity without any justifiable public policy objectives, providing relaxations to such SOEs could severely distort competition*".³¹

In the Indian context, there is a dearth of literature which in a general sense provides the rationale for the exemptions afforded to CPSEs. One of the many reasons could be that post liberalisation of the Indian economy in 1991, just as CPSEs remained '*remnants of a planned economy*' expected

²⁷ *OECD Guidelines*, Annotations to Chapter III: State-owned Enterprises in the marketplace, pg. 45, (n. 13).

²⁸ *Ibid*, pg. 47.

²⁹ *Ibid*.

³⁰ Antonio Capobianco and Hans Christiansen, 'Competitive Neutrality and State-owned Enterprises: Challenges and Policy Options', *OECD Corporate Governance Working Paper No. 1* (2011), pg. 7, <<https://www.oecd-ilibrary.org/docserver/5kg9xfgidhg6-en.pdf?expires=1530781988&id=id&accname=guest&checksum=B7459B449D7E1B3E2C93FE9E838A4193>>, accessed on 26 May 2018.

³¹ Ines Willemyns, 'Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?', *Journal of International Economic Law*, pg. 660, <<https://academic.oup.com/jiel/article/19/3/657/1751149>>, accessed on 27 May 2018.

to act as national champions, the exemptions also remained in the statute book as ‘*remnants of a planned economy*’ with an aim to facilitate their functions.³² One may also argue that exemptions to CPSEs from the mainstream legal framework is also because of the other onerous requirements that CPSEs are required to adhere such as audit by the Comptroller and Auditor General of India or mandatory dividend payment requirements. Further, an alternative framework in the form of the Guidelines has been put in place but details of enforcement of the Guidelines remain sketchy at best. Additionally, economic underpinnings (including contribution of CPSEs to the budget of the Central Government) of developing and nurturing CPSEs as industrial giants in strategic sectors of the Indian economy may also have driven the State to provide exemptions in favour of CPSEs. Lastly, the social and political motivations behind maintaining *status quo* regarding corporate governance exemptions to CPSEs cannot be ignored.

The J. J. Irani Committee Report (2005) (“**Irani Report**”) in relation to exemptions provided to government companies under company law, states as under:³³

“In general, there is little justification for Government companies being provided relaxations in compliance with company law. It is even less if such companies are listed. Not only should such Government companies be able to compete in the market economy with other companies on equal terms, it would not be fair to the investors or creditors if such entities are allowed to present their performance on the basis of dissimilar parameters.”

Government companies may be subject to imposition of non-commercial/ commercially unviable social responsibilities. In this regard, the Irani Report noted that “*costs of such responsibilities should be transparently assessed and provided by the Government through the budget as a subsidy*”.³⁴ The Irani Report stated that “*it is not appropriate that application of the law or standards be relaxed to allow such costs to be incurred in a non-transparent manner*.³⁵”

Further, the Irani Report also assessed that companies may be granted special treatment if they are engaged in activities related to security of the State. However, it also remarked that “*other companies, engaging in commercial activity should compete on the basis of transparency and level playing fields. Preferential treatment to such companies would be to the detriment to the capacity of Indian companies to survive in a competitive market*.³⁶”

Arguments against the grant of exemptions from applicable laws to CPSEs primarily focus on increasing transparency, performance and productivity of CPSEs by ensuring a robust compliance framework. The benefits to the private sector and the industry at large from a competitively neutral regime also cannot be ignored. Further, those who argue against exemptions to CPSEs state that the State as a ‘dominant shareholder’ should depict exemplary conduct. Strict adherence to

³² Please note that Section 620 of the Companies Act, 1956 empowered the Central Government to grant exemptions or modify provisions of the said Act specifically for government companies (as defined under Section 617 of the Companies Act, 1956). The Central Government had granted exemptions to government companies from various provisions of the said Act. We note that majority of the provisions which are currently exempted were also exempted *vide* various notifications under the Companies Act, 1956. Further, most such notifications were issued in the pre-1991 era.

³³ The Irani Report has provided the most critical set of recommendations leading upto the enactment of the Companies Act. See, MCA, ‘Report of the Expert Committee on Company Law’, (2005), para 7.1 - 7.4, <<http://www.mca.gov.in/MinistryV2/classification+and+registration+of+companies.html>>, accessed on 28 May 2018.

³⁴ *Ibid.*

³⁵ *Ibid.*

³⁶ *Ibid.*

corporate governance norms by government companies (including CPSEs) may persuade others to follow as well.³⁷

³⁷ Umakanth Varottil, 'Listed Government Companies and Corporate Governance: A Supplement', IndiaCorpLaw Blog, 12 November 2008, <<https://indiacorplaw.in/2008/11/listed-government-companies-and.html>>, accessed on 28 May 2018.

IV. Case Studies

A major corporate governance problem which arises in Indian CPSEs, is that of protecting the interests of minority shareholders, whose interests often conflict with that of controlling shareholders.³⁸ This particular problem is ‘*complex*’, in view of the fact that mechanisms protecting minority shareholders in Indian CPSEs are recognised as being weaker than those for non-CPSEs.³⁹ Additionally in India, concerns have been raised about the State potentially undermining minority shareholder interests in favour of the controlling shareholder, through a number of debatable transactions.⁴⁰

In this context, certain exemptions provided to CPSEs from complying with corporate governance norms, have resulted in disputes in the past, as detailed in first two case studies below.

The first of these case studies is in relation to the purchase of the entire shareholding of the Central Government in HPCL by ONGC. This case study discusses various corporate governance questions arising in the backdrop of multiple exemptions granted specifically in the context of this transaction.

The second case study concerns the merger of the State Bank of India (“SBI”), a PSB, with its five associate banks and the Bharatiya Mahila Bank, where again the various exemptions granted for this transaction are discussed from a corporate governance perspective.

The third case study discusses the efforts of the Children’s International Investment Fund (“TCI”) against the alleged mismanagement of affairs at Coal India. While this case is not directly related to the exemptions provided to CPSEs under the regulatory framework unlike the two prior case studies, this is intended to illustrate the dangers of policy tunnelling, which is not only detrimental to minority shareholder interest but also to the prospects of the State’s disinvestment policy.

ONGC-HPCL Deal: The Extras of being a CPSE

ONGC is the largest crude oil and natural gas company in India, contributing around 70% to Indian domestic production and is the only CPSE to feature in Fortune’s ‘Most Admired Energy Companies’ list.⁴¹ Acclaimed for its corporate governance practices, Transparency International has ranked ONGC 26th amongst 124 biggest publicly traded global giants.⁴² HPCL, another CPSE, is a downstream oil-refining company.⁴³

³⁸ S. Subramanian, ‘A Comparison of Corporate Governance Practices in State-owned Enterprises and Their Private Sector Peers in India’, (2016), IIM Kozhikode Society & Management Review, 5(2) 200–216, pg. 203-204 <<http://dspace.iimk.ac.in/bitstream/handle/2259/860/200-2016.pdf?sequence=1&isAllowed=y>>, accessed on 01 August 2018.

³⁹ *Ibid.*

⁴⁰ OECD, Directorate For Financial and Enterprise Affairs, Corporate Governance Committee, Working Party on State Ownership and Privatisation Practices, ‘Broadening the ownership of state-owned enterprises: a comparative report’ (April 2015), paragraph 64, <[http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/CA/SOPP\(2015\)1/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/CA/SOPP(2015)1/FINAL&docLanguage=En)>, accessed on 25 June 2018.

⁴¹ ONGC Corporate Profile – The Largest Energy Company in India, <<https://www.ongcindia.com/wps/wcm/connect/en/about-ongc/ongc-at-a-glance/corporate-profile/>>, accessed on 07 June 2018.

⁴² *Ibid.*

⁴³ Introduction - HPCL, <<http://www.hindustanpetroleum.com/aboutus>>, accessed on 08 June 2018.

Both, HPCL and ONGC are CPSEs under the administrative control of the Ministry of Petroleum and Natural Gas, Government of India,⁴⁴ with the government holding 51.11% and 67.72% of their paid-up equity share capital, respectively.⁴⁵ HPCL further holds 16.96% paid-up equity shares in Mangalore Refineries and Petrochemical Ltd,⁴⁶ which is a subsidiary of ONGC.⁴⁷ The Cabinet Committee on Economic Affairs, by way of a decision in July 2017, decided to grant ‘*in-principle*’ approval for the sale of the Central Government’s stake of 51.11% shareholding in HPCL to ONGC, along with the transfer of management and control, resulting in HPCL becoming a subsidiary of ONGC.⁴⁸ ONGC entered into a Share Purchase Agreement (“SPA”) with the President of India (representing the Central Government) to acquire the entire 51.11% shareholding of the Central Government in HPCL on 20 January 2018.⁴⁹ A distinguishing feature of this transaction was the fact that it was between the Central Government and ONGC (a CPSE), and not between two government companies. Thus, it was not covered within the fold of the exemption granted to government companies (including CPSEs) in relation to related party transactions under Section 188 of the Companies Act.

While there has been a general criticism of this transaction, with commentators going so far as to call it an attempt to bridge the Central Government’s fiscal deficit through the use of cash-rich CPSEs,⁵⁰ certain issues concerning corporate governance best practices have also arisen in the backdrop of this transaction. The first concerns the Ministry of Corporate Affairs, Government of India (“MCA”) exempting all cases of combinations involving CPSEs operating in the oil and gas sector, along with their wholly or partly owned subsidiaries, from the application of Sections 5 and 6 of the Competition Act,⁵¹ for a period of five years.⁵² These exemptions have been called into question on grounds of leading to market inefficiencies, as well as hindering competitive neutrality between the public and the private sectors.⁵³

The second concern stems from the exemptions granted to ONGC by SEBI from the application of Regulation 23 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations,

⁴⁴ Government of India, Ministry of Finance, Department of Investment & Public Asset Management, ‘Engagement of Legal Advisers for Strategic Sale of the Government of India’s existing 51.11% of total paid-up equity shareholding in Hindustan Petroleum Corporation Limited (HPCL) to Oil and Natural Gas Corporation Limited (ONGC) along with management control – Request for Proposal’, <https://www.hindustanpetroleum.com/documents/pdf/RFP-LA_0.pdf> accessed on 07 June 2018.

⁴⁵ ONGC, ‘ONGC acquires 51.11% stake of President of India in Hindustan Petroleum Corporation Limited’ (20 January 2018), <<https://www.ongcindia.com/wps/wcm/connect/en/media/press-release/ongc-acquires-51.11-hindustan-petroleum-limited>>, accessed on 08 June 2018.

⁴⁶ *Ibid.*

⁴⁷ Government of India, Ministry of Finance, Department of Investment & Public Asset Management, ‘Engagement of Legal Advisers for Strategic Sale of the Government of India’s existing 51.11% of total paid-up equity shareholding in HPCL to ONGC along with management control – Request for Proposal’, <https://www.hindustanpetroleum.com/documents/pdf/RFP-LA_0.pdf>, accessed on 07 June 2018.

⁴⁸ *Ibid.*

⁴⁹ *ONGC acquires 51.11% stake of President of India in Hindustan Petroleum Corporation Limited*, (n. 45).

⁵⁰ M.K. Venu and Noor Mohammad, ‘In Modinomics, Government Borrowing Is Bizarrely Reduced by Increasing PSU Borrowing’, (*The Wire*, 25 January 2018), <<https://thewire.in/banking/bizarre-textbook-modinomics-government-borrowing-best-reduced-increasing-psu-borrowing>> accessed on 08 June 2018.

⁵¹ Sections 5 and 6 of the Competition Act contain the law on the regulation of combinations, and prevent such combinations which would have an appreciable adverse effect on competition in the relevant market in India.

⁵² MCA Notification No. S.O. 3714(E), (22 November 2017) <<http://www.cci.gov.in/sites/default/files/notification/Notification-22.11.2017.pdf>>, accessed on 08 June 2018.

⁵³ PTI, ‘Oil, gas PSU mergers exempt from CCI approval’, (*India Today*, 23 November 2017), <<https://www.indiatoday.in/pti-feed/story/oil-gas-psu-mergers-exempt-from-cci-approval-1092964-2017-11-23>>, accessed on 08 June 2018.

2015 (“**LODR**”) for the proposed transaction.⁵⁴ This needs to be read with the fact that despite the transaction qualifying as a related party transaction in terms of Section 188 of the Companies Act, for which prior approval of the shareholders of ONGC was required, the same was sought to be obtained only *after* the execution of the SPA.⁵⁵ According to commentators, given the operational and legal complexities associated with the transaction and particularly as a good governance measure, ONGC should have waited for shareholder approval before proceeding to execute the SPA.⁵⁶ Further, ONGC has applied for a special exemption from the shareholder approval requirement from the MCA, since, the exemption currently granted to government companies, only applies in case of a transaction between two government companies.⁵⁷ If this comes through then the shareholder resolution ratifying the HPCL share purchase would be withdrawn, basically rendering such exercise futile.⁵⁸

The third concern pertains to the exemption from the open offer requirement under Regulation 10(1)(a)(iii) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**SAST Regulations**”).⁵⁹ Different views have been expressed in relation to such exemptions granted under the SAST Regulations to ONGC. One view suggests that such exemption should not be afforded to ONGC and a precedent exists in this regard - buying of IBP Company Limited by Indian Oil Corporation Limited (“**IOC**”) as a part of the government’s disinvestment process. In this case, both the acquirer and the acquiree were government companies and the acquirer (IOC) was required to make an open offer.⁶⁰ Such exemption is significant as it effectively denies minority shareholders the opportunity to exit and disables them from obtaining some part of the control premium. However, another view in relation to the case at hand suggests that since the effective controlling entity will remain the same, exemption from an open offer is justified.⁶¹

Commentators, in the case of this particular transaction, have been critical of, and have raised concerns regarding the supposed divergence of regulatory standards between SOEs and private companies, and have raised concerns about the ‘exemptions’, granted to ONGC.⁶² While the parallel and conflicting roles played by the Central Government in its capacity as the owner and

⁵⁴ Regulation 23 of LODR provides for the treatment of related party transactions, including framing of policy on the materiality of such transactions by the concerned listed entity, as well as requirement of prior approval of the audit committee. SEBI *vide* a letter dated 30 November 2017 has granted an exemption to ONGC from the application of Regulation 23 of LODR. See, ONGC Limited, ‘Disclosure on Agreement to acquire 51.11% of equity shares in the capital of HPCL from Government of India’, (20 January 2018), <<https://www.bseindia.com/xml-data/corpfilng/AttachHis/7bc5f72a-55fa-44a1-b385-0666a8e39667.pdf>>, accessed on 07 June 2018.

⁵⁵ PTI, ‘Proxy advisory firm questions exemptions in ONGC-HPCL deal’ (*The New Indian Express*, 04 March 2018), <<http://www.newindianexpress.com/business/2018/mar/04/proxy-advisory-firm-questions-exemptions-in-ongc-hpcl-deal-1781876.html>>, accessed on 07 June 2018.

⁵⁶ *Ibid.*

⁵⁷ Institutional Investors Advisory Services, ‘ONGC acquires HPCL: The Perks of a PSU’, (01 March 2018) <https://docs.wixstatic.com/ugd/91c61f_1fe20c11b683455b9ea7444eec88df6f.pdf>, accessed on 07 June 2018.

⁵⁸ We note that 96.48% of total votes were cast in favour of the resolution ratifying the ONGC-HPCL transaction. See, ONGC Limited, ‘Disclosure of Voting Results of Postal Ballot dated 09 February 2018 – Ratification of Related Party Transaction’, (28 March 2018) <<https://www.bseindia.com/xml-data/corpfilng/AttachHis/7de25ba9-bcb3-4c35-9ae8-81f93e9e6d19.pdf>>, accessed on 07 August 2018.

⁵⁹ Regulation 10(1)(a)(iii) of the SAST Regulations essentially exempt the making of an open offer in case of an acquisition pursuant to inter-se transfer of shares between a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than 50% of the equity shares of such company, other companies in which such persons hold not less than 50% of the equity shares, and their subsidiaries, subject to control over such qualifying persons being exclusively held by the same persons.

⁶⁰ Payaswini Upadhyay, ‘ONGC Buys HPCL Stake: Can Govt Get Away With Avoiding Open Offer?’, (*Bloomberg Quint*, 20 July 2017), <<https://www.thequint.com/news/business/ongc-buys-stake-in-hpcl>>, accessed on 07 June 2018.

⁶¹ *Ibid.*

⁶² *Ibid.*

policy-maker may not be completely exterminated, there is insufficient justification for diluting corporate governance norms for CPSEs.⁶³

Merger of the SBI, its Associate Banks, and the Bharatiya Mahila Bank

The consolidation of PSBs as a high-priority reform was reflected in the 2016-17 Budget Speech of the Finance Minister.⁶⁴ Consequently, the merger of the largest PSB - SBI was initiated with five associate banks, viz. the State Bank of Bikaner and Jaipur, State Bank of Mysore, State Bank of Travancore, State Bank of Hyderabad and State Bank of Patiala,⁶⁵ and the Bharatiya Mahila Bank⁶⁶. The record date for the merger of the five associate banks, as well as the Bharatiya Mahila Bank with the SBI,⁶⁷ was set at 1 April 2017. While the procedure of the merger or amalgamation of any bank with SBI is governed by the provisions of the State Bank of India Act, 1955 (“**SBI Act**”),⁶⁸ the mergers in this case led to the creation of a massive banking entity, which was reportedly in the league of the ‘Global Top 50 Banks of the World’, and with a reported domestic market share of 23%.⁶⁹ In this regard, the exemptions granted to the SBI by way of exemptions from various laws, particularly under the Competition Act and the non-requirement of shareholder approval under the provisions of the SBI Act, has been called into question by commentators.⁷⁰ In a similar vein, commentators have observed that “*the nature of business cannot be the differentiator for investor protection laws*”, thus, pointing to the desirability of aligning provisions of laws governing PSBs such as the SBI with laws as applicable to listed banking companies.⁷¹ While a complete harmonisation may be a policy call given the unique nature of the SBI, gradual steps can be taken to align the framework contained in the SBI Act, as it relates to good corporate governance practices, with those applicable to other listed banking companies.

⁶³ Pallavi Pengonda and Harsha Jethmalani, ‘ONGC-HPCL deal: A marriage of convenience’, (*Livemint*, 21 July 2017), <<https://www.livemint.com/Money/WwUIREdOVg29WgabzyTjkJ/ONGCHPCL-A-marriage-of-convenience.html>>, accessed on 07 June 2018.

⁶⁴ Speech of Shri Arun Jaitley, Minister of Finance, ‘Budget 2016-2017’ (29 February 2016), Paragraph 93, <<https://www.indiabudget.gov.in/ub2016-17/bs/bs.pdf>>, accessed on 07 June 2018.

⁶⁵ See generally, the Acquisition Orders for the five associate banks issued by the Ministry of Finance, Department of Financial Services (22 February 2017), <<http://egazette.nic.in/WriteReadData/2017/174343.pdf>>, accessed on 07 June 2018.

⁶⁶ Press Information Bureau, Government of India, Ministry of Finance, ‘Bharatiya Mahila Bank (BMB) to be merged with State Bank of India (SBI) to ensure greater banking services outreach to a larger number of women, at a faster pace’, <<http://pib.nic.in/newsite/PrintRelease.aspx?relid=159575>>, accessed on 07 June 2018.

⁶⁷ Vishwanath Nair, ‘SBI merger with five associate banks from 1 April’, (*Livemint*, 24 February 2017) <<https://www.livemint.com/Industry/mf507dGEvv1gCGRknnY9GM/SBI-merger-with-five-associate-banks-from-1-April.html>>, accessed on 07 June 2018;

SBI, ‘Scheme of Acquisition of Bharatiya Mahila Bank Limited by State Bank of India’, <<https://www.sbi.co.in/portal/documents/44589/14512694/Scheme+of+Acquisition+of+BMB+by+SBI.pdf/9ed00111-f047-4860-ae58-231de30ebfb4>>, accessed on 07 June 2018.

⁶⁸ Section 35 of the SBI Act.

⁶⁹ S. Adikesavan, ‘SBI, a synonym for resurgent India’, (*The Hindu BusinessLine*, 04 April 2017), <<https://www.thehindubusinessline.com/opinion/sbi-a-synonym-for-resurgent-india/article21948335.ece1>>, accessed on 07 June 2018.

⁷⁰ Stakeholders Empowerment Services, ‘SBI & Associate Banks Merger - Birds Eye View’, <<https://www.sesgovernance.com/pdf/home-reports/SBI%20Associate%20Banks%20Merger%20%20Birds%20Eye%20View.pdf>>, accessed on 07 June 2018.

⁷¹ *Ibid.*

Coal India: A Case of Policy Tunnelling v. Shareholder Activism

Coal India is a Maharatna CPSE which is the single largest coal producer in the world and produces 84% of India's coal requirements.⁷² The efforts of TCI, a prominent activist fund against the alleged mismanagement of the affairs of Coal India, in 2012, was one of the most heated shareholder-led activism episodes in the context of the corporate governance of CPSEs in India.⁷³ The crux of the allegations brought by TCI, which was the second largest shareholder in Coal India at the relevant time (pursuant to an initial public offering by Coal India in 2010) related to several alleged corporate governance lapses on the part of Coal India.⁷⁴

The genesis of these issues was allegedly in the reversal of certain pricing mechanisms by Coal India at the apparent behest of the Ministry of Coal, Government of India in January 2012.⁷⁵ This, in TCI's view, would have led to, *inter alia*, the supply of coal by Coal India at a 70% discount to international market rates resulting in losses amounting to USD 20 billion per year for Coal India. Such fuel supply agreements would have also resulted in Coal India being obligated to supply 80% of the contracted amount of coal at discounted rates, failing which penalties would be imposed on it.⁷⁶

TCI approached several national and international fora to prove the alleged violations of corporate governance norms by Coal India. TCI initiated legal proceedings in India against Coal India and its Board, alleging '*breach of fiduciary duties*',⁷⁷ '*failing to perform their duties with adequate care and skill*',⁷⁸ and harming shareholder interests by selling coal at cheaper rates to power companies. The Central Government was also made a party to such proceedings and was accused by TCI of acting against minority shareholder interest on account of its constant intervention and mismanagement in the affairs of Coal India. TCI demanded compensation to the tune of INR 2,15,250 crore from the Central Government on behalf of Coal India shareholders, alleging, a breach of duty by the Board of Coal India and the Central Government itself, resulting in a loss to shareholders.⁷⁹ While details are not public, the proceedings initiated by TCI against Coal India based on the above allegations, before the Calcutta High Court were subsequently converted into

⁷² Coal India, 'About the company', <<https://www.coalindia.in/en-us/company/aboutus.aspx>> accessed on 07 June 2018.

⁷³ Institutional Investor Advisory Services, 'A field guide to shareholder redressal in India', <<http://docs.manupatra.in/newsline/articles/Upload/7C05ECAC-16B5-485B-88FA-BD2CACBE2397.pdf>> accessed on 07 June 2018. The account of events is based on popular press reports, as no single authoritative account of the entire case is available in the public domain. Wherever appropriate, specific sources have been cited to indicate the source of specific information. See also, Umakanth Varottil, 'Corporate Governance in State-Owned Enterprises', (*NSE Quarterly Briefing*, April 2015), <https://www.nseindia.com/research/content/res_QB9.pdf> accessed on 07 June 2018.

⁷⁴ Sundaresha Subramanian and Jyoti Mukul, 'Hedge fund threatens to sue Coal India's board', (*Business Standard*, 21 January 2013), <http://www.business-standard.com/article/companies/hedge-und-threatens-to-sue-coal-india-s-board-112031300043_1.html> accessed on 7 June 2018; N Sundaresha Subramanian, 'Coal India, TCI and LIC - a triangular love story', (*Business Standard*, 2 January 2015), <http://www.business-standard.com/article/markets/coal-india-tci-and-lc-a-triangular-love-story-115020201569_1.html> accessed on 7 June 2018.

⁷⁵ Thought Arbitrage Research Institute, 'Corporate Governance Issues with Coal India and its minority shareholders', <<http://tari.co.in/wp-content/uploads/2014/02/1344248025Corporate-Governance-Issues-with-Coal-India-and-its-minority-shareholders-06082012.pdf>>, accessed on 07 June 2018.

⁷⁶ *Ibid.*

⁷⁷ Ruchira Singh, 'Hedge fund takes Coal India to court', (*Livemint*, 12 October 2012), <<https://www.livemint.com/Companies/Vj9ofJkEvSVuNHRiUfYUHN/Hedge-fund-takes-Coal-India-to-court.html>> accessed on 07 June 2018.

⁷⁸ *Ibid.*

⁷⁹ Shine Jacob and N Sundaresha Subramanian, 'TCI converts legal case with Coal India akin to class action suit', (*Business Standard*, 25 January 2013), <http://www.business-standard.com/article/companies/tci-converts-legal-case-with-coal-india-akin-to-class-action-suit-112101900038_1.html> accessed on 07 June 2018.

a representative action suit, according to news reports.⁸⁰ Further, a writ petition was also filed by TCI against Coal India in the Delhi High Court pertaining to the Ministry of Coal's alleged directive to roll back a hike in prices announced by Coal India.⁸¹ TCI also invoked provisions of the bilateral investment treaty between the United Kingdom and India of 1994 and between Cyprus and India of 2012, claiming contravention of the '*fair and equitable treatment*' clause, on the ground that the Central Government's management of Coal India was violative of such standard.⁸²

Media reports suggest that that Coal India, in its defence, sought to take up grounds, which it had disclosed in its Red Herring Prospectus ("RHP") filed with the SEBI in September 2010.⁸³ These included grounds such as prior disclosure of *inter alia* the objectives of Government as the company's controlling shareholder possibly conflicting with other shareholder interests, as well as the fact that the President of India could issue directives with respect to the conduct of Coal India's business, as had been disclosed in the RHP.⁸⁴

Eventually, TCI sold off its stake entire shareholding in Coal India,⁸⁵ and consequently, the proceedings at the Calcutta High Court were withdrawn in December 2014, bringing an end to the activism of TCI and the proceedings against the alleged mismanagement of Coal India, which showed complete disregard for minority shareholders' rights demonstrated by the company.⁸⁶

Though the TCI-Coal India saga did not conclusively set a precedent, however, it raised certain important issues pertaining to corporate governance standards in CPSEs. This episode was the first instance where a minority shareholder raised key issues regarding the disregard for shareholder

⁸⁰ *Ibid.*

⁸¹ TNN, 'The Children's Investment Fund sues government, Coal India directors over loss', (*Times of India*, 13 October 2012), <<https://timesofindia.indiatimes.com/business/india-business/The-Childrens-Investment-Fund-sues-government-Coal-India-directors-over-loss/articleshow/16790705.cms>> accessed on 07 June 2018.

⁸² Souvik Ganguly and Shantanu Kanade, 'Revisiting India's Stance On Investor-State Dispute Settlement', (26 September 2013) <<http://indianlawyer250.com/features/article/223/revisiting-indias-stance-investorstate-dispute-settlement/>> accessed on 07 June 2018; Vivek Vashi and Kanika Sharma, 'Increasing litigation under Bilateral Investment Treaties - should the Government be worried?', India Law Journal, <http://www.indialawjournal.org/archives/volume5/issue_2/article_1.html> accessed on 07 June 2018.

⁸³ Coal India Limited, RHP (28 September 2010) <https://www.sebi.gov.in/sebi_data/attachdocs/1287656969580.pdf> accessed on 08 June 2018.

⁸⁴ TNN, 'The Children's Investment Fund sues government, Coal India directors over loss', (*Times of India*, 13 October 2012), <<https://timesofindia.indiatimes.com/business/india-business/The-Childrens-Investment-Fund-sues-government-Coal-India-directors-over-loss/articleshow/16790705.cms>> accessed on 07 June 2018.; See also, Point 25 of Section II of the RHP. Reports indicate that the President of India had issued a Directive under Article 53 of the Constitution to Coal India in April 2012, placing an obligation on Coal India to sign agreements with power producers, undertaking a supply commitment of 80% of the contracted quantity of coal required by the power producers, and pay heavy penalties in case of any deficit in such supply. See, Neeraj Menon and Lzafeer Ahmad, 'Presidential Directive to Ease Coal Supply', Bar and Bench, <<https://barandbench.com/wp-content/uploads/2016/11/Presidential-Directive-to-Ease-Coal-Supply.pdf>> accessed on 07 June 2018. This Directive was strongly criticised by TCI, which was quoted as allegedly stating that the Directive only strengthened their legal case against Coal India and the GOI. See, Vidya Ram, 'Directive to Coal India only strengthens our case, says Children's Investment Fund' (*The Hindu BusinessLine*, 4 April 2012), <<https://www.thehindubusinessline.com/companies/directive-to-coal-india-only-strengthens-our-case-says-childrens-investment-fund/article20417491.ece1>> accessed on 07 June 2018. The power of the President of India to issue directives to Coal India can be traced back to its Articles of Association. The Memorandum and Articles of Association of Coal India (as on September 2014) at Article 41, indicate, for instance, that the President of India is empowered to give directions to Coal India as to '*the exercise and performance of its functions in matters involving national security or substantial public interest*'. See, Coal India Limited, 'Memorandum and Articles of Association' <https://www.coalindia.in/DesktopModules/DocumentList/documents/Memorandum_and_Articles_of_Association_of_Coal_India_Limited%20_21012015.pdf> accessed on 07 June 2018.

⁸⁵ Pinak Ghosh, 'UK hedge fund exits Coal India', (*The Telegraph*, 17 October 2014), <https://www.telegraphindia.com/1141017/jsp/business/story_18935311.jsp> accessed on 07 June 2018.

⁸⁶ *TCI Cyprus Holdings v. Coal India Limited & Anr.*, CS No. 349 of 2012, the High Court at Calcutta, Order dated 18 December 2014 passed by Justice Soumen Sen.

rights in a CPSE. The negative investor sentiment garnered by such episodes assume significance in light of the intention of the present government to disinvest its shareholding in several CPSEs.⁸⁷

⁸⁷ Speech of Shri Arun Jaitley, Minister of Finance, ‘Budget 2018-2019’, (1 February 2018), Paragraphs 123, 126, <<https://www.indiabudget.gov.in/ub2018-19/bs/bs.pdf>> accessed on 01 August 2018. This speech highlights the Central Government’s roadmap to divest its stake in various CPSEs.

V. International Perspective

Globally, various jurisdictions have adopted distinct approaches to SOE governance. For the present analysis, we have narrowed down on three jurisdictions, Singapore, Brazil and Norway based on a combination of factors including - the stage of development of the economy, governmental structure, economic philosophy, relevance of SOEs, etc. The discussion on each of these countries also looks at one of its pre-eminent SOEs and how the experiences of the SOE in question may better inform an understanding of the experience of such jurisdictions in viewing competitive neutrality as an integral component of corporate governance.

Even though the United States of America (“US”) is often viewed as a leader in corporate governance reforms and the People's Republic of China (“China”) has the highest number of SOEs, we have not studied these jurisdictions in detail, as the relevance of SOEs in these two countries depicts two extreme ends of the spectrum,⁸⁸ which renders their experience of limited value in the Indian context.

US

The US asserts itself as the world's largest capital market and the prime originator of ‘best practices’ in corporate governance. However, it is also exceptional in its resentment to government ownership of the enterprise.⁸⁹ Legislative history in the US suggests a restrictive trend towards State ownership of enterprises. In the mid-nineteenth century, constitutions of most states of US came to prohibit state holdings in private companies.⁹⁰ In the aftermath of the Great Depression, a new variety of corporations surfaced, known as Government-Sponsored Enterprises which basically obtained State support without ownership and with a public mission but were owned and controlled by private shareholders.

An OECD study (2017) on the size and sectoral distribution of SOEs, which comprehensively studied economic parameters such as enterprise value and a number of employees of such SOEs in 40 countries including the US, states that there are only 16 SOEs in the US which jointly have a negative enterprise value of USD 21.6 billion.⁹¹ While we do not believe that there are no lessons to be learnt from the US experience in SOE governance,⁹² we understand that its comparison to India, which has a far greater concentration of SOEs, may not be appropriate.

⁸⁸ An OECD study (2017) on the size and sectoral distribution of SOEs, which comprehensively studied economic parameters such as enterprise value and a number of employees of such SOEs in 40 countries including the US, states that there are only 16 SOEs in the US which jointly have a negative enterprise value of USD 21.6 billion. In case of China, the said study notes that while the rest of the 39 nations have a total of 2467 SOEs, China alone has 51,341 SOEs. Chinese SOEs commanded an enterprise value of USD 29,201.1 billion vis-à-vis a total of USD 2407.8 billion of all the other 39 nations put together. See, *OECD, The Size and Sectoral Distribution of State-owned enterprises*, (2017), (n.05).

⁸⁹ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 13.

⁹⁰ Lawrence M. Friedman, ‘A history of American Law’, 121 (3rd eds., 2005); John Joseph Wallis, ‘Constitutions, Corporations, and Corruption: American States and Constitutional change, 1842 to 1852’, 65 J. Econ. Hist. (2005) 211, 232, 251.

⁹¹ *OECD, The Size and Sectoral Distribution of State-owned enterprises*, (2017), (n.05).

⁹² *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 15-18.

China

The OECD study (2017) notes that while the rest of the 39 nations have a total of 2467 SOEs, China alone has 51,341 SOEs. Chinese SOEs commanded an enterprise value of USD 29,201.1 billion vis-à-vis a total of USD 2407.8 billion of all the other 39 nations put together.⁹³

The reason for such scale of SOEs in China stems from its State-driven economic model. Chinese SOEs are compartmentalised into different business groups, each under a parent (holding) company which is legally organised as a wholly State-owned limited liability company under the Chinese company law.⁹⁴ Such a holding company has just one shareholder – the State-Owned Assets Supervision Administration Commission (“SASAC”). SASAC was established directly under the Chinese State Council (Chinese Cabinet) in 2003 with an attempt to consolidate holdings in SOEs. Prior to SASAC, respective ministries held control over these SOEs. However, the appointment of senior management in SOEs is subject to the decision of the Chinese Communist Party which has a highly institutionalised arrangement in this regard. Party centrality has been a defining characteristic of Chinese SOE governance.⁹⁵ Based on international corporate governance norms in respect of SOEs, scholars state that the governance structures are dysfunctional or lacking in China.⁹⁶ Some even argue that the distinction between SOEs and private companies in relation to the role of State actors is unclear.⁹⁷ Notably, while private companies outperform SOEs in terms of profitability, productivity, job creation and debt levels, even private companies have weak and merely compliant governance systems.⁹⁸ Further, since political factors are the underlying premise for the role of both SOEs and private companies unlike most other jurisdictions,⁹⁹ we do not attempt to analyse China in greater detail, in this Report.

Singapore

The Asian Corporate Governance Association has repeatedly ranked Singapore as having the best corporate governance framework in Asia.¹⁰⁰ A study has shown that Government-Linked Companies (“GLCs”), the Singaporean equivalent of SOEs, not only command a higher valuation than their private counterparts, but also are more profitable due to leaner operations and better

⁹³ OECD, *The Size and Sectoral Distribution of State-owned enterprises*, (2017), (n.05).

⁹⁴ It is regulated under Chapter 2, Section 3 of the (Chinese) Company Law, 1994, <<http://www.jus.uio.no/lm/china.company.law.1993/>>, accessed 25 February 2018.

⁹⁵ Curtis J. Milhaupt, ‘Chinese Corporate Capitalism in Comparative Context’, in *The Beijing Consensus? How Has China Changed: The Western Ideas of Law and Economic Development* (Weitseng Chen ed., Cambridge University Press, April 2017).

⁹⁶ Li-Wen Lin, ‘State Ownership and Corporate Governance in China: An Executive Career Approach’ (2013) 3 Columbia Business Law Review 743. Sonja Opper & Sylvia Schwaag-Serger, ‘Institutional Analysis of Legal Change: The Case of Corporate Governance in China’, (2008) 26 WUSTL 245, <https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1154&context=law_journal_law_policy>, accessed 20 May 2018; Zhong Zhang, ‘The Shareholder Derivative Action and Good Corporate Governance in China: Why the Excitement Is Actually for Nothing’, (2011) 28 UCLA PBLJ, 174, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2641863, accessed 22 May 2018.

⁹⁷ Curtis J. Milhaupt and Wentong Zheng, Beyond Ownership: State Capitalism and the Chinese Firm, (2015) 103 Georgetown Law Journal 665.

⁹⁸ Asian Corporate Governance Association, ‘Awakening Governance: The evolution of corporate governance in China’, (2018), pg. 97-99, <<https://www.acga-asia.org/specialist-research.php>>, accessed on 02 August 2018.

⁹⁹ *Ibid.*

¹⁰⁰ Asian Corporate Governance Association, ‘CG Watch 2016 – Ecosystems Matter’, <<https://www.acga-asia.org/research.php>>, accessed on 27 May 2018.

management of expenses.¹⁰¹ Overall, several factors including high governance standards, strong enforcement mechanisms and the demonstrated success of the Singaporean GLC model, qualify Singapore as a jurisdiction to draw lessons from with respect to governance of SOEs.

SOE Governance Structure

The Singaporean model of SOE governance is based on the holding company model. Temasek Holdings Pte Ltd (“**Temasek**”), is wholly owned by the Minister for Finance, Singapore. Temasek was formed in 1974 as a limited holding company to commercially manage the State’s investments in GLCs and other government holdings.¹⁰² GLCs include companies that are wholly owned by the Singapore Government, those in which the Government has a majority or minority share, and their subsidiaries.¹⁰³ These GLCs are subject to a similar standard of regulation and governance as private firms.¹⁰⁴

Competitive Neutrality

In the 2002 Budget Statement, the Minister of Finance explained the Singapore Government’s relationship with GLCs. The Budget Statement clarified that the government would “*not favour GLCs with special privileges or hidden subsidies*” or “*burden them with uneconomic ‘national service’ responsibilities*”. On the other hand, GLCs are “*expected to compete on a level playing field*” with private companies. The 2002 Budget Statement also clearly spelt out that the government does not “*interfere with the operations of the GLCs*” and GLCs “*operate as commercial entities*”.¹⁰⁵ Despite the dominant ownership and control of the government, GLCs are professionally-managed with limited interference from the government. Temasek’s policy is to ensure that independent Boards of portfolio companies provide the requisite strategic direction and monitoring so as to benefit all shareholders, including the minority shareholders.¹⁰⁶

GLCs operate on a commercial basis, with a focus on bottom-line performance.¹⁰⁷ To mitigate the risk of GLCs becoming politically driven, the Singapore government has “*construed a highly visible and well-tailored regulatory regime, which aims to prevent the government from abusing its position as the ultimate controlling shareholder*” of GLCs.¹⁰⁸ Additionally, voluntary

¹⁰¹ James S. Ang & David K. Ding, ‘Government ownership and the performance of government-linked companies: The case of Singapore’, (2006) 16 Journal of Multinational Financial Management, pg. 64, 80, 85 – 86.

¹⁰² Temasek, FAQs, <<http://www.temasek.com.sg/abouttemasek/faqs>>, accessed on 24 May 2018.

¹⁰³ *Government ownership and the performance of government-linked companies*, (n. 101), pg. 64-88.

¹⁰⁴ Speaking in Parliament in March 2001, Minister of Finance of Singapore, Mr. Richard Hu ‘reiterate[d] that GLCs operate on a commercial basis; they do not receive any subsidies or preferential treatment from the Government and are subject to the same regulations and market forces as private entrepreneurs’. See Anthony Shome, ‘Singapore’s State-Guided Entrepreneurship: A Model for Transitional Economies?’, (2009) 11 New Zealand Journal of Asian Studies 1, pg. 326.

¹⁰⁵ The Budget Statement 2002

<https://www.singaporebudget.gov.sg/data/budget_2002/download/FY2002_Budget_Speech.pdf>, accessed on 28 May 2018.

¹⁰⁶ Dan W. Puchniak & Umakanth Varottil, ‘Related Party Transactions in Commonwealth Asia: Complexity Revealed’, Law European Corporate Governance Institute, (2018) Working Paper N° 404/2018, <<https://ssrn.com/abstract=3169760>>, accessed on 20 May 2018.

¹⁰⁷ Carlos D. Ramírez & Ling Hui Tan, ‘Singapore Inc. Versus the Private Sector: Are Government-Linked Companies Different’, (2003) International Monetary Fund Working Paper <<http://www.imf.org/external/pubs/ft/wp/2003/wp03156.pdf>>, accessed on 20 May 2018.

¹⁰⁸ Dan W. Puchniak & Luh Lan, ‘Independent Directors in Singapore: Puzzling Compliance Requiring Explanation’, (2016), NUS Working Paper 015/006, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2604067>, accessed on 10 May 2018.

restrictions are placed by the Temasek Charter on the involvement of Temasek in the management of its portfolio companies.¹⁰⁹ While Temasek (by virtue of being an ‘exempt private company’ under the Singapore company law) is exempt from public reporting requirements, its financials are audited by an international auditing firm and are published. Temasek, because of its performance and transparency, is often viewed as setting the “*gold standard*” as a government-owned investment fund and receives the highest ranking in the Linaburg-Maduell Transparency Index, which is the global benchmark rating government-owned investment vehicles on ten fundamental principles.¹¹⁰

Despite certain criticisms in relation to political appointments, Singapore appears to have achieved the “*best of both worlds*” with its GLC strategy: the monitoring benefits of a controlling shareholder as well as effective institutional checks which have mitigated the problems of minority shareholder exploitation.¹¹¹

Case Study: Temasek

Temasek was set up in 1974 for the specific purpose of managing Singapore's commercial interests in SOEs.¹¹² The objective behind creating Temasek as a separate company, was to run the investments of the State in companies across sectors of the economy, on a commercial basis.¹¹³ Setting up Temasek as a separate company effectively separated the role of the government as a shareholder from its role as regulator and policy maker.¹¹⁴ Consolidating government ownership in various GLCs at one place, also enabled the government to clarify its ownership policy and implement its policies consistently across its investments.¹¹⁵

The independence of Temasek’s Board, as well as the clarity of the company’s goals as set out in its Charter, have been commended by critics.¹¹⁶ In fact, Temasek’s high standards of corporate governance are widely acknowledged, owing to the demonstrated positive impact of Temasek on the governance models of the companies it invests into.¹¹⁷ It is hard to find a better example to drive home the point of the State leading by example by adhering to highest corporate governance norms.

¹⁰⁹ Temasek Review (2017), <<https://www.temasek.com.sg/en/our-financials/library/temasek-review.html>>, pg. 04, accessed on 12 May 2018

¹¹⁰ The Linaburg-Maduell Transparency Index, <<https://www.swfinstitute.org/sovereign-wealth-fund-rankings/>>, accessed on 10 May 2018.

¹¹¹ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 43. For a detailed analysis on the unique experiences and circumstances which led to the success of GLCs in Singapore, see, Tan Cheng-Han, Dan W. Puchniak, Umakanth Varottil, ‘State-Owned Enterprises In Singapore: Historical Insights Into a Potential Model For Reform’, National University of Singapore -Centre for Asian Legal Studies, Working Paper 2015/03, <<https://ssrn.com/abstract=2580422>>, accessed on 21 May 2018.

¹¹² Isabel Sim, Steen Thomas and Gerard Yeong, ‘The State as Shareholder: The Case of Singapore’, The Centre for Governance, Institutions and Organisations (CGIO), NUS Business School, <<https://www.cimaglobal.com/Documents/Our%20locations%20docs/Malaysia/Centre%20of%20Excellence/NUS%20-%20The%20State%20as%20Shareholder%20-%20compressed.pdf>> accessed on 15 July 2018.

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.*

¹¹⁶ *Ibid.*

¹¹⁷ *Ibid.*

Interestingly, Temasek's success has been attributed to a number of factors which have been well-documented.¹¹⁸ These factors include strong governance standards for all government agencies in Singapore, which sets the foundation for and reflects in the strong corporate governance of SOEs as well.¹¹⁹ The second factor which is cited while evaluating Temasek's success generally, is its adherence to foreign regulation, as a result of its considerable foreign investment.¹²⁰ This arises because Temasek regularly accesses the capital markets, while its investee businesses also have considerable business interests outside Singapore. This helps insofar as it needs Temasek to be subject to market discipline, and behave in a manner consistent with the regulations of multiple jurisdictions including the US, the United Kingdom and the European Union, as well as be responsible for the activities of its investee companies.¹²¹ The third factor, which has been described as one of the reasons behind the success of the Temasek model is in the State itself acting in a manner so as to signal to the market the need for good corporate governance, and lead by example.¹²² Temasek and its investee companies continually act as the benchmark for investors in the market, thereby challenging conventional notions that SOEs cannot be market leaders in corporate governance.¹²³

Therefore, as the example of Temasek and the associated Temasek model of corporate governance of SOEs demonstrate, it is possible to be an SOE and exhibit the highest standards of corporate governance. Additionally, as Temasek's success shows, good corporate governance in SOEs also requires credible commitment to creating robust governance frameworks for public institutions, adherence to regulatory frameworks and market discipline, as well as the will of the State to assume the role of a market leader in corporate governance. Thus, the key takeaway from Temasek's experience is the fact that with credible commitment to the cause of upholding the highest standards of corporate governance, SOEs can be indeed be market leaders.

Brazil

An OECD study (2017) states that there are 134 SOEs in Brazil.¹²⁴ These are classified into two categories¹²⁵ – (a) if the majority of shares with voting rights of an SOE are held by the State, the entity is regarded as a 'mixed-capital company',¹²⁶ and (b) if all shares with voting rights are held by the State, the entity is called a 'public company'.¹²⁷

¹¹⁸ Christopher Chen, 'Solving the Puzzle of Corporate Governance in State-Owned Enterprises: The Path of the Temasek Model in Singapore and Lessons for China', (2016) Northwestern Journal of International Law & Business, Vol. 36 No. 2, 303 - 370, pg. 361-370.

¹¹⁹ *Ibid.*

¹²⁰ *Ibid.*

¹²¹ *Ibid.*

¹²² *Ibid.*

¹²³ *Ibid.*

¹²⁴ OECD, 'The Size and Sectoral Distribution of State-owned enterprises', (2017), (n.05), pg. 39-40.

¹²⁵ Paragraph I of Article 173 of the Constitution of the Federal Republic of Brazil provides that "the law shall establish the legal status of a public company, a mixed-capital company and its subsidiaries that exploit economic activity in the production or sale of goods or services". Constitution of The Federal Republic of Brazil, Art. 173, §1º, <http://www.planalto.gov.br/ccivil_03/Constituicao/Constituicao.htm#art173>, accessed on 21 May 2018; See also, Article 2 of the SOE Statute which states that "Exploitation of economic activity by the State shall be exercised by means of a public company, the joint stock company and its subsidiaries".

¹²⁶ Article 1, SOE Statute.

¹²⁷ Article 3, SOE Statute.

SOE Governance Structure

The Department of Coordination and Control of State-Owned Enterprises (“DEST”) within the Ministry of Planning, Budget and Management is responsible for SOE ownership.¹²⁸ While SOEs in Brazil are formally linked to the respective ministry with jurisdiction over their market activity, they are also subject to different forms of centralized oversight and control.¹²⁹

DEST is responsible for establishing corporate governance guidelines, approving the allocation of income, fixing the remuneration of directors, appointing one director and approving bylaws and capital increases.¹³⁰ On the other hand, the Ministry of Finance approves financial statements, appoints one Fiscal Council member,¹³¹ represents the State at shareholder meetings and authorizes issues of debt and securities.¹³² Additionally, the relevant sectoral ministry appoints a majority of non-executive directors and sets out the strategy of the Board and the investment plan.¹³³ In July 2016, the government transformed DEST into the Secretariat of Coordination and Governance of State-Owned Enterprises, with a view towards strengthening SOE governance and monitoring and possibly paving the way for future privatizations.¹³⁴

Competitive Neutrality

In the early years, the Brazilian government exempted SOEs from the provisions of the Corporations Law, 1940.¹³⁵ However, when the new Corporation Law, 1976 was promulgated, publicly traded mixed economy corporations were subjected to the same corporate law rules and regulations as private companies.¹³⁶ The new Corporation Law, 1976 expressly imposed on directors and controlling shareholders of mixed economy corporations the same fiduciary duties applicable to privately owned companies¹³⁷ – the object being to impose a minimum necessary protection for minority shareholders of mixed economy corporations.¹³⁸ In fact, *vide* an amendment to the Brazilian Constitution in 1998, Article 173 of the Constitution was amended to subject a public company, a mixed-economy corporation and its subsidiaries “*to the legal regime of private companies, including civil, commercial, labor and tax rights and obligations*”.¹³⁹

¹²⁸ OECD (2013), ‘Ownership Oversight And Board Practices For Latin American State-Owned Enterprises’, <<https://www.oecd.org/daf/ca/2011LatinAmericanCorporateGovernanceRoundtableSOEOwnership2013.pdf>>, accessed on 21 May 2018.

¹²⁹ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg.33.

¹³⁰ OECD, ‘Ownership Oversight and Board Practices for Latin American State-Owned Enterprises’, (n. 128), pg. 8, paragraph 21.

¹³¹ *Ibid*; The Fiscal Council carries out responsibilities similar to an audit committee.

¹³² *Ibid*.

¹³³ *Ibid*.

¹³⁴ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 33.

¹³⁵ Maria Pargendler, ‘Unintended Consequences of State Ownership’, (2012) Theoretical Inquiries in Law 13.2, pg. 507, <<http://eial.tau.ac.il/index.php/til/article/download/169/146>>; Law No. 6.404>, accessed on 21 May 2018.

¹³⁶ *Ibid*, pg. 510; Lei No. 6.404, Article. 238,

<http://www.cvm.gov.br/export/sites/cvm/subportal_ingles/menu/investors/anexos/Law-6.404-ing.pdf>, accessed on 21 May 2018.

¹³⁷ *Ibid*.

¹³⁸ *Ibid*.

¹³⁹ Article 21, Constitutional Amendment No. 19, of June 4, 1998,

<http://www.planalto.gov.br/ccivil_03/Constituicao/Emendas/Emc/emc19.htm#art22>, accessed on 26 May 2018.

Notably, from time to time, statutory law has exempted SOEs from bankruptcy laws, though the constitutionality of this special regime remains a subject of debate.¹⁴⁰

In 2015, the BM&FBovespa, the Brazilian stock exchange, launched a voluntary SOE Governance Program.¹⁴¹ However, in the wake of corruption scandals, the Brazilian National Congress enacted the Public Companies Law, June 2016 (the “**SOE Statute**”).¹⁴² This law aims to set ‘*higher standards of governance for Brazil’s SOEs*’.¹⁴³ The SOE Statute is seen as one of the responses offered by Brazil’s Parliament to the severe governance challenges faced by SOEs in Brazil.

The SOE Statute requires that a clear policy steer, in the form of an annual letter, must be issued to highlight the SOE’s public policy objectives and quantify its financial implications.¹⁴⁴ It also requires SOEs to put in place and disclose a policy for related-party transactions.¹⁴⁵ Additionally, minimum qualifications of and restrictions on the appointment of directors and officers have been introduced. It has also introduced practices that aim to preserve the independence of the Boards of SOEs.¹⁴⁶ However, certain SOEs (conceptualised under the SOE Statute as SOEs where State is majority shareholder and operating revenue is less than R\$ 90,000,000,00) are exempted from the application of certain provisions of the SOE Statute.¹⁴⁷ The SOE Statute is a strong step forward towards ameliorating the negative reputation of SOEs and attracting investment in the key sectors of the Brazilian economy.¹⁴⁸

Case Study: Petrobras

Petrobras was established in 1953, with the distinction of being one of the oldest National Oil Companies (“**NOCs**”) worldwide, and Brazil’s flagship oil company.¹⁴⁹ Formed as a pivotal component of an ‘*inward-oriented*’ industrialization drive, Petrobras was initially granted sole rights in domestic upstream oil exploration and production, subsequently diversifying to other fields such as petrochemicals.¹⁵⁰ Interestingly, Petrobras as one of the world’s pre-eminent State-owned NOCs is viewed as a powerful organization which though functions as part of the State apparatus, addressing a number of non-commercial aspirations (including factors such as

¹⁴⁰ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 28.

¹⁴¹ For a detailed discussion on Brazil’s SOE Governance Program, see <http://www.bmfbovespa.com.br/en_us/listing/equities/soe-governance-program/>, accessed on 25 May 2018.

¹⁴² SOE Statute, Law No. 13, 303, <http://www.planalto.gov.br/ccivil_03/_ato2015-2018/2016/Lei/L13303.htm>, accessed on 25 May 2018.

¹⁴³ OECD (2018), Brazil: a key partner for the OECD, pg. 32, <<http://www.oecd.org/brazil/Active-with-Brazil.pdf>>, accessed on 26 May 2018.

¹⁴⁴ Article 8, Paragraph I, SOE Statute; Renato Poltronieri, Decree Regulates The State Companies Law, <<https://www.demarest.com.br/en-us/publicacoes/demarestnews-decreto-8945-2016-lei-das-estatais>>, accessed on 26 May 2018.

¹⁴⁵ Article. 8, Paragraph VII, SOE Statute.

¹⁴⁶ Article 22, SOE Statute.

¹⁴⁷ Article 1, § 1, SOE Statute - Title I of this Act, except the provisions of arts. 2^a, 3^a, 4^a, 5^a, 6^a, 7^a, 8^a, 11, 12 and 27 shall not apply to public company and the joint stock company that has, together with its subsidiaries, the previous year, gross operating revenue less than R\$ 90,000,000.00 (ninety million Reais).

¹⁴⁸ Carlos Augusto Junqueira and Eduardo Abrantes, ‘Brazil - State-owned enterprises’, (*IFLR*, 22 August 2016), <<http://www.iflr.com/Article/3580251/Brazil-State-owned-enterprises.html>>, accessed on 22 May 2018.

¹⁴⁹ Andrea Goldstein, ‘The Emergence of Multilatinas: The Petrobras Experience’, (2010), Universia Business Review, num. 25, pg. 98-111, 100-104, <<http://www.redalyc.org/pdf/433/43312280006.pdf>>, accessed on 15 July 2018.

¹⁵⁰ *Ibid.*

employment generation, price control, etc.), also enjoys a level of managerial autonomy and is expected to perform commercially.¹⁵¹

Petrobras listed its securities on the New York Stock Exchange (“NYSE”) in 2000 – this was in addition to its shares trading on the São Paulo Stock Exchange since 1968.¹⁵² Additionally, Petrobras’ shares have been trading on the Madrid Stock Exchange¹⁵³ and the Buenos Aires Stock Exchange¹⁵⁴ since 2002 and 2006 respectively.¹⁵⁵ With this listing, Petrobras’s shareholding became more dispersed, with retail investors substantially participating in the same.¹⁵⁶ Even though the listing of its securities diluted government ownership of Petrobras, control still remained with the Government.¹⁵⁷

The example of Petrobras has been cited as an example of how corporate governance of SOEs could be enhanced post ‘democratizing’ such SOE’s share capital, leading to an enhancement of company value.¹⁵⁸ It has been suggested that the regulatory framework applicable to listed SOEs presents an opportunity for improvement in corporate governance, which in the case of Petrobras is clearly evident.¹⁵⁹ Post-listing of its securities in various stock exchanges, the requirement to comply with the varying regulatory frameworks including those of the BM&FBovespa of Brazil, the Securities and Exchange Commission and the NYSE in the US, the Madrid Stock Exchange of Spain and Buenos Aires Stock Exchange of Argentina, led to the adoption of corporate governance best practices by Petrobras across jurisdictions.¹⁶⁰ Particularly, complying with the requirements of the Sarbanes-Oxley Act, 2002 of the US has had positive effects on enhancing the corporate governance standards in Petrobras, setting stage for its growth into a globally successful company.¹⁶¹ The listing of Petrobras’s securities and its consequent adherence to enhanced corporate governance frameworks has found favour even with multilateral organizations such as the World Bank.¹⁶²

However, notably in 2014 a massive corruption scandal involving high-level functionaries of Petrobras, politicians and a cartel of companies was unearthed, colloquially known as ‘*Operation Carwash*’.¹⁶³ This has been reportedly one of the most damaging corruption scandals to have hit

¹⁵¹ *Ibid.*

¹⁵² US Securities and Exchange Commission, ‘Form 20-F Annual Report Pursuant To Section 13 Or 15(D) Of The Securities Exchange Act Of 1934 for the fiscal year ended December 31, 2008: Petrobras’ <<https://www.sec.gov/Archives/edgar/data/1119639/000095012309009383/y76586e20vf.htm>>, pg. 22, 117, accessed on 02 August 2018.

¹⁵³ Madrid Stock Exchange is the largest stock exchange of Spain.

¹⁵⁴ Buenos Aires Stock Exchange is the primary stock exchange of Argentina.

¹⁵⁵ *US Securities and Exchange Commission, Form 20-F*, (n. 152).

¹⁵⁶ Andrea Goldstein, ‘The Emergence of Multilatinas: The Petrobras Experience’, (2010), Universia Business Review, num. 25, pg. 100-104, <<http://www.redalyc.org/pdf/433/43312280006.pdf>>, accessed on 15 July 2018.

¹⁵⁷ *Ibid.*

¹⁵⁸ Sodali and Governance Consultants S.A., ‘White Paper: The Importance of Corporate Governance in State Owned Enterprises – SOEs’, (June 2012), Prepared for the Latin American Development Bank, pg. 63-68, 69, <<https://www.oecd.org/daf/ca/SecondMeetingLatinAmericaSOECAFWhitePaper.pdf>>, accessed on 15 July 2018

¹⁵⁹ *Ibid.*

¹⁶⁰ *Ibid.*

¹⁶¹ *Ibid.*; The Sarbanes-Oxley Act, 2002 seeks to ‘protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to securities laws and for other purposes’. The Act is considered to have enhanced reforms in the US securities regulation framework by enhancing corporate responsibility, enhancing financial disclosures and combating corporate and accounting fraud. See, U.S. Securities and Exchange Commission, ‘The Laws That Govern The Securities Industry’, <<https://www.sec.gov/answers/about-lawsshtml.html>>, accessed on 01 August 2018.

¹⁶² The World Bank Group, ‘Corporate Governance of State-Owned Enterprises: A Toolkit’, (2014) <<https://openknowledge.worldbank.org/bitstream/handle/10986/20390/9781464802225.pdf>>, pg. 43-44, accessed on 15 July 2018.

¹⁶³ David Segal, ‘Petrobras Oil Scandal Leaves Brazilians Lamenting a Lost Dream’ (*The New York Times*, 7 August 2015) <<https://www.nytimes.com/2015/08/09/business/international/effects-of-petrobras-scandal-leave-brazilians-lamenting-a-lost-dream.html>>. accessed on 07 August 2018.

Brazil in recent years, with billions of dollars of money being allegedly laundered and paid in kick-backs over a prolonged period of time.¹⁶⁴ Such were the consequences of Operation Carwash's fallout, that Petrobras was the subject of class-action lawsuits in the US.¹⁶⁵ While certain commentators note that Operation Carwash questions conventional '*wisdom regarding the existence of SOEs and their capacity to remain insulated from political interference*',¹⁶⁶ it is important to highlight that Brazil did usher in reforms in its corporate governance framework including the enactment of the SOE Statute in the wake of such massive governance lapses, as mentioned previously.

In sum, the example of Petrobras in Brazil points out that the effect of subjecting SOEs to the same governance standards as non-SOEs, is positive for the growth of the SOE. Requiring SOEs to face market discipline (and consequently adopt allied regulatory frameworks), therefore, is not only beneficial to the cause of competitive neutrality, but also enhances corporate governance, thereby positively impacting company value. Moreover, effective corporate governance of SOEs, as the fallout of Operation Carwash represents, is not a one-time affair, but requires constant intervention.

Norway

An OECD study (2017) states that Norway has 55 SOEs which account for an enterprise value of USD 107.9 billion which is a sizable figure in comparison to other OECD countries.¹⁶⁷ These SOEs are divided into four categories based on the State's objectives behind the ownership: (1) commercial objectives; (2) commercial objectives and objective of maintaining head office functions in Norway; (3) commercial objectives and other specifically defined objectives; and (4) sectoral policy objectives.¹⁶⁸

SOE Governance Structure

Under the Norwegian Constitution, SOEs fall under the administration of government ministries, but the Norwegian Parliament (*Storting*) has the express authority to instruct the government with respect to SOEs.¹⁶⁹ Norway considered but ultimately vetoed the adoption of a holding company model to avoid adding layers to its SOE holding structure.¹⁷⁰ However, it has followed a trend towards centralization of shareholdings by allocating interests in most commercial SOEs to the "*ownership department*" of the Ministry of Trade, Industry and Fisheries, especially since 2001.¹⁷¹

¹⁶⁴ *Ibid.*

¹⁶⁵ *Ibid.*

¹⁶⁶ See, Monica Arruda de Almeida and Bruce Zagaris, 'Political Capture in the Petrobras Corruption Scandal: The Sad Tale of an Oil Giant', *The Fletcher Forum of World Affairs*, Vol 39:2 (Summer 2015), 87-99, pg. 96-97.

¹⁶⁷ *OECD, The Size and Sectoral Distribution of State-owned enterprises*, (2017), (n. 05), pg. 65.

¹⁶⁸ Norwegian Ministry of Trade, Industry and Fisheries, *The State Ownership Report* (2016), pg. 6, <<https://www.regjeringen.no/contentassets/b7e367d388ba41dd839f34d64c0e4cc1/the-state-ownership-report-2016.pdf>>, accessed on 21 May 2018.

¹⁶⁹ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 19.

¹⁷⁰ In 2004, a preparatory committee in charge of reviewing the organisational structure and administration of state ownership offered only timid support on value maximisation objective; Norwegian Ministry of Trade and Industry, 'An Active and Long-Term State Ownership', Report to the Storting (White Paper) No. 13 (2006–2007) (hereinafter "2006-2007 White Paper"), pg. 70, <https://www.regjeringen.no/contentassets/01527a83111e45639d5dbb0d84882a44/eng/pdfs/stm200620070013000en_pdfs.pdf>, accessed on 15 May 2018.

¹⁷¹ *Ibid.*

However, for certain SOEs such as Equinor ASA (earlier known as Statoil ASA),¹⁷² which is a leading conglomerate in the energy sector, the government shareholding is administered by the Ministry of Petroleum and Energy.¹⁷³ Yet, there is a formal separation of functions between the Ministry of Petroleum and Energy (as an administrative ministry in-charge of Equinor ASA) and the Norwegian Petroleum Directorate (which is a technical advisory agency empowered to regulate the petroleum sector). Therefore, Equinor ASA, like private oil firms, is subject to regulatory oversight by the Norwegian Petroleum Directorate, a technical advisory agency.¹⁷⁴ The State's involvement as a shareholder is channelled through shareholder meetings, in accordance with the Norwegian Public Limited Liability Companies Act, 1999. However, in case of Equinor ASA, the Ministry of Petroleum and Energy has admitted to exercising influence through informal meetings as well.¹⁷⁵ The Norwegian Government has, in fact, reemphasised on continued political and governance supervision along with maintaining transparency.

Distinctively, in Norway, serving public servants in the Central Government are precluded from serving on SOE Boards. This prohibition traces back to a fatal accident in 1962 which led to the death of miners, commonly known as the “King’s Bay Affair”. This incident involved a State-owned mining company, which had the Minister of Industry serving on its Board.¹⁷⁶ The original rationale behind the preclusion was not to prevent political interference in management, but to discourage Parliament from holding the government accountable for business decisions of SOEs.¹⁷⁷

Competitive Neutrality

Norway’s listed SOEs are subject to the same corporate and securities laws as those governing private firms, including the Public Limited Liability Companies Act, 1999 and stock exchange regulations.¹⁷⁸ Norway’s corporate law provides for a strong principle of equal treatment.¹⁷⁹ The Norwegian Government has admitted the importance of treating all shareholders equally.¹⁸⁰ Morten M. Kallevig, representing the Royal Norwegian Ministry of Trade and Industry, has acknowledged that the Ministry or its officials do not take part in the day-to-day running of the company where

¹⁷² Statoil ASA is known as Equinor ASA, post a resolution passed in May 2018 to this effect, to support its “*strategy as a broad energy company*”. See, Equinor ASA, ‘About our name change’ <<https://www.equinor.com/en/about-us/about-our-name-change.html>>, accessed on 16 July 2018.

¹⁷³ *Ibid*, pg. 23.

¹⁷⁴ *Ibid*.

¹⁷⁵ BeateSjåfjell, ‘Sustainable Companies: Possibilities and Barriers in Norwegian Company Law’, University of Oslo Faculty of Law Legal Studies, Research Paper Series No. 2013-20, <<https://ssrn.com/abstract=2311433>>, accessed on 26 May 2018.

¹⁷⁶ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 22. Mark C. Thurber & Benedicte Tangen Istad, Norway’s Evolving Champion: Statoil and the Politics of State Enterprise (2010) 32 (Program on Energy & Sustainable Dev., Working Paper No. 92, 2010), <https://fsi-live.s3.us-west-1.amazonaws.com/s3fspublic/WP_92%2C_Thurber_and_Istad%2C_Statoil%2C_21May2010.pdf>, accessed on 26 May 2018. The King’s Bay Affair is used to refer to the fatal accident which lead to death of several miners at King Bay’s mines in November 1962. A commission was constituted by the Storting which found the then Minister of Industry liable for several deficiencies in the management of the mine. This ultimately lead to the fall of the Norwegian Government.

¹⁷⁷ *Governance challenges of Listed State-owned Enterprises*, (n. 06), pg. 22.

¹⁷⁸ *Ibid*, pg. 20.

¹⁷⁹ 2006-2007 White Paper, (n. 170).

¹⁸⁰ For a Detailed Description of Norway’s Principles of Good Ownership, see Norwegian Ministry of Trade and Industry, The Government’s Ownership Policy (2008), pg. 67 <https://www.regjeringen.no/globalassets/upload/nhd/statenseierberetning/pdf/engelsk/the_governments_ownership_policy_2008.pdf>, accessed on 11 May 2018.

the State owns shares.¹⁸¹ The Norwegian Government's objective is that an SOE should be run according to the same principles as a well-run private company.¹⁸²

The Norwegian Ministry has stressed that the State must not favour its own companies and treat all companies in the same sector equally.¹⁸³ Doing so will enable the State to earn the confidence of market participants and ensure that development of SOEs takes place on a sound economic basis, which in turn increases the value of the State's assets.¹⁸⁴

The Norwegian Government's Policy states that "*the government's approach to such cases will be to ensure that the state's management of companies does not distort competition between publicly and privately owned companies competing in the same industry. This requires continuous reassessment of such companies, as industries and markets develop over time*".¹⁸⁵

An OECD study on the Norwegian economy concludes by stating that "*State-ownership administration is in many respects exemplary. For instance, governance guidelines generally follow accepted good practice. Also, some progress has been made in increasing the independence of the regulators of state-owned companies, though more could be done.*"¹⁸⁶

Case Study: Equinor ASA

Statoil ASA (now known as Equinor ASA) is the Norwegian national oil company.¹⁸⁷ Along with Brazil's Petrobras, Equinor is considered to be one of the prominent State-controlled oil companies.¹⁸⁸ Being partially privately owned since 2001 (because of its listing on the Oslo Stock Exchange and the NYSE),¹⁸⁹ Equinor is considered to have '*formal governance measures beyond reproach*'.¹⁹⁰ Though Equinor's evolution over time has closely mapped its relationship with the government of Norway, the approach adopted by the Norwegian government to separate policy, regulatory and commercial functions is considered exemplary.¹⁹¹

¹⁸¹ Ownership Function of the Norwegian State, OECD Russian Corporate Governance Roundtable Meeting, (Moskva 2-3 June 2005), <<https://www.oecd.org/daf/ca/35175246.pdf>>, accessed on 11 May 2018.

¹⁸² *Ibid.*

¹⁸³ OECD, OECD Reviews of Regulatory Reform: Norway 2003, pg. 117, <https://books.google.co.in/books?id=vgI6_q98YVkC&pg=PA117&lpg=PA117&dq=whitepaper+norway+same+legal+treatment+STATE+OWNED+ENTERPRISE&source=bl&ots=cDcc_ZaXBY&sig=QpbzHCXFrYIOFIZR7uMn4ZndBjU&hl=en&sa=X&ved=0ahUKEwix_Mjo_pXbAhXFP48KHTWvBuUQ6AEITjAH#v=onepage&q=whitepaper%20norway%20same%20legal%20treatment%20STATE%20OWNED%20ENTERPRISE&f=false>, accessed on 12 May 2018.

¹⁸⁴ *Ibid.*

¹⁸⁵ The Norwegian Government Policy for Reduced and Improved State Ownership (based on White Paper No 22 (2001-02), pg. 7, <https://www.regjeringen.no/globalassets/upload/kilde/nhd/rap/2002/0015/ddd/pdfv/157550-white_paper_no_22_2001-2002.pdf>, accessed on 27 May 2018.

¹⁸⁶ OECD Economic Surveys – Norway, January 2018, pg. 31, <<https://www.oecd.org/eco/surveys/norway-2018-OECD-economic-survey-overview.pdf>>, accessed on 14 May 2018.

¹⁸⁷ Mark C .Thurber and Benedicte Istad, 'Norway's Evolving Champion: Statoil and the Politics of State Enterprise', (2010), Program on Energy and Sustainable Development, Stanford University, Working Paper no. 92 <https://fsi-live.s3.us-west-1.amazonaws.com/s3fs-public/WP_92%2C_Thurber_and_Istad%2C_Statoil%2C_21May2010.pdf>, accessed on 15 July 2018, pg. 5 -38.

¹⁸⁸ *Ibid.*

¹⁸⁹ Equinor ASA, 'Corporate Governance', <<https://www.equinor.com/en/about-us/corporate-governance.html>>, accessed on 16 July 2018.

¹⁹⁰ Norway's Evolving Champion: Statoil and the Politics of State Enterprise, (n. 187)

¹⁹¹ *Ibid.*

The success of Equinor notwithstanding, what really does stand out is Equinor's separation from the Norwegian State, despite the considerable inter-linkage and tussle between the State and Equinor.¹⁹² Indeed, the control of Equinor, as has been well documented, has been a matter of some consternation over the years, with the insistence of Equinor on enjoying privileges being met with attempts from the State to cut back on Equinor's privileges, to prevent the creation of a '*State within a State*'.¹⁹³ In fact, the formal separation of the political and commercial role of the State in managing Equinor was a conclusion reached early on, with consequent reforms being carried on to this effect in the 1980s with a number of powers of Equinor being clipped, including the right to interest in future concessions, elimination of veto powers over field decisions, etc.¹⁹⁴

With the so-called Mongstad debacle,¹⁹⁵ occurring, the focus shifted from such time onwards, to ensuring that Equinor developed an arms-length relationship with the Norwegian State.¹⁹⁶ This was achieved because of the realisation that Equinor's survival was dependent on its ability to effectively compete abroad and the merits of having a stronger corporate culture, with the use of formal methods of corporate governance featuring prominently on the list of Equinor's management.¹⁹⁷ This was sought to be done by the partial privatization of Equinor, and the subsequent listing of its shares on the Oslo Stock Exchange¹⁹⁸ and NYSE.¹⁹⁹ In the aftermath of Equinor's privatization, the formal arms-length relationship between the Norwegian State and Equinor as a majority shareholder indicates that in certain senses, the independence of the Norwegian State from Equinor has definitely taken shape – the example used to illustrate this is the suit filed against Equinor by the Norwegian government in 2008, to recover dues owed by the company in relation to the expansion of the Kårstø gas processing terminal.²⁰⁰

The example of Equinor serves as an important reminder that the independence of SOEs, no matter what their size or stature, is critical. In this regard, as Equinor shows, corporate governance frameworks which ought to focus on the at-par treatment of SOEs with their non-SOE counterparts or competitive neutrality, not only have a pivotal role to play, but may also help in minimizing the State's overarching presence as a majority shareholder

Lessons for India

A study of best practices in corporate governance of SOEs in the three jurisdictions discussed above, reveals one design that is "*the lack of a design*". While SOEs form the very edifice of China's fast-growing economy, in the US, the case seems to be opposite. Also, the centralised regime in the form of a holding company structure has worked out to Singapore's advantage whereas Norway, another '*gold standard*' country has consciously rejected the holding company

¹⁹² *Ibid.*

¹⁹³ *Ibid.*

¹⁹⁴ *Ibid.*

¹⁹⁵ *Ibid.* The Mongstad incident involved a massive cost overrun on a project which was intended to expand the capacity of a refinery. This excess spending was heavily criticized by the Norwegian press.

¹⁹⁶ *Norway's Evolving Champion: Statoil and the Politics of State Enterprise*, (n. 187).

¹⁹⁷ *Ibid.*

¹⁹⁸ Oslo Stock Exchange is a stock exchange operating in Norway.

¹⁹⁹ *Norway's Evolving Champion: Statoil and the Politics of State Enterprise*, (n. 187).

²⁰⁰ *Ibid.*

model. Brazil, on the other hand, has a similar model of SOE governance, as is currently adopted by India.

India has valuable lessons to learn from these economies. For starters, we must contemplate devising an Indian model for SOE governance since we have neither accepted (like Singapore) nor consciously rejected (like Norway) the holding structure model.²⁰¹ Laying down clear policy objectives for SOE governance would also go a long way in bringing transparency for investors, creditors and other stakeholders – a lesson to be learnt from Singapore, Norway, and Brazil. Cases like the recent HPCL stake sale, the sale of coal at subsidized prices by Coal India and the recent proposal for ONGC to bear the brunt of government's decision to reduce fuel prices²⁰² in India, clearly highlight the '*political*' benefits of control exercised by the Central Government in India, as a majority shareholder of CPSEs. Regulation of related party transactions as part of the corporate governance framework for SOEs also assumes significance in this context. As discussed earlier, while CPSEs are exempt from the full rigor of regulation governing related party transactions in India, Singapore and Norway apply similar norms on SOEs as applicable to other private players.²⁰³ In Brazil, under the SOE Statue, SOEs are required to put in place and disclose a policy for related-party transactions.²⁰⁴ Thus, in terms of the OECD principle which recommends a level playing field between SOEs and private companies,²⁰⁵ Singapore and Norway appear to score well, with Brazil making sincere efforts (one of it being the introduction of the SOE Statue) towards improving SOE governance in general.

Thus, certain experiences of overseas economies discussed above and their successes and failure in regulating SOEs can serve as a valuable aid for Indian policy-makers in their attempt to bring an overhaul in the legal framework for CPSE governance in India. However, needless to add, the corporate governance norms in any country do not operate in a silo and are affected by various other economic, political and social factors which must be borne in mind before transplanting internationally used methods and policies in the Indian landscape.

²⁰¹ While in India, a holding company structure for PSBs has been considered but has not been implemented. See, Report of the Committee to review the Governance of Boards of Banks of India, 13 May, 2014, <<https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/BCF090514FR.pdf>> accessed on 02 May 2018.

²⁰² While no executive decision has been taken in this regard, news report suggests that the government is mulling on the proposal to cut fuel prices for which ONGC may be required to bear the burden for such subsidy, see 'Govt to ask ONGC to bear fuel subsidy to help cut petrol, diesel prices', (*Livemint*, 01 June 2018), <<https://www.livemint.com/Companies/h8kLbprGfCM1sJ0WNpjMSI/Govt-to-ask-ONGC-to-bear-fuel-subsidy-to-help-cut-petrol-di.html>>, accessed on 02 June 2018.

²⁰³ Singapore has been ranked 1st in the "Extent of Conflict of Interest Regulation Index" which is also referred to as the "Related Party Transaction Index" under the World Bank's Doing Business Report, (2018), <<http://www.doingbusiness.org/reports/globalreports/doing-business-2018>>, accessed on 15 June 2018. Section 156 of the Companies Act, 2006 (Singapore) requires disclosure from every director or chief executive officer of company who is interested in a transaction/ proposed transaction. In case of listed companies, Rule 904 of the Mainboard Rules of the Singapore Stock Exchange defines interested person transaction. Rule 918 and Rule 919 of the Mainboard Rules require shareholder approval (by way of 'majority of minority' vote) in case when an interested person transaction is above the prescribed threshold. Interested person transactions are also governed by an accounting standard, the Singapore Financial Reporting Standard 24 (FRS24) aims at disclosure of interested person transactions in the periodic financial statements, which applies to both listed and unlisted companies. In Norway, while the Public Companies Act, 1997 defines 'related parties'. Also, shareholder approval for related party transactions, subject to certain conditions, may be required. See, Lars-Kaspar Andersen, Kristina Sandanger and Ole Christian Muggerud, 'Corporate Governance and director's duties in Norway: Overview', UK Practical Law, <[https://uk.practicallaw.thomsonreuters.com/6-551-0927?transitionType=Default&contextData=\(sc.Default\)](https://uk.practicallaw.thomsonreuters.com/6-551-0927?transitionType=Default&contextData=(sc.Default))>, accessed on 16 June 2018.

²⁰⁴ Article. 8, Paragraph VII, SOE Statute.

²⁰⁵ OECD, 'The OECD Guidelines on Corporate Governance of State-Owned Enterprises', (2015 Edition), Guideline III: <<http://www.oecd-ilibrary.org/content/uploads/2017/07/OECD-2015.pdf>>, accessed on 07 June 2018.

VI. Conclusion

As the recent Report of the Uday Kotak Committee constituted by SEBI (“**Kotak Committee**”) had emphasised, SOEs in India face unique corporate governance challenges, unlike their private sector counterparts.²⁰⁶ More particularly, with respect to exemptions granted to SOEs in India, the Kotak Committee initiated a discussion in the right direction by recommending that listed SOEs fully comply with the provisions of the LODR.²⁰⁷ However, the broader issue of whether the overall statutory framework on exemptions given to SOEs requires re-consideration, especially in the context of corporate governance, has not been evaluated enough in India.²⁰⁸

The present Report, therefore, has attempted to highlight the various statutory exemptions pertaining to corporate governance granted to CPSEs as an indicator for the lack of competitive neutrality. It also seeks to demonstrate through case studies how these exemptions result in a complete disregard for corporate governance practices which hampers the interests of non-government stakeholders of such CPSEs.

Importantly, it may be argued that apart from the immediate adverse impact caused to non-government stakeholders such as minority investors, lack of competitive neutrality in the governance framework for SOEs also affects the government in the long term. The Legal Matrix in **Annexure A** demonstrates how the regulatory exemptions granted to CPSEs result in lack of accountability in these companies. The upshot is that the lack of competitive neutrality erodes value from CPSEs. Given that disinvestment of government shareholding in CPSEs is an integral part of the “*Three Year Action Agenda*” of the government,²⁰⁹ actions that restore or increase the valuation of CPSEs deserve to be studied. Adopting a market-tested sound governance framework is certainly one such action.

Long-term ill effects of the lack of accountability and consequent value erosion in operations of CPSEs is best manifested by the financial condition of Air India and the lack of appetite demonstrated by the private sector in investing in it.²¹⁰ Reportedly, the Government wants to list 14 CPSEs on stock exchanges in the near future, as well as undertake strategic disinvestment in 24 CPSEs, including Air India.²¹¹

If the government is desirous of getting reasonable returns from the disinvestment, it is important to ensure that CPSEs are valuable to prospective investors. It is also important to ensure that minority shareholders in CPSEs are assured that their investments in CPSEs will be protected by adequate corporate governance standards. One way to start this process would be to create a ‘*level playing field*’. Signalling to minority shareholders the intent to hold CPSEs to the same standards of governance as their private sector counterparts, would certainly incentivise minority investors to participate in the disinvestment process. Given the enormity of the Central Government’s ambitious disinvestment programme, with targets for the present financial year set as high as INR

²⁰⁶ SEBI, Report submitted by the Committee on Corporate Governance, October 2017, pg. 96, <<http://www.nfcg.in/KOTAKCOMMITTEREPORT.pdf>>, accessed on 07 June 2018.

²⁰⁷ *Ibid.*

²⁰⁸ Shailesh Haribhakti, Vedika Mittal & Param Pandya, ‘Is India Inc ready to raise the corporate governance bar?’, (*Business Standard*, 15 October 2017), <http://www.business-standard.com/article/opinion/sebi-panel-on-corporate-governance-is-india-inc-ready-to-up-the-bar-117101500647_1.html>, accessed on 07 June 2018

²⁰⁹ NITI Aayog, Government of India, ‘Three Year Action Agenda 2017-18 to 2019-20’ (23 April 2017), Paragraph 16.3, <<http://niti.gov.in/writereaddata/files/coop/ActionPlan.pdf>>, accessed on 07 June 2018.

²¹⁰ CAPA India, ‘Air India Privatisation’, <https://www.capaindia.com/air-india-privatisation>, accessed on 20 June 2018. See also, Sindhu Bhattacharya, ‘No Takers For Air India Stake Sale. Here’s Why it Crashed Before Takeoff’, (*News18*, 01 June 2018), <<https://www.news18.com/news/opinion/no-suitors-for-air-india-stake-sale-heres-why-it-crashed-before-takeoff-1765421.html>>, accessed on 28 June 2018.

²¹¹ *Speech of Shri Arun Jaitley, Minister of Finance*, (n. 87).

80,000 crores,²¹² the immediacy for corporate governance reforms cannot be understated. Towards that end, leveling the regulatory framework for CPSEs should figure at the top of the reform agenda, or else the professed notion of ‘*unlocking value*’ through disinvestment will remain a pipe dream.

Lastly, as the Report discusses, there is no one particular approach to the corporate governance of SOEs which is followed the world over. This ‘lack of design’ in corporate governance models world over, then, indicates that social, economic and cultural aspects have a significant role to play in ensuring that policy-makers, arrive at a distinctive ‘Indian model’ for the governance of CPSEs.

²¹² *Ibid*, Paragraph 126.

VII. Next Steps

We understand that the Central Government's objective has always been to improve the corporate governance framework applicable to CPSEs which is evident from the fact that compliance with the Guidelines, which was earlier voluntary was made mandatory from 2010 onwards. However, as discussed in **Annexure A** to this Report, these Guidelines have not served their purpose mainly due to lack of effective enforcement.²¹³ Moreover, since the Companies Act provides for a robust governance framework and a streamlined enforcement mechanism, it may serve as a better alternative than the Guidelines. In this backdrop, it may be worthwhile to consider phasing out the Guidelines and related exemptions.

Towards this end, one of the most preliminary steps is to classify all corporate governance exemptions granted to CPSEs according to the purpose served by the exemption. For example, in our opinion, certain exemptions granted to CPSEs such as exemption from Section 164(2) of the Companies Act (this provision disqualifies directors of companies that have not filed financial statements or annual returns for three years or failed to repay deposits, redeem debentures or pay dividend declared by the company for a period of over one year) do not resonate with the intent of the government to increase accountability of the Board of CPSEs.

Another example is the exemption from Section 186 of the Companies Act which places restrictions and reporting requirements for loans and investments made by companies. Exemption from this provision may actually expose government finances to unnecessary lapses. In our opinion, a purpose based classification will reveal that a majority of the exemptions may not be necessary for most CPSEs except those engaged in sectors strategic for national security such as atomic energy, defence and space. We propose that in order to undertake this classification as well as to review the broader corporate governance framework for CPSEs, a Committee on Corporate Governance Reforms for CPSEs must be set up as indicatively represented below.

²¹³ Please see under 'Company Law' Point 1 and Point 2 of Table 1 in Annexure A.

STEP 01

Committee on Corporate Governance Reforms for CPSEs (CCGRC)*

Constitute the CCGRC with representatives from:

- Ministry of Heavy Industries & Public Enterprises;
- Ministry of Corporate Affairs;
- Securities & Exchange Board of India;
- Competition Commission of India; and
- Experts on corporate law, securities law and competition law including academics, practitioners and industry representatives.

STEP 02

Terms of Reference of CCGRC

The CCGRC must address issues such as:

- Review of the corporate governance framework for CPSEs;
- Statutory exemptions to CPSEs;
- Ownership structure of CPSEs;
- The CCGRC may constitute different working groups for each of the issues identified, including those listed above.

STEP 03

Comprehensive Corporate Governance Policy for CPSEs

- Findings of the CCGRC may culminate into a policy outlining the future outlook of corporate governance norms for CPSEs.

* We note that the Department of Heavy Industries, Ministry of Heavy Industries and Public Enterprises had constituted a Committee on June 16, 2014 to 'suggest changes/modifications in the DPE guidelines relating to Board of Directors of CPSEs and Corporate Governance' which was reconstituted on March 24, 2017. Therefore, instead of constituting the CCGRC, the terms of reference of the existing Committee may be revised and additional members may be nominated based on their areas of expertise and the revised terms of reference.

Annexure A - Legal Matrix

Notes:

- All exemptions for CPSEs under the Companies Act as stated in Table 1 below have been made pursuant to the notification issued by the MCA under Section 462 of the Companies Act.²¹⁴ As stated in Column B of Table 1, in place of certain exemptions, corresponding Guidelines are applicable to CPSEs. However, as discussed in Column C of Table 1, in most cases enforcement of the Guidelines remains questionable and the prescribed sanction for non-compliance is not at par with the Companies Act.
- Exemptions/modification in terms of securities laws and competition law applicable to CPSEs is provided in the relevant securities law/competition law statute itself as explained in detail in Columns A and B of Table 1.

Table 1: Exemptions granted to CPSEs under company law, securities regulation and competition law in India

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
Company Law			
1.	Exemption from Section 134(3)(e) of Companies Act²¹⁵ Section 134(3)(e) requires listed companies and certain other companies, to disclose in the Report of the Board - the company's policy on directors' appointment and remuneration including criteria for determining the qualifications, positive attributes, independence of a	A government company is exempted from such disclosure requirements in the Report of the Board which is placed in the general meeting of its shareholders.	<ul style="list-style-type: none"> The non-government shareholders of CPSEs have no role in ratifying the appointment of the directors. In fact, the Board itself is not empowered to prescribe criteria or appoint directors.

²¹⁴ All exemptions under the Companies Act are made pursuant to the Notification No. GSR 463 (E), dated 05 June 2015, as amended by Notification No. GSR 582 (E) dated 13 June 2017, Notification No. GSR 582 (E) , <http://www.mca.gov.in/Ministry/pdf/Exemptions_to_govt_companies_05062015.pdf>, accessed on 08 May 2018.

²¹⁵ Section 134 of the Companies Act corresponds to Section 215, 216, 217 and 218 of the Companies Act, 1956. No exemption to these sections was granted to government companies under the Companies Act, 1956.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
	<p>director, policy for remuneration of directors, key managerial personnel and other employees, etc. as provided under Section 178(3) of the Companies Act.</p> <p>The Report of the Board is placed in the general meeting of the shareholders of the company.²¹⁶</p>	<p>The Guidelines state that the Board shall comprise of: (a) Functional Directors (the equivalent of Executive Director); (b) Nominee Directors (directors appointed by the administrative ministry); and (c) Independent Directors. They also provide the necessary qualifications for each category of directors.²¹⁷ Each CPSE is required to constitute a Remuneration Committee (“RC”) comprising of at least three directors, all of whom should be part-time Directors (i.e. Nominee Directors or Independent Directors).²¹⁸</p>	<ul style="list-style-type: none"> Violation by non-government companies, of Section 134(3)(e) which provides for certain disclosures in the Report of the Board is punishable with a fine between INR 50,000 to INR 25 lakh and imprisonment for an officer in default with maximum 3 years or INR 50,000 to INR 5 lakh or both. Pursuant to the exemption granted to CPSEs, this sanction is presumably not applicable to CPSEs. The only deterrent is the annual grading of all CPSEs published by DPE wherein CPSEs are rated as ‘Excellent’, ‘Very Good’, ‘Good’, ‘Fair’ or ‘Poor’. The consequences of non-compliance with applicable laws may result in shifting the CPSE in a lower category or deduction of marks from the aggregate score of the CPSE. Other consequences for employees are limited to performance pay variance based on the rating. The absence of adequate sanctions for violating the Guidelines raises questions on its enforcement.

²¹⁶ Section 134(3)(e) of the Companies Act.

²¹⁷ Paragraph 3.1 read with Annex-I of the Guidelines.

²¹⁸ Paragraph 5.1 of the Guidelines.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			<ul style="list-style-type: none"> ▪ Section 178(1) of the Companies Act which provides for constitution of a Nomination and Remuneration Committee (“NRC”), is applicable to CPSEs. However, since directors of CPSEs are appointed by administrative ministries of the Central Government, the NRC effectively acts as the RC. ▪ The Report of the Comptroller and Auditor General of India (“CAG Report”)²¹⁹ lists that atleast 6 CPSEs have not constituted RC as required by the Guidelines. ▪ Violation of Section 178(1) of the Companies Act is punishable with a fine between INR 1 lakh to INR 5 lakh and imprisonment for an officer in default with maximum 1 year or INR 25,000 to INR 1 lakh or both. Apart from the downgrade in ratings discussed earlier, no punishment of the like nature has been

²¹⁹ The Report of the Comptroller and Auditor General of India for the year ending March 31, 2016 (Report No. 6 of 2017) on General Financial Reports of CPSEs,<<https://www.cag.gov.in/content/report-6-2017-compliance-audit-union-government-general-financial-reports-central-public>>, accessed on 01 May 2018. As on 31 March 2016, there were 607 CPSEs under the audit jurisdiction of the Comptroller and Auditor General of India. These included 410 government companies, 191 government controlled other companies and 6 statutory corporations. This Report deals with 384 government companies and corporations (including 6 statutory corporations) and 170 government controlled other companies. 53 CPSEs (including 21 government controlled other companies) whose accounts were in arrears for three years or more or were defunct/under liquidation or whose first accounts were not received or were not due were not covered the CAG Report. Please note that the Comptroller and Auditor General of India has not issued any report after the CAG Report in relation to General Financial Reports of CPSEs.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			provided for violation of the Guidelines by CPSEs.
2.	<p>Exemption from Section 134(3)(p) of the Companies Act²²⁰</p> <p>Section 134(3)(p) provides that the Board of all listed companies and other public companies with paid-up share capital of INR 25 crores or more is required to include in the Report of the Board a statement indicating the manner in which formal annual performance evaluation of the Board, its committees, and individual directors has been made.</p> <p>The Report of the Board is placed in the general meeting of the shareholders of the company.²²¹</p>	<p>A government company is exempted from such disclosure requirements in the Report of the Board.</p> <p>This exemption results in a void with respect to the evaluation of the performance of Nominee and Independent Directors of CPSEs as the Guidelines provide for the evaluation of only the Functional Directors on the Board by the administrative ministry.²²²</p>	<ul style="list-style-type: none"> Even with regard to the evaluation of functional directors, the Guidelines require that self-evaluation reports should be approved by the Board of the CPSEs before submitting them to DPE. However, the CAG Report, in the case of National Thermal Power Corporation Limited noted that the management submitted self-evaluation reports for the financial years 2014-15 and 2015-16 to DPE without obtaining approval of its Board.²²³ The CAG Report attributes this as a failure of the DPE to ensure compliance with its own guidelines.²²⁴ This serves as an example of the lack of accountability in the parallel corporate governance framework applicable to CPSEs in India.

²²⁰ Section 134 of the Companies Act corresponds to Section 215, 216, 217 and 218 of the Companies Act, 1956. No exemption to these sections was granted under the Companies Act, 1956.

²²¹ Section 134(3)(e) of the Companies Act.

²²² OECD, Professionalising Boards of Directors of State-Owned Enterprises: Stocktaking of National Practices, (2018), pg. 25, <<http://www.oecd.org/daf/ca/Professionalising-boards-of-directors-of-SOEs.pdf>>, accessed on 25 May 2018.

²²³ CAG Report, (n. 219), pg. 72.

²²⁴ *Ibid.*

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			<ul style="list-style-type: none"> Violation of Section 134(3)(p) which provides for disclosure in relation to annual performance evaluation of the Board, by companies, is punishable with a fine between INR 50,000 to INR 25 lakh and imprisonment for an officer in default with maximum 3 years or a fine of INR 50,000 to INR 5 lakh or both. Apart from the downgrade in ratings discussed earlier, no punishment of the like nature has been provided for violation of the Guidelines by CPSEs.
3.	<p>Exemption from Section 149(6)(a) of the Companies Act²²⁵</p> <p>This Section vests the responsibility with the Board to ensure that an Independent Director is a person of integrity and possesses relevant expertise and experience.</p>	<p>For all government companies, this determination is to be done by the administrative ministry or department of the government which is in charge of such company.</p> <p>The Guidelines²²⁶ provide the criteria for selection of</p>	<ul style="list-style-type: none"> Since '<i>relevant expertise and experience</i>' for the appointment of Independent Directors is left to be determined by the administrative ministries instead of the Board, it may leave room for political appointments.²²⁷ Moreover, even though such directors may not have a direct pecuniary relationship with

²²⁵ Section 149 of the Companies Act corresponds to Section 252, 253, 258 and 259 of the Companies Act, 1956. Government companies were exempt from the application of Section 259 which pertains to obtaining sanction of the Central Government for increasing the number of directors (Notification No. GSR 235, dated 31 January 1978). No exemption with regard to Section 252, 253, 258 was granted to government companies under the Companies Act, 1956.

²²⁶ Paragraph 3.1.4 of the Guidelines.

²²⁷ Please note that the appointment of an Independent Director is made by the Appointment Committee of Cabinet (ACC). However, the administrative ministry proposes the names of the Independent Directors. These candidatures are scrutinised by the Public Enterprises Selection Board (PESB). After obtaining inputs from the Central Vigilance Commission, these candidatures are sent to the ACC which is final arbiter in this matter. For details on board selection and appointment of CPSEs, see World Bank, Republic of India - Report on Corporate Governance of Central Public Sector Enterprises, (2010) pg. 37, <[http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/India\(CG_Public_Sector_Enterprises.pdf\)](http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/India(CG_Public_Sector_Enterprises.pdf))>, accessed on 05 June 2018.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
		Independent Directors which <i>inter alia</i> includes the absence of a pecuniary relationship with the company apart from remuneration payable, the absence of relation with members of the Board or employees one level below the Board, etc.	<p>the CPSE as per the Guidelines, there may be a <i>quid pro quo</i> in the present or future by way of a promise to appointment to other vacant posts by the government, grant of government licenses or contracts and so on.</p> <ul style="list-style-type: none"> Illustratively, a 2010 World Bank Report on Corporate Governance of CPSEs notes that “<i>The present arrangements combine the conflicting roles of policy-making and ownership in some ministries, allow political interference in board appointments and commercial decision-making to continue, and weaken board powers.</i>”²²⁸
4.	<p>Exemption from Section 149(6)(c) of the Companies Act²³⁰</p> <p>This Section states that for appointment as an Independent Director there should be no pecuniary relationship between such director and the company, its holding, subsidiary and associate companies, or their promoters or directors for a certain period.</p>	<p>All government companies have been exempted from this requirement.</p> <p>For the alternate framework under the Guidelines, please see above at Point 1.</p>	<ul style="list-style-type: none"> Violation of Section 149 of the Companies Act, which provides for the composition of the Board, by a company or an officer in default is punishable with a fine between INR 50,000 to INR 5 lakh.²²⁹ Apart from the downgrade in ratings by DPE discussed earlier, no punishment of the like nature has

²²⁸ *Ibid*, pg. 19.

²²⁹ Since no specific penalty is being provided for violation of Section 149 of the Companies Act, Section 172 of the said Act shall apply.

²³⁰ Section 149 of the Companies Act corresponds to Section 252, 253, 258 and 259 of the Companies Act, 1956. Government companies were exempt from the application of Section 259 which pertains to obtaining sanction of the Central Government for increasing the number of directors (Notification No. GSR 235, dated 31 January 1978). No exemption with regard to Section 252, 253, 258 was granted to government companies under the Companies Act, 1956.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			been provided for violation of the Guidelines by CPSEs.
5.	<p>Exemption from Section 152(5) of the Companies Act²³¹</p> <p>Section 152(5) requires that a person appointed as a director is required to give his consent to hold the office of the director. Such consent must be also filed with the Registrar of Companies within 30 days of his/her appointment.</p> <p>The proviso to this Section requires that in case of an appointment of Independent Director in the general meeting, the notice of such meeting shall contain a statement that in the opinion of the Board such person fulfills the conditions specified in the Companies Act for such appointment.</p>	<p>All government companies have been exempted from this provision if the appointment of such director is done by the government.</p> <p>There is no requirement in the Guidelines for the concerned ministry to issue a statement confirming that the criteria for appointment of an Independent Director as prescribed under the Guidelines has been compiled with.</p>	<ul style="list-style-type: none"> Lack of accountability in the appointment of Independent Directors for CPSEs leaves room for politicising appointments. As stated above, this also potentially facilitates the government to enter into <i>quid pro quo</i> transactions by way of (present or future) assurances for appointment to lucrative posts, grant of government licenses or contracts and so on.

²³¹ Section 152 of the Companies Act corresponds to Section 254, 255, 256 and 264 of the Companies Act, 1956. No exemption with reference to Section 254 was provided under the Companies Act, 1956. Section 255 (Appointment of directors and proportion of those who are to retire by rotation) and Section 256 (Ascertainment of directors retiring by rotation and filling of vacancies) were exempted for (a) a government company in which the entire paid-up share capital is held by the Central Government or by any State Government or partly by the Central Government and partly by one or more State Governments; and (b) a subsidiary of a Government company, referred to in clause (a) above, in which the entire paid-up share capital is held by that government company (Notification No. GSR 906, dated 30 July 1981). Section 264 (Consent of candidate for directorship to be filed with the company and consent to act as director to be filed with the Registrar) was exempted for a government company in which the entire paid-up share capital is held by the Central Government or by any State Government or partly by the Central Government and partly by one or more State Governments (Notification No. GSR 577(E), dated 16 July 1985).

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
6.	<p>Exemption from Section 164(2) of the Companies Act²³²</p> <p>This provision bars the appointment or reappointment of a person as a director in any company for five years if such person is or has been a director of a company which has not filed financial statements or annual returns for a continuous period of 3 financial years or has failed to repay deposits accepted by it or interest thereon or to redeem any debentures or interest thereon or pay any dividend declared, and such failure has continued for one year or more.</p>	<p>All government companies have been exempted from this provision.</p> <p>The Guidelines do not provide for such disqualification.</p>	<ul style="list-style-type: none"> ▪ The primary purpose of the disqualification is to protect the public from persons whose past record as directors shows them to be unsuitable for the post.²³³ Exemption from such disqualification for directors of CPSEs vitiates any attempt at ensuring accountability of directors of CPSEs. ▪ Notably, the CAG Report states that nine CPSEs have not submitted their annual returns for a period of three years or more.²³⁴ It may be argued that such exemptions tend to encourage such lackadaisical behaviour on the part of directors and fails to create a framework where directors ensure that compliance requirements, such as filing of annual returns are met. ▪ Violation of Section 164 which provides for disqualification of directors by a company or an officer in default, is punishable with a fine between INR 50,000 to INR 5 lakh.²³⁵

²³² Section 164 of the Companies Act corresponds to Section 202 and 274 of the Companies Act, 1956. No exemption with regard to these Sections was provided to government companies under the Companies Act, 1956.

²³³ Lord Brown-Wilkinson V-C in *Lo-Line Electric Motors Ltd., Re*, 1988 BCLC 698.

²³⁴ CAG Report, (n. 219), Paragraph 19.

²³⁵ Since no specific penalty is being provided for violation of Section 149 of the Companies Act, Section 172 of the said Act shall apply.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
7.	<p>Exemption from Section 178(2), (3) and (4) of the Companies Act²³⁶</p> <p>Section 178 which deals with NRC is applicable to all listed companies and such other class or classes of companies as may be prescribed.²³⁷</p> <p>Section 178(2) states that the NRC shall identify persons who are qualified to become directors and senior management in accordance with the criteria laid down, make recommendations to the Board for appointment and removal of directors and senior management and specify the manner of evaluation of the performance of the Board, its committees, directors.</p> <p>Section 178(3) of the Companies Act requires the NRC to formulate the criteria for determining qualifications, positive attributes, and independence of a director and recommend a policy to the Board, relating to the remuneration of directors, key managerial personnel, and other employees. Also, this policy must be displayed on the company website and the web address must be disclosed in the Report of the Board.</p>	<p>Pursuant to the exemption for government companies, such policy is required to be made only for senior management and not for appointments to the Board.</p> <p>For details on the applicable law under the Guidelines, please refer to Point 1 and 2 above.</p>	<ul style="list-style-type: none"> ▪ For detailed remarks on these issues, please refer to Point 1 and 2 above. ▪ A World Bank Report notes that the remuneration levels in CPSEs are often significantly below what Board members are paid by comparable companies in the private sector.²³⁸ While government control prevents the Board of a CPSE from overpaying itself, low compensation makes it difficult to attract talent that could add value to the company. It also creates perverse incentives for Board members. This may manifest in various ways such as holding unnecessary Board meetings in order to increase sitting fees.²³⁹

²³⁶ There was no provision in the Companies Act, 1956 which corresponds to Section 178 of the Companies Act.

²³⁷ The other classes of companies along with the threshold requirement triggering the application of Section 178 is prescribed in Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014.

²³⁸ The World Bank, ‘Corporate Governance of State-Owned Enterprises: A Toolkit’, (2014), pg. 201-202,

<<http://documents.worldbank.org/curated/en/228331468169750340/pdf/913470PUB097810B00PUBLIC00100602014.pdf>>, accessed on 25 May 2018.

²³⁹ *Ibid.*

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
	Section 178(4) of the Companies Act provides the essential attributes of remuneration policies framed by the NRC. These include ensuring that the remuneration is reasonable and sufficient to attract, retain, and motivate directors, the relationship of remuneration to performance is clear and that the remuneration comprises of a balance between fixed and incentive pay.		
8.	<p>Exemption from Section 185 of the Companies Act²⁴⁰</p> <p>Section 185 lays down the general rule that no company shall directly or indirectly advance a loan or give a guarantee or provide security for a loan taken by (a) any director of a company, or of a company which is its holding company or any partner or relative of any such director; or (b) any firm in which any such director or relative is a partner.</p> <p>As an exception, Section 185(2) provides that subject to various conditions including obtaining a special resolution, a company may advance such loan or guarantee or security.</p>	<p>A government company can provide loans or guarantees or security to or on behalf of its directors if the administrative ministry or department in charge of a government company has granted an approval for the same.</p> <p>There is no equivalent prohibition, as envisaged under Section 185 of the Companies Act, in the Guidelines.</p>	<ul style="list-style-type: none"> ▪ Vesting authority to sanction such loans, securities, etc. for directors of CPSEs with the government makes directors and officers of CPSEs susceptible to the demands of the government and may threaten their independence in decision-making. ▪ Violation of Section 185 is punishable with a fine and imprisonment for the officer/director involved as well as a fine for the company. However, it is unclear if this punishment is applicable for a violation of the limited exemption by government companies and its directors and officers.

²⁴⁰ Section 185 of the Companies Act corresponds to Section 295 and Section 296 of the Companies Act, 1956. The application of Section 295 (Loan to Directors, etc.) was exempted in case when a government company had obtained the approval of the Ministry or Department of the Central Government which is administratively in charge of the company or, as the case may be, the State Government (Notification No. GSR 581(E), dated 16 July 1985). Note that Section 296 only provides that Section 295 shall apply to any transaction represented by a book debt which was from its inception in the nature of a loan or an advance.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
9.	<p>Exemption from Section 186 of the Companies Act²⁴¹</p> <p>Section 186 provides various conditions regarding the provision of loans or investments by companies. This Section <i>inter alia</i> provides that:</p> <ul style="list-style-type: none"> (a) investments may be made through not more than two layers of investment companies,²⁴² subject to certain exclusions; (b) companies must not provide a loan, guarantee or acquire securities, if it exceeds 60% of the company's paid-up capital, free reserves and securities premium account, or 100% of its free reserves and securities premium account, whichever is more; (c) if any such transaction exceeds the limit prescribed in point (b) above, approval of the shareholders by way of a special resolution shall be required. 	<p>This Section does not apply to (a) government company engaged in defence production; (b) a government company, other than a listed company which obtains an approval of the ministry or department which is administratively in-charge of such company.</p> <p>There are no equivalent provisions in the Guidelines.</p>	<ul style="list-style-type: none"> ▪ This exemption may result in weakening the financial fundamentals of these CPSEs. Consequently, if at any time in the future the government is desirous of divesting its stake in part or full in these CPSEs, private sector entities may be reluctant to invest.

²⁴¹ Section 186 of the Companies Act corresponds to Section 372A of the Companies Act, 1956. The application of Section 372A was exempted in case when (a) any company established with the object of financing, where a State Government has made, or agreed to make, to the company a special advance for the purpose of loans or advances to or subscribing to the capital of private industries/enterprises in India; (b) a Government company in respect of which the entire paid-up capital is held by - (1) the Central Government and its nominees; or (2) a State Government and its nominees and that such company has obtained the approval of the Central Government or the State Government, as the case may be, before making any loan or giving any guarantee or providing any security under the said section (Notification No. GSR 990, dated 9 August 1975 & Notification No. GSR 309, dated 20 February 1978).

²⁴² The term "investment company" has been defined in the Explanation to Section 186 of the Companies Act to mean '*a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than 50% of its total assets, or if its income derived from investment business constitutes not less than 50% as a proportion of its gross income*'.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
	<p>(d) a loan or guarantee or security provided by the company to its wholly owned subsidiary or a joint venture company or acquisition made by a holding company of securities of its wholly owned subsidiary shall be an exception to the condition in point (c) above;</p> <p>(e) all such transactions are required to be disclosed in the financial statements;</p> <p>(f) any such transaction, if the limit prescribed in point (b) above is crossed, would require the approval of the public financial institution concerned if a term loan is subsisting, subject to certain conditions.</p> <p>(g) any loan provided under this Section shall not have an interest rate lower than the prevailing yield of one-year, three-year, five-year or ten-year government security closest to the tenor of the loan.</p>		

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
10.	<p>Exemption from first and second proviso of Section 188 (1) of the Companies Act²⁴³</p> <p>Section 188 provides for regulation and disclosure of related party transactions.</p> <p>Certain transactions with related parties²⁴⁴ such as sale, purchase, disposal, lease of property among others, require the approval of the Board.</p> <p>The first proviso to Section 188(1) requires that if the company meets certain transaction/ share capital thresholds, shareholder resolution is required in addition to the Board resolution for entering into a related party transaction, except in case of a transaction between a wholly owned subsidiary and a holding company.</p>	<p>Contracts or arrangements between two unlisted government companies are exempt from this Section. Transactions between an unlisted government and a private company are also exempt from this Section if an approval of the concerned administrative ministry or department of the relevant government is obtained.</p> <p>Kindly refer the section on securities law below for related party transaction exemption to listed government companies.</p>	<ul style="list-style-type: none"> CPSEs in India are spared from the full rigor of related party transaction regulation.²⁴⁵ These exemptions fail to account for the '<i>political private benefits of control</i>' that the government may seek to enjoy at the expense of minority shareholders in CPSEs.²⁴⁶ This exemption particularly assumes significance in the case of listed CPSEs. The anecdotal evidence in case of Coal India²⁴⁷ and the recent share purchase²⁴⁸ of HPCL by ONGC has raised eyebrows in relation to related party transactions entered into by government companies. A brief analysis of these cases has been provided in Chapter IV of this Report.

²⁴³ Section 188 of the Companies Act corresponds to Sections 294, 294A, 294AA, 297 and 314 of the Companies Act, 1956. Government companies were exempted from the application of Section 294, 294AA (2) and (3) of the Companies Act, 1956 (Notification No. GSR 578(E), dated 16 July 1985). No exemption with regard to Section 297 and 314 of the Companies Act, 1956 was provided to government companies. Note that Section 294 and 294AA pertains to prohibition of appointment of sole-selling agents. These sections and its exemption is substantially different from the current premise of Section 188 of the Companies Act.

²⁴⁴ The term 'related party' is defined under Section 2(76) of the Companies Act which includes a director of the company or her relatives, key managerial personnel or her relative, firm, in which a director, manager or her relative is a partner, among others. The term 'relative' is defined in Section 2(77) of the Companies Act.

²⁴⁵ Dan W. Puchniak & Umakanth Varottil, 'Related Party Transactions in Commonwealth Asia: Complexity Revealed', Law European Corporate Governance Institute, Working Paper N° 404/2018, May, 2018, pg. 21, <http://www.ecgi.global/sites/default/files/working_papers/documents/finalpuchniakvarottil.pdf>, accessed on 25 May 2018.

²⁴⁶ Dan W. Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G. Hill & Randall S. Thomas (eds.), Research Handbook On Shareholder Power, 527–32 (Edward Elgar Publishing, 2015).

²⁴⁷ See generally, Curtis J. Milhaupt & Mariana Pargendler, RPTs in SOEs: Tunnelling, Propping, and Policy Channelling, European Corporate Governance Institute, Law Working Paper N° 386/2018, (March, 2018), <http://www.ecgi.global/sites/default/files/working_papers/documents/finalmilhauptpargendler.pdf>, accessed on 25 May 2018.

²⁴⁸ Institutional Investors Advisory Services, 'ONGC acquires HPCL: The Perks of a PSU', 01 March 2018, <https://docs.wixstatic.com/ugd/91c61f_1fe20c11b683455b9ea7444eec88df6f.pdf>, accessed on 27 May 2018.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
	The second proviso to Section 188(1) requires a ' <i>majority of minority</i> ' vote for passing an ordinary resolution since related parties are not allowed to vote, subject to certain exemptions.	The Guidelines provide that all related party transaction must be presented before the audit committee for review and must be disclosed in the Annual Report.	<ul style="list-style-type: none"> ▪ The CAG Report has noted that the books of Hindustan Antibiotics Limited reflect loans and advances to related parties of a subsidiary company amounting to INR 25.30 crores.²⁴⁹ The related party, in this case, is Maharashtra Antibiotics and Pharmaceutical Limited, which is a defunct company and whose financial statements have not been maintained and reconciled since 2010-11.²⁵⁰ Notably, details of the grant of the loan, which is unlikely to be recovered, was not disclosed.²⁵¹ ▪ Violation of Section 188 which provides for regulation of related party transactions by any director or employee of a company – (a) in case of a listed company, is punishable with imprisonment up to 1 year or with fine between INR 25,000 to INR 5 lakhs or with both; (b) in case of any other company is punishable with fine between INR 25,000 to INR 5 lakhs. Apart from the downgrade in ratings discussed earlier, no punishment of

²⁴⁹ CAG Report, (n. 219), pg. 26.

²⁵⁰ Ibid.

²⁵¹ Ibid.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			like nature has been provided for violation of the Guidelines by CPSEs.
11.	<p>Exemption from Section 203(1), (2), (3) and (4) of the Companies Act²⁵²</p> <p>Section 203 provides the appointment process for a key managerial personnel.</p> <p>Section 203(1) <i>inter alia</i> provides that every company belonging to the prescribed class or classes of companies²⁵³ is required to have the following key managerial personnel:</p> <ul style="list-style-type: none"> (a) Managing Director or Chief Executive Officer or Manager and in their absence, a Whole-time Director; (b) Company Secretary; (c) Chief Financial Officer; 	<p>Pursuant to the exemption, sub-sections (1), (2), (3) and (4) of Section 203 are not applicable to a Managing Director, Chief Executive Officer or manager and in their absence in case of a Whole-time Director of a government company.</p> <p>The Guidelines describe the role of the Chairman and/ or Managing Director, however, they do not provide clear rules for re-appointment.</p>	<ul style="list-style-type: none"> ▪ As of 11 April 2017, 42 CPSEs did not have a regular Managing Director/Chairman & Managing Director /Chairman.²⁵⁵ ▪ The Kotak Committee has recommended that for all listed entities, the role of Chairman and Managing Director or Chief Executive Officer must be separated to ensure the independence of the board and avoid concentration of authority.²⁵⁶ Thus, the exemption provided to CPSEs from Section 203(1) in relation to separation of these roles is not in consonance with national and international best practices.

²⁵² Section 203 of the Companies Act corresponds to Section 269, 316 and 386 of the Companies Act, 1956. Government companies were generally exempt from the application of Section 269 (Notification No. GSR 235, dated 31 January 1978) and such government companies whose entire share capital is owned by the Central Government or the State Government were exempted from the application of the Section 386 of the Companies Act, 1956 (Notification No. GSR 577(E), dated 16 July 1985). No exemption with regard to Section 316 of the Companies Act, 1956 was provided to government companies.

²⁵³ See Rule 8 and 8A, Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014.

²⁵⁵ Ministry of Heavy Industries and Public Enterprises, Functioning of PSUs without head, PIB Press Release, (11 April 2017), <<http://pibregional.nic.in/PressReleseDetail.aspx?PRID=1487571>>, accessed on 12 July 2018.

²⁵⁶ Since the requirement to separate the roles of Chairman and Managing Director or Chief Executive Officer under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 is discretionary in nature, the Kotak Committee based on international best practices in United Kingdom, Australia, recommended that such separation should be mandatory for listed companies who have 40% or more public shareholding. SEBI, Report submitted by the Committee on Corporate Governance, October 2017, pg. 20, <<http://www.nfcg.in/KOTAKCOMMITTEREPORT.pdf>>. Further, the LODR has been amended by virtue of SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 dated May 09, 2018 to mandate the separation of roles for the top 500 listed companies (based on their market capitalisation as on the end of the financial year) with effect from 01 April 1 2020. Presently, the top 500 listed companies also include certain listed CPSEs.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
	<p>Further, Section 203(1) states that subject to the articles of association or a company carrying multiple businesses, the Chairman shall not act as the Managing Director/ Chief Executive Officer at the same time.</p> <p>Section 203(2) requires that every whole-time key managerial personnel of a company shall be appointed by means of a Board resolution containing terms and conditions of appointment including the remuneration.</p> <p>Section 203(3) provides that a whole-time key managerial personnel shall not hold directorship in more than one company except in subsidiary companies of the company. It further provides for certain conditions when this subsection will not apply.</p> <p>Section 203(4) requires that if the positions of whole-time key managerial personnel are vacated, the resulting vacancy should be filed up in not more than 6 months from the date of such vacancy.</p>	<p>Further, the Guidelines provide that guidelines and policies evolved by the Central Government with respect to the structure, composition, selection, appointment and service conditions of Boards of Directors and senior management personnel shall be strictly followed.²⁵⁴ However, it does not provide any restriction on the number of directorships as provided in Section 203(3) of the Companies Act.</p> <p>While certain other circulars provide for succession planning, they do not provide for a particular timeline like the Companies Act for the appointment of these key managerial personnel.</p>	<ul style="list-style-type: none"> ▪ The CAG Report notes that in 18 CPSEs, vacancies of Independent Directors and in 9 CPSEs vacancies of Functional Directors were not filled in time i.e. within 6 months from the date of vacancy.²⁵⁷ ▪ Some glaring examples of delay in appointment as highlighted in the CAG Report include: <ul style="list-style-type: none"> (a) 74 months delay in appointing of Director (Finance) in case of HMT Limited (a listed CPSE);²⁵⁸ (b) 36 and 34 months delay in appointing Independent Director for the Fertilizers and Chemicals Travancore Limited and Bharat Heavy Electricals Limited, respectively.²⁵⁹ ▪ Violation by other companies, of Section 203 which provides for the appointment of key managerial personnel is punishable with a fine between INR 1 lakh to INR 5 lakh and fine for

²⁵⁴ Paragraph 3.4.3 of the Guidelines.

²⁵⁷ CAG Report, (n. 219), pg. vii.

²⁵⁸ *Ibid*, pg. 43.

²⁵⁹ *Ibid*, pg. 42.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			an officer in default of upto INR 50,000. In case of a continuing violation, a further fine of INR 1,000 per day may also be imposed. Apart from the downgrade in ratings discussed earlier, no punishment of the like nature has been provided for violation of the Guidelines by CPSEs.
12.	<p>Exemption from Section 439(2) of the Companies Act²⁶⁰</p> <p>Section 439(2) provides that court of law cannot take cognizance of offences under the Companies Act unless made by a written complaint by the Registrar of Companies, shareholder or member²⁶¹ of the company or person authorised by the Central Government for the said purpose.</p>	<p>Pursuant to the exemption, for government companies, cognisance of offences under the Companies Act can only be taken, if made by a written complaint by a person authorised by the Central Government.</p> <p>The Guidelines do not deal with this aspect.</p>	<ul style="list-style-type: none"> For CPSEs that undertake purely commercial functions in the economy, especially listed CPSEs, there does not seem to be any rationale for routing accountability in courts of law through the government. Moreover, the role of the government as a majority shareholder may prejudice its decisions. This exemption in effect renders minority shareholders and other stakeholders in CPSEs remediless for violations of the Companies Act against the might of the government.

²⁶⁰ Section 439 of Companies Act corresponds to Section 621 and Section 624 of the Companies Act. Section 621 was modified in case of government companies to mean that only the courts of law can only take cognizance of offences under the Companies Act, 1956 only after a written complaint has been made a person authorised by the Central Government (Notification No. SRO 355, dated 17 January 1957 as amended by Notification No. GSR 1473, dated 16 December 1961 and Notification No. GSR 236, dated 31 January 1978).

²⁶¹ The term ‘member’ was introduced *vide* the Companies (Amendment) Act, 2017 which has not been notified.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
Securities Law²⁶²			
1.	<p>Regulation 23, LODR</p> <p>Regulation 23 requires <i>inter alia</i> the following:</p> <ul style="list-style-type: none"> (1) Regulation 23(2) - Prior approval of the audit committee for all related party transactions; (2) Regulation 23(3) - Omnibus approval may be granted by audit committee based on predetermined criteria; and (3) Regulation 23(4) - Material related party transactions require the approval of shareholders and related parties shall abstain from voting on such resolution. 	<p>Regulation 23(5) exempts the application of Regulation 23(2), 23(3) and 23(4) in relation to transactions entered into between two government companies.</p>	<ul style="list-style-type: none"> ▪ For a detailed analysis of related party transactions, please also refer to the discussion on Section 188 of the Companies Act in Point 10 above. ▪ In case of listed government companies, the question of interest of minority shareholders gains importance. Therefore, the Guidelines require that listed CPSEs must adhere to guidelines issued by SEBI.²⁶³ However, with respect to related party transactions between two government companies, SEBI regulations (such as the LODR itself) provide an exemption. This effectively leads to a void in the regulation of such transactions. ▪ The Kotak Committee was of the view that all listed entities, government or private, should be treated at par with respect to governance standards.²⁶⁴

²⁶² Please note that in this part of the Legal Matrix, we have only examined treatment of listed CPSEs under securities laws in India.

²⁶³ The Guidelines state that – “In so far as listed CPSEs are concerned, they have to follow the SEBI Guidelines on Corporate Governance. In addition, they shall follow those provisions in these Guidelines which do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines”.

²⁶⁴ SEBI, Report submitted by the Committee on Corporate Governance, October 2017, pg. 96, <<http://www.nfcg.in/KOTAKCOMMITTEREPORT.pdf>>, accessed on 17 June 2018.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
2.	<p>Regulation 38 of the LODR read with Rule 19A of the Securities Contracts (Regulation) Rules, 1957 (“SCR Rules”)</p> <p>Regulation 38 of LODR requires that every listed entity must comply with Rule 19A of SCR Rules which mandates every listed company to maintain public shareholding of at least 25% (“MPF”). Originally, a public sector company²⁶⁵ was exempt from the MPF requirement. The Securities Contracts (Regulation) (Second Amendment) Rules, 2014 deleted the exemption available to public sector companies and mandated them to comply with the MPF requirement within 3 years.²⁶⁶</p>	Last year, the Government extended the deadline for government companies to comply with the MPF requirement to 21 August 2018. ²⁶⁷	<ul style="list-style-type: none"> The rationale behind the insertion of Rule 19A in the SCR Rules, can be noted from the Press Release dated 4 June 2010, issued by the Ministry of Finance, Government of India, which <i>inter alia</i> states that “<i>A dispersed shareholding structure is essential for the sustenance of a continuous market for listed securities to provide liquidity to the investors and to discover fair prices. Further, the larger the number of shareholders, the less is the scope for price manipulation.</i>”²⁶⁸ BSE PSU, a dedicated web portal of BSE Limited states that as on 31 March 2018, 29 CPSEs (which includes PSBs, PBICs, and other CPSEs) did not comply with the MPF requirement.²⁶⁹

²⁶⁵ Rule 2(da) of the SCR Rules defines a ‘public sector company’ to mean a body corporate constituted by an Act of Parliament or any State Legislature and includes a government company. Rule 2(c) of the SCR Rules defines a government company to mean a company in which not less than 51% of the share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

²⁶⁶ The Securities Contracts (Regulation) (Second Amendment) Rules, 2014 were enforced on 22 August 2014. These rules are available at <https://www.sebi.gov.in/legal/rules/aug-2014/notification-securities-contracts-regulation-second-amendment-rules-2014_28373.html>, accessed on 27 May 2018.

²⁶⁷ The Ministry of Finance, Government of India *vide* Securities Contracts (Regulation) (Third Amendment) Rules, 2017, has granted extension of one year for PSUs, to comply with the MPF requirement. Therefore, the deadline as per the earlier notification which was 21 August 2017, now stands extended to 21 August 2018 for the above purpose. See Securities Contracts (Regulation) (Third Amendment) Rules, 2017, <https://www.sebi.gov.in/legal/rules/jul-2017/securities-contracts-regulation-third-amendment-rules-2017-w-e-f-july-3-2017-_35291.html>, accessed on 27 May 2018.

²⁶⁸ Press Release dated 04 June 2010, Ministry of Finance, Government of India, <<http://www.pib.nic.in/newsite/erelcontent.aspx?relid=62326>>, accessed on 15 June 2018.

²⁶⁹ BSE PSU, PSU Public Offers in Pipeline, <http://www.bsepsu.com/dis_pipeline.asp#Divestments>. The said data has been obtained from PRIME Database.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			<ul style="list-style-type: none"> ▪ A SEBI circular provides for a penalty of INR 5,000/- per day till the non-compliance of Regulation 38 continues and if such non-compliance continues for more than a year, a penalty of INR 10,000/- per day may be imposed. It also provides for the freezing of holding of the promoter and promoter group.²⁷⁰ It remains to be seen if non-compliant CPSEs will be subjected to such penalties upon expiry of the exemption provided by the Central Government.
3.	<p>Regulation 11, SAST Regulations</p> <p>Upon substantial acquisition of shares or voting rights or acquisition of control of a target company whether directly or indirectly, the SAST Regulations require an acquirer to make an 'open offer' for acquiring shares or voting rights to public shareholders of the target company.²⁷¹</p> <p>Regulation 11 grants a general power to SEBI to exempt certain entities from the open offer requirement.</p>	<p>Under the general exemption power in Regulation 11 of the SAST Regulations, SEBI has often exempted CPSEs from the open offer requirement imposed by the SAST Regulations.</p>	<ul style="list-style-type: none"> ▪ The rationale behind having an open offer requirement is to provide an exit option to shareholders of the target company due to the change of control or substantial acquisition of shares of the target company.²⁷² ▪ The open offer rule ensures that public shareholders gain atleast some of the control premium by forcing the acquirer to make an

²⁷⁰ SEBI Circular CFD/CMD/CIR/P/2017/115 dated 10 October 2017, <https://www.sebi.gov.in/legal/circulars/oct-2017/non-compliance-with-the-minimum-public-shareholding-mps-requirements_36216.html>, accessed on 20 June 2018.

²⁷¹ The SAST Regulations also provide specific threshold requirement in relation to substantial acquisition of shares or voting rights or acquisition of control of a target company for making an open offer.

²⁷² Frequently Asked Questions, SAST Regulations, pg. 03, <https://www.sebi.gov.in/sebi_data/faqfiles/aug-2017/1503313163982.pdf>, accessed on 15 June 2018.

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			<p>open offer.²⁷³ Further, a study also states that the open offer favours retail shareholders in the post-acquisition short period.²⁷⁴ Thus, an exemption from open offer may not be in the best interests of retail/ small shareholders.²⁷⁵</p> <ul style="list-style-type: none"> ▪ Using Regulation 11(3) of SAST Regulations, SEBI has in the past exempted the Central Government from making an open offer when it increased its shareholding in IFCI Limited, a CPSE, by conversion of debentures held by it into equity shares. This was the first exemption provided by SEBI under the SAST Regulations.²⁷⁶ ▪ Exemption from provisions of SAST Regulations has also been provided to PSBs including Indian Overseas Bank,²⁷⁷ IDBI

²⁷³ Shaun J Mathew, 'Hostile Takeovers in India: New Prospects, Challenges and Regulatory Opportunities', *Columbia Business Law Review* 2007, (2007), pg. 807, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1693821, accessed on 20 June 2018.

²⁷⁴ V.K. Nangia, Rajat Agrawal and K. Srinivasa Reddy, 'Open Offers and Shareholders Earnings – Evidence From India', (2011), pg. 14, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1763153>, accessed on 22 June 2018 .

²⁷⁵ Payaswini Upadhyay, 'ONGC Buys HPCL Stake: Can Govt Get Away With Avoiding Open Offer?', (*Bloomberg Quint*, 20 July 2017), <<https://www.thequint.com/news/business/ongc-buys-stake-in-hpcl>>, accessed on 01 June 2018.

²⁷⁶ 'SEBI gives exemption from obligation of open offer', (*M&A Hotline, Nishith Desai Associates*, 12 October 2012), <<http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/event1.html>>, accessed on 01 June 2018.

²⁷⁷ Girish Babu, 'SEBI grants exemption to Centre to raise stake in IOB', (*Business Standard*, 30 September 2016), <http://www.business-standard.com/article/finance/sebi-grants-exemption-to-centre-to-raise-stake-in-iob-116093001183_1.html>, accessed on 28 May 2018.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
			Bank, ²⁷⁸ United Bank of India, ²⁷⁹ Vijaya Bank, ²⁸⁰ and Andhra Bank ²⁸¹ .
Competition Law			
1.	<p>Section 54 of the Competition Act</p> <p>Section 54 provides that the Central Government may exempt the following entities from the application of any provision of the Competition Act –</p> <ul style="list-style-type: none"> (a) any class of enterprises on the grounds of interest of the security of the State or public interest; (b) any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries; 	<p>A Notification dated 22 November 2017 issued by the MCA exempted all cases of combinations under Section 5 of the Competition Act involving the CPSEs operating in the oil and gas sectors under the Petroleum Act, 1934 or under the Oilfields (Regulation and Development) Act, 1948 from the application of provisions of Sections 5 and 6 of the Competition Act for 5 years.²⁸²</p> <p>A Notification dated 30 August 2017 issued by the MCA exempted</p>	<ul style="list-style-type: none"> ▪ An OECD study has analysed in detail the merits of competitive neutrality between government companies and their private sector peers, particularly in relation to their treatment under competition law regime.²⁸⁴ This study concluded that various jurisdictions (including India) provide exemptions to SOEs which may adversely impact competition vis-à-vis private players in the market. The study recommended that limited exemptions must be provided. ▪ A Vidhi Report titled ‘Systematizing Fairplay’ also suggests that in order to

²⁷⁸ SEBI Press Release dated 28 March 2012, <https://www.sebi.gov.in/media/press-releases/mar-2012/grant-of-exemption-to-government-of-india-for-the-proposed-acquisition-of-shares-of-idbi-bank-limited_22439.html>, accessed on 28 May 2018.

²⁷⁹ ‘SEBI exempts govt from making open offer for United Bank’, (*Livemint*, 05 December 2018), <<https://www.livemint.com/Money/JFdS9hjzF6azpi5ho8NlTP/Sebi-exempts-govt-from-making-open-offer-for-United-Bank.html>>, accessed on 28 May 2018.

²⁸⁰ ‘SEBI exempts government from open offer to buy Vijaya Bank shares’, (*NDTV Profit*, 17 February 2014), <<https://www.ndtv.com/business/sebi-exempts-government-from-open-offer-to-buy-vijaya-bank-shares-380887>>, accessed on 28 May 2018.

²⁸¹ ‘Andhra Bank stake buy: Centre gets exemption from open offer’, (*Hindu BusinessLine*, 17 May 2017), <<https://www.thehindubusinessline.com/markets/andhra-bank-stake-buy-centre-gets-exemption-from-open-offer/article9705960.ece>>, accessed on 28 May 2018.

²⁸² Notification S.O. 3714(E), MCA, <<http://www.cci.gov.in/sites/default/files/notification/Notification-22.112017.pdf>>, accessed on 28 May 2018.

²⁸⁴ OECD, ‘State-Owned Enterprises And The Principle of Competitive Neutrality’, <<https://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/50251005.pdf>>, accessed on 01 June 2018.

Sr. No	A - Relevant statutory provision	B - Application to CPSEs	C - Remarks
	(c) any enterprise which performs a sovereign function on behalf of the Central Government or a State Government provided that the Central Government may grant the exemption only in respect of activity relatable to the sovereign functions.	all cases of reconstitution, transfer of the whole or any part thereof and amalgamation of nationalized banks, under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (“ Banking Companies Acts ”), from the application of provisions of Sections 5 and 6 of the Competition Act for a period of 10 years. ²⁸³	<p>prevent the unbridled exercise of the discretionary power granted to the executive under the Competition Act, clear definitions or guidance must be provided for terms such as ‘public interest’ and ‘sovereign function’ which have been used in Section 54. Further, it also recommends that exemptions to SOEs must be narrowly drawn to prevent distortion to the competitiveness of markets.²⁸⁵</p> <ul style="list-style-type: none"> ▪ These exemptions to CPSEs in the oil and gas sector and PSBs have been criticised. Please see the case study on the acquisition of controlling stake in HPCL by ONGC and the merger of SBI and its associate banks in this Report.

²⁸³ Notification S.O. 2828(E), MCA, <http://www.mca.gov.in/Ministry/pdf/Notification_31082017.pdf>, accessed on 01 June 2018.

²⁸⁵ Vedika Mittal Kumar, Shehnaz Ahmed, Param Pandya, Debanshu Mukherjee, Joyjayanti Chatterjee, Ritwika Sharma, 'Systematising Fairplay – Key issues in the Indian Competition Law Regime, (2017), Vidhi Centre for Legal Policy, <<https://vidhilegalpolicy.in/reports/2017/11/25/report-on-systematizing-fairplay-key-issues-in-the-indian-competition-law-regime>>, accessed on 01 June 2018.

Regulatory Arbitrage in PSBs

While we have not covered in detail the exemptions available to CPSEs in the Indian financial sector, we note that there is a significant regulatory arbitrage between PSBs and their peers in the private sector.

The Table below illustrates examples of instances in law where differential treatment is meted out to PSBs and private sector banks in India.

Table 2: Exemptions granted to PSBs

Sr. No.	Relevant Statutory Provision	Remarks
1.	<p>Banking Regulation Act, 1949 (“BR Act”)</p> <p>All commercial banks in India are regulated by the RBI under the BR Act. Additionally, all PSBs are regulated by the Central Government under the Banking Companies Acts and the SBI Act, as may be applicable.</p> <p>Section 51 of the BR Act provides that only certain provisions of the BR Act will apply to PSBs. Examples of the regulatory arbitrage between private sector banks and PSBs are as below:²⁸⁶</p> <p>(a) Section 10B(6) of the BR Act that provides for removal of the Chairman and Managing Director of a</p>	<ul style="list-style-type: none"> ▪ The Committee to review the Governance of Boards of Banks of India (2014) noted that PSBs are subject to directions of the Ministry of Finance, Government of India and RBI. Noting that multiplicity in the regulation of PSBs is counter-productive, the Committee suggested that RBI should be the sole regulator for PSBs and private banks alike. It also recommended a holding company structure for PSBs.²⁸⁸ ▪ The Banks Board Bureau (“BBB”) observed that there is a need for an ownership-neutral regulatory environment for banks without requiring the government to completely divest its holding in PSBs.²⁸⁹

²⁸⁶ These issues were also raised by Dr. Urjit Patel, Governor, RBI in an address at Gujarat National Law University, Gandhinagar, India dated 14 March 2018 titled ‘Banking Regulatory Powers Should Be Ownership Neutral’, https://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=1054, accessed on 01 June 2018.

²⁸⁸ Chapter 4, Report of the Committee to review the Governance of Boards of Banks of India, (2014), <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/BCF090514FR.pdf>, accessed on 01 June 2018.

²⁸⁹ See Governance, BBB’s Compendium of Recommendations, (2017), <http://www.banksboardbureau.org.in/WhatsNew/Details?id=20>, accessed on 01 June 2018.

	<p>banking company by the RBI is not applicable to PSBs.²⁸⁷</p> <p>(b) Section 36AA (1) of the BR Act which grants RBI the power to remove managerial and other persons from office is not applicable to PSBs and hence, RBI cannot replace directors or management of PSBs.</p> <p>(c) Since PSBs are not banking companies registered under the Companies Act, Section 36ACA (1) of the BR Act that provides for supersession of a Board of a bank by the RBI is not applicable to PSBs.</p> <p>(d) PSBs do not require a license from RBI under Section 22 of the BR Act. Consequently, RBI cannot revoke a PSBs banking license under Section 22(4) of the BR Act as it can in the case of private sector banks.</p> <p>(e) RBI cannot trigger winding-up of PSBs under Section 38 of the BR Act.</p> <p>(f) RBI cannot provide a direction ordering a merger in the case of PSBs as per Section 45 of the BR Act.</p>	<ul style="list-style-type: none"> ▪ The BBB recommended insertion of a provision in the Banking Companies Acts to state that wherever the provisions of these Acts are inconsistent with the provisions of Companies Act, the provisions in these Acts would not be applicable, provided there is no inconsistency with any provisions of the BR Act, in which case the provisions of BR Act should be applicable.²⁹⁰ ▪ A World Bank Report also raised similar concerns and recommended that legal reforms are highly desirable in order to empower the RBI to fully exercise the same responsibilities for PSBs as it does for private sector banks, and to ensure a level playing field in supervisory enforcement.²⁹¹
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²⁸⁷ The only exception to this point is IDBI Bank Ltd., for which the Clause 120 of its Articles of Association grants the RBI the requisite authority to remove such officers.

²⁹⁰ *Ibid.*

²⁹¹ International Monetary Fund & World Bank, ‘India Financial Sector Assessment Program, Detailed Assessment of Observance - Basel Core Principles For Effective Banking Supervision’, (2018), pg. 07, <<http://documents.worldbank.org/curated/en/158741516303040317/pdf/122859-WP-P160281-PUBLIC-1-19-9-am-India-FSAP-Update-2017-DAR-BCP-Public.pdf>>, accessed on 01 June 2018.



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