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CORPORATE GOVERNANCE AND THE INDIAN PRIVATE EQUITY MODEL

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Abstract Private Equity (PE) firms have long invested in Western firms using a leveraged buyout (LBO) model, whereby they acquire a company that they can grow with the ultimate goal of either selling it to a strategic buyer or taking it public. Unable to undertake the traditional LBO model in India, PE investors in Indian firms have developed a new model. Under this Indian PE Model, PE firms typically acquire minority interests in controlled companies using a structure that is both hybridized from other Western investment models and customized for India's complex legal environment. As minority shareholders in controlled firms, PE investors in India have developed several strategies to address their governance concerns. In particular, PE investors in India have focused on solutions to address local problems through the use of agreements that govern (i) the structuring of minority investments, (ii) investor control rights, and (iii) exit strategies. Nevertheless, recent governance and regulatory difficulties highlight the continuing uncertainty surrounding the Indian PE model.

I. INTRODUCTION

India's economic growth over the past decade has attracted unprecedented foreign direct investment (FDI). Much of this FDI has consisted of investments by private equity (PE) firms. In 2005-2012, PE firms were responsible for over

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$50 billion of total FDI.[1] In 2014 alone, PE investment accounted for 53% of the $29 billion FDI inflow into India.[2] PE firms, including Western PE firms, have become active investors in many sectors of India's economy.

PE firms have long been important investors in Western markets. In the United States and other Western economies, PE firms traditionally seek to acquire companies that they can grow and improve with the ultimate goal of either selling the company to a strategic buyer or taking the company public via an initial public offering (IPO).[3] In implementing this model, PE buyers tend to acquire companies through the use of leverage. In a typical PE-sponsored leveraged buyout (LBO), the company's assets are used as collateral for the debt and its income is used to service the debt.[4]

While the traditional PE model has been successful in developed economies, transplanting the LBO model to India is difficult due to various legal constraints. Accordingly, PE firms in India have developed an alternate model that is both hybridised from other investment models in the West, such as venture capital (VC) investments, and customised for India's complex regulatory and governance environment.[5] Thus, rather than engaging in traditional LBOs, PE firms primarily engage in minority investments in promoter-controlled firms.[6] For example, a 2015 report by Bain & Company indicated that over 90% of PE investment deals in 2014 consisted of minority stake deals.[7]

Like other Asian countries, concentrated ownership dominates the Indian corporate landscape.[8] Because of the ownership structure of Indian firms, controlling shareholders (i.e., promoters) play an important and pervasive role in Indian corporate governance.[9] Indian company founders or promoters have generally wel-

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1 Bain & Company, India Private Equity Report (2013).

2 Bain & Company, India Private Equity Report (2015).

3 Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees*, 63 Vanderbilt Law Review 1161, 1170 (2010).

4 Jeffrey Blomberg, *Private Equity Transactions: Understanding Some Fundamental Principles*, 17 Business Law Today 51, 51–52 (2008).

5 Rustom Kharegat et al., *Private Equity in India*, KPMG 3 (2009).

6 Bain & Company, India Private Equity Report 1 (2011). Reports indicate that minority investments have decreased somewhat. According to a recent McKinsey report, while in 2006-2007 only 13% of Indian PE investments by value were control investments, in 2013 29% of such investments were control investments. Vivek Pandit, *Private Equity in India: Once Overestimated, Now Underserved*, McKinsey Insights (February 2015), *available at* http://www.mckinsey.com/insights/financial_services/private_equity_in_india.

7 Bain & Company (2015), *supra* note 2, at 31.

8 Rajesh Chakrabarti, William Megginson & Pradeep K. Yadav, *Corporate Governance in India*, 20 Journal of Applied Corporate Finance 59 (2008); Lee Kha Loon & Angela Pica, *Independent Non-Executive Directors: A Search for True Independence in Asia*, CFA Institute Centre. for Financial Market Integrity Codes, Standards, and Position Papers (2010), *available at* http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n1.1.

9 The concept of "promoter" has specific legal significance in the Indian context. Promoters in India are typically controlling shareholders, but can also be those instrumental in a public

comed the involvement of PE investors in providing funding and strategic advice to their companies. Nevertheless, the dominance of promoters exposes PE investors in India to the typical corporate governance concerns faced by minority shareholders. In fact, PE investors in India often list corporate governance as a primary area of concern.[10]

As minority investors in controlled firms, PE firms in India confront the corporate governance concerns that permeate the Indian environment. As corporate law scholars have long recognized, the nature of corporate governance concerns differ based on the ownership structure of firms.[11] While for publicly owned firms with diverse ownership the governance concern is primarily about the agency costs of management vis-à-vis shareholders, for firms with controlling shareholders the "fundamental concern that needs to be addressed by governance arrangements is the controlling shareholder's opportunism."[12] In controlled firms, minority stockholders are often concerned with self-dealing transactions and other types of expropriation or extraction of wealth (tunneling) by majority stockholders.[13] But minority shareholders generally have limited power under corporate

offering or those named in the prospectus as promoters. Section 2(69) of the Companies Act, 2013 defines a "promoter" as "a person who (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act. Section 2(27) of the Companies Act, 2013 defines control as "the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner." *See also* Regulations 2(1)(za), Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (August 26, 2009), *available at* http://www.sebi.gov.in/guide/sebiidcrreg.pdf.

10 Bain & Company (2015), *supra* note 2, at 36.

11 For an overview of the differences between controlled and non-controlled companies, see Lucien A. Bebchuk & Assef Hamdani, *The Elusive Quest for Global Governance Standards*, 157 University of pennyslyvania Law Review . 1263, 1281–85 (2009). *See also* John Armour et al., *What is Corporate Law?*,The Anatomy of Corporate Law: A Comparative Approach 31 (R. Kraakman et al. eds., 2d ed., 2009); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 University of pennyslyvania Law Review 785 (2003).

12 Bebchuk & Hamdani, *supra* note 11, at 1282. *See also* Gilson & Gordon, *supra* note 11; Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 Harvard Law Review. 1641 (2006).

13 *See, e.g.*, Simon Johnson et al., *Tunneling*, 90 American Economic Review 22 (2000) (defining tunneling as the "transfer of resources out of a company to its controlling shareholder (who is typically also a top manager)"). There is also some concern that the prevalence of pyramidal ownership by family business groups with considerable economic power can affect voting by minority shareholders and even institutional investors, due to such shareholders' business ties with the group. *See* Tarun Khanna & Yishay Yafeh, *Business Groups in Emerging Markets: Paragons or Parasites?*, 45 Journal Of Economic Literature 331–73 (2007); Yishay Yafeh & Assaf Hamdani, *Institutional Investors as Minority Shareholders* 1, 3 (October 10, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1641138.

law to affect the activities of the controlling stockholder through contesting control, voting rights, or pressuring the board of directors.[14]

Given somewhat limited protections for minority shareholders under Indian company law, PE investors in India have devised various contractual protections to address the corporate governance challenges prevalent in India due to the ownership structure of most Indian firms. Accordingly, PE investors have focused their strategies and shareholders' agreements on several major issues: (i) structuring of minority investments, (ii) investor control rights, and (iii) exit strategies. The strategies used by PE firms also reflect their ongoing concerns regarding the governance of Indian firms. While recent reforms in Indian company law may address some of these concerns, these reforms also generate other uncertainties with respect to PE investments in Indian firms.

This article proceeds as follows. Section I provides an overview of the general state of PE investments in Indian firms. Section II then addresses the Indian PE model, explaining why undertaking traditional LBOs is impracticable in India. Part II explores some of the challenges PE investors face in implementing minority investments in Indian firms. Part III then explores the structure of PE investments in Indian firms and chronicles the contractual methods through which PE investors have addressed some of these challenges via provisions in their shareholders' agreements. Part III also examines the difficulties that PE investors continue to face in designing and enforcing shareholders' agreements.

II. PRIVATE EQUITY INVESTMENTS IN INDIA

India's economy has undergone significant transformations since 1991.[15] India's rapid economic growth, together with its economic liberalisation, has attracted global attention. Foreign investors have rushed to direct capital into India. Indian firms and entrepreneurs have generally welcomed and advocated for the rise in inbound foreign investment, including investments from PE firms.[16]

PE activity in India surged in the first half of the last decade. Some of the world's most prominent PE firms have set up local offices in India. Firms such as Goldman Sachs, Warburg Pincus, Blackstone, Carlyle, KKR, and TA Associates have undertaken multi-million and even billion dollar transactions in India.

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[14] *See* Bebchuck & Hamdani, *supra* note 11, at 1281–83.

[15] For an excellent account of India's economic transformation, see Arvind Panagariya, India: The Emerging Giant 107 (2008).

[16] Dhammika Dharmapala & Vikramaditya S. Khanna, *Corporate Governance, Enforcement, and Firm Value: Evidence from India*, 29 (Olin Working Paper No. 08-005, Univ. of Michigan Law & Economics, 2011), *available at* http://ssrn.com/abstract=1105732; *see also* Umakanth Varottil, *A Cautionary Tale of the Transplant Effect on Indian Corporate Governance*, 21National Law School of India Review. 1, 8-9 (2009).

However, unlike in the West where PE firms generally undertake buyouts, in India, PE firms have generally undertaken minority investments.

Part A below provides an overview of the trends in PE activity in India over the past decade. Part B provides a brief overview of India's foreign investment regime. Since many PE firms investing in Indian companies are foreign PE firms, they must ensure that their investments comply with the country's foreign investment rules.

A. An Overview of India's PE Activity

Despite the attractiveness of the potential of the Indian market, PE investments into India have fluctuated widely over the past several years.[17] These fluctuations are due to the country's economic and political uncertainty, as well as regulatory uncertainty, such as the recent 2012 controversy regarding India's fluctuating tax policies.[18] PE investments into India experienced significant growth in 2006-2010, but dipped considerably after 2008.[19] The past year has seen some recovery. For example, India's total PE deal value in 2014 grew 28% from 2013 levels to $15.2 billion, inching closer to the 2007 peak levels.[20] Further, in 2014 the number of exits increased by 14% from 2013, although the exit value decreased by 22%.[21] Table 1 summarises the value of PE investments in Indian firms as well as the value of exits from such investments.

[17] Anita Raghavan, *India's Private Equity Industry Shakes Off its Doldrums*, New York Times (April 6, 2015) *available at* http://www.nytimes.com/2015/04/07/business/dealbook/indias-private-equity-industry-shakes-off-its-doldrums.html.

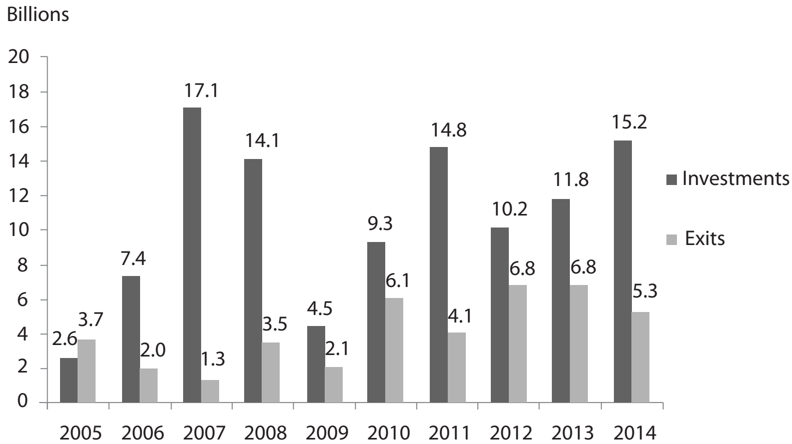
[18] Bain & Company (2013), *supra* note 1.

[19] KPMG, *Returns from Indian Private Equity*, KPMG Report 11 (2011); *Slowdown in PE continues; quarterly investment dips 34% to below $1.9-B,* The Venture Intelligence Blog (July 8, 2012) *available at* http://ventureintelligence.blogspot.in/2012_07_01_archive.html.

[20] Bain & Company (2015), *supra* note 2, at 16.

[21] *Id*.

Table 1: Annual PE Investments into and Exits from Indian Firms



Source: Bain & Company (2015)

PE activity in 2015 appears to follow the positive trends of 2014. The first quarter of 2015 saw 130 PE deals worth $2.77 billion - the best performing first quarter since 2011.[22] Despite the increase in PE deals, exit activity remains sluggish and almost 50% of total exits happened through strategic deals valued at $584 million across 12 deals.[23]

Overall, the initial exuberance of Western PE firms for investing in India has tempered.[24] PE firms have typically become much more stringent in choosing Indian target companies.[25] Moreover, India's recent economic struggles along with significant regulatory uncertainty have meant that PE firms must place an even greater emphasis on managing corporate governance and exit strategies. Given the history of the value of exits thus far, PE firms fear being unable to exit companies and also fear that target companies will seek to block any exit. Accordingly, PE firms are screening the management of target companies much more closely, attempting to build stronger ties with them on the front end, and are then structuring tougher contractual provisions in their deals.

In order to understand the strategies that PE firms use to address the aforementioned issues, it is first necessary to understand the Indian PE Model.

22 PricewaterhouseCoopers India, MoneyTree India Report (2015).

23 *Id.*

24 *See* Boby Kurian & Reeba Zachariah, *Global Private Equity Biggies Put India Story on Hold*, Times of India, July 26, 2012,http://timesofindia.indiatimes.com/business/india-business/Global-private-equity-biggies-put-India-story-on-hold/articleshow/15155080.cms.

25 Bain & Company, India Private Equity Report (2012).

B. The Regulatory Framework for Investments by PE Firms

Investments by PE firms in India are governed by a complex set of federal laws, and a variety of regulators including the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI) and the Foreign Investment Promotion Board (FIPB). For purposes of this article, the complex regulatory structure governing fund establishment and formation are not addressed.[26] Needless to say, both domestic and foreign PE and venture capital funds are subject to extensive regulation related to fund structuring and licensing.

Indian PE fund structuring underwent a major shift in 2012 with the passage of SEBI's Alternative Investment Fund (AIF) Regulations, 2012 to regulate private pools of capital. Prior to passage of the AIF regulations, PE funds in India operated under a variety of complex regulatory systems.[27] An AIF can be set up as a trust (the most commonly used structure), a company, a limited liability partnership, or a body corporate.[28] The AIF Regulations cover a broad range of funds so that every fund established in India for the purpose of pooling money from investors, whether Indian or foreign, on a private basis for investing it further falls under the umbrella of the regulations, unless specifically excluded. PE funds generally fall within category II of the AIF regulations, and are not excluded from such regulations.

The general rules of Indian company law and the exchange control regulations govern the investments made in India by foreign PE firms. The Foreign Exchange Management Act, 1999 (FEMA) and the rules promulgated thereunder, regulate foreign investments into India. Foreign PE investments can be made through several regimes, including foreign direct investment (FDI), foreign portfolio investment (FPI) or foreign venture capital investment (FVCI).[29] SEBI grants some benefits to funds that register as a Foreign Venture Capital Investor (FVCI) under the SEBI (Foreign Venture Capital Investors) Regulations 2000 (FVCI Regulations).[30] The FVCI regulatory framework "attracts foreign investors while allowing India to maintain control over issues such as investor qualifications and debt to equity ratios."[31]

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26 For an overview of fund regulation, see Siddharth Raja & Ashwini Vittalachar, *Private Equity in India: Market and Regulatory Overview*, Private Equity and Venture Capital Global Guide 2015/16 (2015), *available at* global.practicallaw.com/8-504-2425.

27 Existing venture capital funds that were registered under SEBI's 1996 Venture Capital Fund Regulations were grandfathered in. For details of this scheme, see Nishith Desai Associates, *Funds Hotline: Alternative Investment Funds Regime* (May 24, 2012) (on file with author).

28 *See* Rupinder Malik, Sidharrth Shankar & Vatsal Gaur, *India*, GETTING THE DEAL THROUGH: PRIVATE EQUITY (TRANSACTIONS) 226 (2013).

29 *See* Nishith Desai Associates, PRIVATE EQUITY AND PRIVATE DEBT INVESTMENTS IN INDIA 7 (April 2015).

30 *See* Raja & Vittalachar, *supra* note 26.

31 Kelly Fisher & Sophie Smyth, *US Private Equity Investments in Emerging Economies*, 12 JOURNAL OF INTERNATIONAL BUSINESS AND LAW 223, 235 (2013).

PE firms have invested in a variety of Indian companies, although various exchange control norms may limit the potential targets for foreign PE firms and the ability of funds to undertake buyouts. Investments by foreign PE firms may be governed by India's FDI rules. FDI generally does not require regulatory approval and falls under the "automatic route" of the RBI.[32] Nevertheless, unless the company operates in a sector in which 100% FDI is allowed, various sectoral caps may apply. Accordingly, the PE fund may not be able to acquire 100% of the shares of such a company without approval from the FIPB, which may not always be forthcoming. Moreover, FDI is prohibited in certain sectors, such as gambling or betting.

III. THE INDIAN PRIVATE EQUITY MODEL AND OBSTACLES FACED BY INVESTORS

PE firms in India broadly undertake two types of deals: "growth" deals, where a PE fund buys a minority stake in a company, but does not get involved in the day-to-day management; and "buyouts," where a PE fund buys an ownership stake and runs the business as well. PE firms generally have the option of investing in private companies, public companies (both listed and unlisted), and private companies that are subsidiaries of public companies. The structural impediments to LBOs—such as the prohibition on using leverage in such deals, a practice that is widely used elsewhere, which makes returns more attractive—bolster the predominance of minority investments. Thus, the vast majority of PE firms in India undertake "growth" deals with minority investments in public or private companies.[33]

For PE firms, such minority investments can present significant challenges given India's complex legal environment. Part A below explains why PE firms investing in Indian companies have generally been unable to use the traditional leveraged buyout (LBO) model that is commonly used in the West. A PE firm's status as a minority investor can cause friction with the Indian promoter. Part B discusses some of the problems that PE firms have faced when dealing with promoters. In addition to corporate governance challenges related to promoter control, the Companies Act generally imposes greater requirements, particularly corporate governance requirements, on public companies and their subsidiaries. Indian securities regulation prescribes even more rigorous norms for public listed companies. Thus, PE firms face significant obstacles when investing in listed companies in India. Part C discusses additional legal issues faced by PE firms investing in listed companies.

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32 Reserve Bank of India (RBI), *Master Circular on Foreign Investments in India* (Master Circular No.15/2012-13) (2012).

33 *See* Bain & Company (2011), *supra* note 6, at 5-8, 20.

A. Challenges for the Traditional Private Equity Model

Due to India's complex legal framework and restrictions, PE firms investing in Indian companies have generally been unable to use the traditional LBO model that is commonly used in the West. Part 1 below provides a brief overview of the traditional LBO model. Part B then examines the legal and regulatory hurdles to an LBO of an Indian company.

(a) The Traditional Private Equity Model

In the West, PE firms are typically privately-held partnerships that acquire and "take private" publicly-traded companies so that the shares of public investors will be bought out and the company will be de-listed from the stock market. PE firms rarely use their own cash as the only currency for the acquisition consideration. More typically, PE acquisitions are structured as LBOs in which the PE firm completes the acquisition using significant debt financing from a consortium of lenders. In a PE-sponsored LBO, the seller's assets are used as collateral and the seller's cash flows are used to service the debt.[34] In order to service this debt, the company's management is then required to "adhere to strict, results-oriented financial projections" and to "operate the company within tight budgetary and operational constraints".[35]

(i) Corporate governance in PE acquisitions

In connection with their significant ownership stake, PE firms are often heavily involved in the governance of the acquired firm. A principal question in corporate governance is: Who controls the board of the company? In general, the PE owner directs all aspects of the board of directors of an acquired company. Not only does the PE owner select the vast majority of the company's board of directors, the general partners of the PE fund often serve as board members with significant involvement in devising and executing the company's strategic plan, with a focus on improving the company's financial performance. In addition to board representation, the PE owner typically exercises control over many aspects of the board's decision-making process through the use of shareholder agreements. It is common for PE investors to negotiate an ability to veto key decisions, including the following: amending the articles of incorporation; changing the nature of the business; change in control transactions; issuing securities; engaging in non-arm's length transactions; replacing the CEO; incurring debt; and approving the budget. Under most PE shareholder agreements, an effective veto can be established by requiring shareholder approval for certain actions and by requiring that those actions be approved by a super-majority of the board. Shareholder agreements

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[34] *See* Jeffrey A. Blomberg, *Private Equity Transactions: Understanding Some Fundamental Principles*, 17 Bus. L. Today 51, 51–52 (2008).

[35] Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 Del. J. Corp. L. 1, 9 (2008).

may also include other important provisions such as transfer restrictions (which prohibit transfers of target securities for a particular time period and transfers in excess of specified percentages), tag-along rights (i.e., the right of a shareholder to transfer securities to a person who is purchasing securities from another holder), and drag-along rights (i.e., the right of a shareholder to require other holders to transfer securities to a person who is purchasing in excess of a specified percentage of securities from such shareholder).

(ii) PE exit strategies

PE funds have contractually limited lifetimes—typically around 10 years. Accordingly, a PE firm must manage the acquired company with exit strategies in mind in order to realise its investment as soon as possible. In the West, PE firms generally have two exit options: (i) an IPO of the company; or (ii) a sale of the company to a strategic buyer or another financial buyer.[36] In connection with these exit strategies, PE firms often seek specific contractual rights in the shareholder agreement such as demand and piggyback registration rights (which may include the right to force an IPO), put rights, or mandatory redemption provisions.[37]

(b) Legal Challenges for Use of the Traditional PE Model in India

In addition to regulations regarding fund structuring and licensing, PE firms in India face a host of regulations related to the structure of their investments in their portfolio companies. These various regulations place significant hurdles that make both buyouts and traditional LBOs exceedingly difficult to undertake in India.[38] The following sections discuss some of these hurdles.

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36 *See* Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees*, 63 Vanderbilt Law Review 1161, 1170 (2010).

37 *See* Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 Vanderbilt Law Review 1405, 1415-16, (2008); Gordon Smith, *The Exit Structure of Venture Capital*, 53 UCLA Law Review 315, 348-354 (2005).

38 In addition to the legal restrictions discussed in this section, market conditions also present challenges for PE firms seeking to undertake traditional LBOs. PE firms often undertake LBOs by leverage or debt that is issued and serviced by the target company. Thus, financing an LBO requires access to a deep debt market. However, India's corporate debt market is small and marginal compared to the corporate bond markets in developed countries. For a full discussion, see Vikramaditya Khanna & Umakanth Varottil, *Developing the Market for Corporate Bonds in India* (Nationall Stock Exch. of India Ltd., Working Paper No. 6, 2012), *available at* http://www.nseindia.com/research/content/WP_6_Mar2012.pdf.

(i) Legal and regulatory restrictions on LBOs

PE firms looking to undertake traditional Western-style LBOs face significant restrictions from both regulatory rules and provisions of the Indian Companies Act.[39]

The Reserve Bank of India (RBI) prohibits Indian banks from granting loans for the purchase of shares in an Indian company.[40] Several RBI Master Circulars mandate that domestic banks cannot grant loans to any borrowers that use the equity or debt of the company as collateral.[41] Moreover, the RBI strongly limits a bank's total exposure to the capital markets.[42] Given these restrictions, a PE investor will be unable to use the shares of a target company as collateral in order to finance an LBO by raising debt in India.

In addition to the RBI restrictions, a Press Note by the Foreign Investment Promotion Board (FIPB), India's highest authority regulating foreign investment in India, has placed several roadblocks to leveraging debt for the purchase of an Indian company.[43] The FIPB prohibits foreign investment companies from borrowing from Indian banks to purchase the securities of an Indian company. It also requires foreign PE firms to obtain permission from the FIPB for establishing a foreign-owned holding company in India. Moreover, it mandates FIPB approval if the foreign-owned holding company decides to purchase the shares of an Indian company.

The provisions of the Indian Companies Act present additional obstacles for traditional LBOs as companies are not allowed to leverage their assets to raise investments. The Companies Act, 1956, as well as the new Companies Act, 2013, prohibit public companies (which include private companies that are subsidiaries of a public company) from providing financial assistance to any person for the purchase of their shares.[44] Thus, a traditional LBO where debt is raised by using

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[39] *See* Narendra Chokshi, *Challenges Faced in Executing Leveraged Buyouts in India: The Evolution of the Growth Buyout (*Apr. 2, 2007) (unpublished manuscript), *available at* https://www.stern.nyu.edu/sites/default/files/assets/documents/uat_024317.pdf.

[40] *See* Chokshi, *supra* note 39, at 15; Archana Rajaram & Amrita Singh, *India*, *in* Private Equity: Fund Formation and Transactions in 42 Jurisdictions Worldwide 217, 219 (Casey Cogut ed., 2009) (discussing debt-financing structures). In December 2013, the RBI released a Discussion Paper on "Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalizing Distressed Assets in the Economy" which explores allowing PE firms to conduct LBOs of distressed companies. *See* James Crabtree, *India Central Bank Invites Buyout Groups to Clean Up Bad Debts*, Financial Times (Dec. 17, 2013).

[41] Reserve Bank of India, *Master Circular on Exposure Norms,* RBI/2012-13/68 DBOD. No.Dir. BC.3/13.03.00/ 2012-13 (2012); see Chokshi, *supra* note 39, at 15 (noting that banks cannot make loans to industrial, corporate or other borrowers).

[42] Reserve Bank of India, *Discussion paper on Regulation of Off-Balance Sheet Activities of Banks*, DBOD. BP. No. 12048/21.04.141/2009-10 (2010).

[43] Foreign Investment Promotion Board, Press Note 9 (1999).

[44] *See* § 77(2) , the Companies Act, 1956 and § 67(2),the Companies Act, 2013.

the company's assets as collateral is not permitted for public companies. This restriction applies to all public companies, whether listed or unlisted.[45]

Since the restrictions in the Companies Act do not apply to a private company, a listed public company could conceivably delist its securities and convert itself into a private company prior to being acquired via an LBO. However, the delisting and conversion processes are not simple, and are subject to both significant shareholder and regulatory approvals.[46] Delisting is considered an "onerous" and often unsuccessful process as it requires the separate approval of a 2/3 majority of a company's shareholders.[47] Furthermore, the votes cast in favour of the resolution by public shareholders should be at least two times the votes cast by public shareholders against the resolution.[48] In addition, under SEBI's rules, in order to delist a company two thresholds must be met (A) the shareholding of the acquirer together with the shares tendered by public shareholders must reach 90 per cent of the total share capital of the company and (B) at least 25 per cent of the number of public shareholders, holding shares in dematerialised mode as of the date of the board meeting which approves the de-listing proposal, have participated in the reverse book building process; although this requirement is not applicable to cases where the acquirer and the merchant banker demonstrate to the stock exchanges that they have delivered the letter of offer to all the public shareholders.[49]

In 2015, SEBI amended the Delisting Regulations in order to address concerns related to the complexities of the delisting process and to make delisting easier.[50] Key changes to the 2009 Delisting Regulations include reductions in statutory

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[45] § 2(71), Companies Act, 2013 defines a public company as a company which is not a private company. A private company is defined under Section 2(68) of the Companies Act, 2013 as a company which by its articles restricts the right to transfer its shares; limits the number of its members to two hundred, and prohibits any invitation to the public to subscribe for any securities of the company. Under the Companies Act, a public has more reporting and compliance obligations than a private company. *See* Vinod Kothari & Aditi Jhunjhunwala, *Finally Some Exemptions to Private Companies*, IndiaCorpLaw Blog (June 9, 2015), *available at* http://indiacorplaw.blogspot.com/2015/06/lenders-empowered-to-take-control-over.html.

[46] The delisting of listed securities is governed by the Securities Contracts (Regulation) Rules, 1957 and the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, and various amendments thereto.

[47] *See* Vikramaditya S. Khanna & Umakanth Varottil, *Regulating Squeeze Outs in India: A Comparative Perspective* 11-12 American Journal of Comparative Law (Forthcoming 2015); NUS Law, Working Paper No. 2014/009, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2479678.

[48] See Securities and Exchange Board of India, The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, (June 10, 2009), *available at* http://www.sebi.gov.in/acts/delisting2009.pdf.

[49] Securities and Exchange Board of India, The Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2015, (March 24, 2015), *available at* http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427261684807.pdf.

[50] *See* Rachit Gupta, *Delisting made easier: SEBI amends the delisting norms*, PSA E-Newsline, April 27, 2015 *available at* http://www.psalegal.com/upload/publication/assocFile/ENewslineApril2015.pdf.

timelines, new thresholds for a successful delisting, changes in pricing mechanisms and providing for stock exchange platforms for delisting. In addition, the amendments place additional responsibilities on the board of directors of the company proposed to be delisted, including a determination by the board that the delisting is in the interest of the shareholders.[51]

(ii) Challenges with exits through public offerings

India's complex set of regulations and its recent economic turmoil also limit a PE firm's exit opportunities.[52] In the West, IPOs are often a preferred method of exit for PE investors. Similarly, PE investors often seek IPO exit rights in shareholders' agreements with Indian portfolio companies. PE investors may choose to exit in an IPO pursuant to an offer for sale. Under Regulation 26(6) of the SEBI (ICDR) Regulations, 2009, an offer for sale may be made if the equity shares have been held by the sellers for a period of at least one year prior to the filing of the draft offer document with SEBI.[53]

Over the past several years, PE firms have struggled to use IPOs as an attractive exit as India's IPO market experienced a significant slow-down.[54] However, there are some indications of an upward trend for PE-backed IPOs in 2015. As of the Spring of 2015, SEBI had already approved 10 IPOs and was said to be examining an additional 14 IPOs, with most involving PE-backed companies.[55] Given fluctuations in the global economy, however, it is still too early to say whether IPOs will become the dominant mode of exit.

While shareholder agreements often include an IPO as an exit right for PE investors, the ability of PE investors to demand an IPO is significantly limited and the enforceability of such rights has not been tested in the Indian courts.[56] PE investors who seek to push an IPO over the objections of a promoter will face

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[51] Securities and Exchange Board of India, The Securities and Exchange Board of India (Delisting of Equity Shares) (Amendment) Regulations, 2015, (March 24, 2015), *available at* http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427261684807.pdf.

[52] Market factors as well as the legal limitations discussed play an important role in exiting. If the company's operations are located solely in India, an IPO in Indian markets would be most lucrative. However, if the company operates predominantly overseas or has a major export aspect to its business, an offering in foreign capital markets is likely to be more profitable.

[53] Securities and Exchange Board of India, The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, (August 26, 2009), *available at* http://www.sebi.gov.in/guide/sebiidcrreg.pdf.

[54] Raja & Vittalachar, *supra* note 26; *India's New Wave of Private Equity Investment*, Knowledge@Wharton (April 25, 2014), *available at* http://knowledge.wharton.upenn.edu/article/indias-new-wave-private-equity-investments/.

[55] Rajesh Mascarenhas, Sneha Shah and Baiju Kalesh, *India Inc. plans to raise Rs 25,000 crore in FY16: Investor appetite for mid-caps reignites the primary market*, Econ. Times, Apr. 27, 2015, *available at* http://articles.economictimes.indiatimes.com/2015-04-27/news/61577936_1_ipo-market-inox-wind-rural-electrification-corp.

[56] Malik, Shankar & Gaur, *supra* note 28.

difficulty since "the offer document needs to be signed by all the directors of the company, and therefore despite contractual obligations to provide such an exit (even if placed on the promoters of the target), the promoters and other directors could always cite their fiduciary duties towards the company as a ground for not causing an IPO, should they feel that causing an IPO is not aligned with their fiduciary duties towards the company."[57]

A number of SEBI regulations add complexity to a public market exit and make it clear that PE investors engaged in a buyout of an Indian company may not be able to exit cleanly through an IPO.[58] According to the SEBI's listing requirements, Indian companies must identify the promoters of the listing company for purposes of minimum contributions and the promoter lock-in. Furthermore, the Companies Act, 2013 includes significant disclosure requirements for promoters in a company's offering prospectus. Promoters are also subject to a certain lock-in of their shares. SEBI's guidelines stipulate lock-in requirements on promoters' shares to ensure that the control and management of the company is consistent after the public offering. The minimum contribution of 20% that promoters make will be locked in for three years. If the promoters' contribution is over 20%, the additional contribution is locked in for one year. Moreover, a PE firm's pre-IPO shares may be locked in for a year (and even longer if the PE firm is deemed a promoter) after the date of allotment in the public issue.[59]

(c) Investing in Listed Companies

Even if not undertaking a buyout, PE investments in publicly-traded or listed companies—private investments in public equity, known as PIPE transactions—can be quite complicated. PE investors need to be cautious when receiving non-public information; moreover, such transactions can be subject to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter , "Takeover Code").

(i) Due diligence issues in PIPE transactions

Prior to committing capital, PE firms conduct extensive due diligence on target companies. Indian law, however, has long imposed major obstacles on an investor's ability to perform this due diligence on a listed company.[60] Since required

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57 *Id*.

58 For an overview of capital markets transactions in India, see Zia Mody, *Securities Regulation* in Capital Markets in India (Rajesh Chakrabarti and Sankar De, eds., 2010).

59 *See* Nishith Desai Associates, s*upra* note 29, at 29. The one year lock-in period is not applicable to foreign venture capital investors (FVCIs) that are registered with SEBI so long as such funds have owned the issuer's securities for at least one year.

60 Tarun M. Stewart & Cyril S. Shroff, *Investing in Indian PIPEs*, 10 Journal of Private Equity 87, 88 (2007) (discussing challenges to effective due diligence).

disclosures are limited and do not include financial projections or future business plans, PE firms often approach the target's management to request access to current financial, operational, and legal data of the company.

PE firm have been extremely cautious because due diligence investigations of listed companies are covered by the provisions of the SEBI's insider trading regulations.[61] During due diligence, the PE investor may obtain unpublished, price-sensitive information. The insider trading regulations generally restrict persons that obtain this information about a listed company from buying or selling securities of that company. A non-exhaustive list of information that is price-sensitive includes periodic financials, intended declaration of dividends, stock issuance or repurchase plans, expansion plans, a proposed merger or consolidation, or a sale of assets or business units. A PE firm receiving any of this information could be at risk of being considered an "insider" covered by the regulations, thus limiting its ability to perform a successful due diligence investigation.[62]

SEBI's insider trading regulations underwent a significant overhaul in May 2015 when the SEBI (Prohibition of Insider Trading) Regulations, 2015 (New Regulations) came into force.[63] The regulations generally expanded the scope of compliance and restrictions with respect to trading based on unpublished information, including prohibiting communication to any person of unpublished price sensitive information with respect to a company or securities, listed or proposed to be listed. Despite their expanded scope, the new regulations do provide some relief for PE investors. The new regulations provide an exception for communications for all legitimate purposes, performance of duties or discharge of legal obligations.[64] Nevertheless, the exception provided by the new regulations may not fully satisfy PE investors. Under the new regulations, in the case of divulgence of unpublished information where the board of the company believes the access to be in the best interest of the company but where there is no open offer, the price-sensitive information needs to be disseminated to the public two trading days before the transaction. Experts in India have commented that such dissemination may lead to speculative trading and may adversely impact the pricing of the transaction.[65]

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[61] Umakanth Varottil, *Legal Hurdles to Private Equity Investments*, IndiaCorpLaw Blog (May 20, 2008), *available at* http://indiacorplaw.blogspot.com/2008/05/legal-hurdles-to-private-equity.html (discussing SEBI's takeover regulations).

[62] Umakanth Varottil, *SEBI Reforms – Part 1: Inisder Trading*, IndiaCorpLaw Blog (Novembery 20, 2014), *available at* http://indiacorplaw.blogspot.com/2014/11/sebi-reforms-part-1-insider-trading.html.

[63] Securities and Exchange Board of India, The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, (January 15, 2015), *available at* https://www.clpindia.in/doc/Annexure%20I.pdf.

[64] *See* Cyril Shroff, *Indian Update – New Insider Trading Laws in India: How much is too much?* XBMA (April 22, 2015) *available at* http://xbma.org/forum/indian-update-new-insider-trading-laws-in-india-how-much-is-too-much/.

[65] *Id*.

(ii) Takeover regulations and PIPE transactions

The Takeover Code applies to the acquisition of shares in a public listed company that would take the investor's ownership in such a company over certain specified percentages, and to the acquisition of "control" over the company, whether or not any shares are being acquired. The Takeover Code requires PE firms that acquire a substantial number of shares or voting rights of a listed company to make a mandatory offer, along with significant disclosures, to the public shareholders of that company.

The Takeover Code underwent significant amendments in late 2011, in part to provide greater flexibility to investors, including PE firms.[66] For example, under the pre-2011 rules, investors could not acquire 15% or more of a listed Indian company without making a mandatory offer for an additional 20% of the outstanding public shares (Open Offer). Pursuant to the advice of the Takeover Regulations Advisory Committee (TRAC), the revised code increased this 15% trigger to 25%.[67] In addition, acquirers holding 25% or more voting rights in the target company can acquire additional shares or voting rights up to 5% of the total voting rights in any financial year, up to the maximum permissible non-public shareholding limit (generally 75%). However, a mandatory open offer is triggered by creeping acquisition of more than 5% voting rights in a financial year by an acquirer who already holds 25% or more voting rights in the target company. These changes were designed in part to enable the PE industry to enter into transactions of a more reasonable size.[68]

Other accompanying changes may also alter the predominance of minority investments by PE funds. For example, a key change in the Takeover Code is to increase the size of the mandatory offer from 20% to 26% of the public shares.[69] Thus, acquirers proposing to acquire 25% or more of the target company will have to make an open offer to acquire an additional 26% of the public's shares. These changes may enable PE funds that are willing to comply with due diligence and disclosure requirements to obtain a majority stake or to take over an Indian company that has a founder/promoter who holds less than 50% of the company's outstanding shares.[70] Of course, PE investors will need a greater

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[66] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2010, *Report of the Takeover Regulations Advisory Committee Under the Chairmanship of Mr. C. Aghuthan*.

[67] *Id*.

[68] Somasekhar Sundaresan, *Insider Track on the Takeover Code* in IVCA, Reporting on Indian Private Equity & Venture Capital 5 (2010); Prashant Mehra, *What is the Impact of Changes to Takeover Rules?*, Reuters (July 20, 2010) *available at* http://in.reuters.com/article/2010/07/20/idINIndia-50260620100720.

[69] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

[70] Dilip Maitra, *Barbarians at the Gate*, Deccan Herald (July 27, 2010) *available at* http://www.deccanherald.com/content/83782/barbarians-gate.html.

amount of capital to complete an offer. Some analysts predict that the increase in the size of the mandatory offer will benefit foreign PE investors who can raise capital overseas at a lower cost.

One significant impact of the Takeover Code for PIPE transactions is the definition of "control" under the code. When a PE firm acquires rights in listed companies (e.g., veto rights on key decisions), the PE firm may have obtained "control" over the company, triggering the mandatory offer requirements. This is largely due to the SEBI's adoption of an expansive interpretation of the term "control." The Takeover Code defines "control" in a broad, inclusive manner, as including: "the right to appoint the majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner." Thus far, it remains up in the air whether a PE fund with certain veto powers or influence on strategic decisions has "control" and must, therefore, conduct a mandatory offer.[71]

The new Takeover Code no longer allows PE investors to pay promoters up to a control premium as a non-compete fee. Thus, all shareholders must be offered the same price per share by the PE investor. Analysts have argued that this change overlooks the fact that promoters are knowledgeable about the day-to-day operations and management of the company, and that if promoters depart the company without a non-compete agreement, a major threat to the interests of the PE acquirer and the company exists.

The Takeover Code also imposes disclosure obligations on PE investors. Under the Takeover Code, disclosures are required to be made in the following cases: (i) an acquirer along with persons acting in concert (PACs) acquires 5% or more of the shares of the target; (ii) any 2% change (increase or decrease) in such acquirer's shareholding in the target; (iii) annual disclosure of aggregate shareholding by every person along with PACs holding 25% or more of the voting rights in a target; and (iv) annual disclosure of aggregate shareholding by the promoters along with PACs.[72]

B. Promoter Control of Indian Firms

The vast majority of PE investments in India are minority stakes in companies. In addition to the restrictions on LBOs discussed above, the traditional

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71 Vishal Shah & Smit Sheth, *Proposed Takeover Norms Could Be a Game Changer*, Reuters (December 23, 2010), *available at* http://blogs.reuters.com/india-expertzone/2010/12/23/new-takeover-regulations-could-be-a-game-changer/.

72 *See* Nishith Desai Associates, Public M&As in India: Takeover Code Dissected 12 (August 2013) *available at* http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Ma%20Lab/Takeover%20Code%20Dissected.pdf

family-controlled ownership structure of Indian firms has resulted in the small ownership stake of PE investors. Such minority investments are not without risks and frictions with promoters.

Cultural conditions play an important role in the predominance of minority investments by PE firms. Traditionally, India's business owners pass on businesses to family members.[73] Management, which often includes company founders, is usually unwilling to cede control of their businesses to PE investors.[74] The desire to retain control has resulted in more minority investments.

The predominance of promoter-controlled family-owned companies in India combined with the perception that some companies lack professional management, transparency, and modern management systems have led to governance concerns among PE investors.[75] Since investments usually involve a minority stake, PE firms have limited influence over the company's direction and may experience roadblocks in their attempts to drive fast growth. Family dynamics and relationships may add to the problem, and contribute to issues about the adaptability of the firm.[76] Moreover, the management information that a family-owned company provides to its foreign PE may be subpar compared to the information that PE firms receive from management in the West.

The corporate governance of Indian firms can result in friction between PE investors and promoters. PE managers face the dual task of discovering the right company at the right valuation that also understands the value of a PE partnership. Some promoters have viewed PE firms simply as a source of capital rather than as an influx of capital plus expertise as well as knowledge of best business practices. In other words, promoters expect PE firms to be passive investors on the sidelines while PE investors seek to play a pivotal role in guiding the business. Since management focuses on getting the most money for the sale of a stake in their business, valuation has often been the overriding consideration in choosing a PE investor to the exclusion of other considerations. In India's initial PE boom, the growing pools of PE capital led to fierce competition among PE firms. Consequently, the target company's management often held the bargaining power and dictated the terms of investments.

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73 Afra Afsharipour, *Corporate Governance Convergence: Lessons from the Indian Experience*, 29 Northwestern Journal of International Law & Business , 335, 362-63 (2009).

74 Bain & Company (2011), *supra* note 6, at 20.

75 Ambayat Shruti, *M&A and PE deals face slowdown as policy paralysis bites,* Financial Express (April 7, 2012), *available at* http://archive.financialexpress.com/news/m-a-and-pe-deals-face-slowdown-as-policy-paralysis-bites/933711.

76 Stephen Aldred & Michael Flaherty, *Bain, TPG's Lillput woes a warning on India investing*, Reuters, (May 18, 2012), *available at* http://in.reuters.com/article/2012/05/18/india-buyout-idUSL4E8G318Y20120518.

The Lilliput Kidswear controversy is a prime example of PE concerns regarding corporate governance.[77] In 2010, Bain Capital and TPG Capital invested roughly USD 86 million for a 45% stake in the Indian clothing company. By 2011, tensions between Bain/TPG and Lilliput's founder Sandeep Narula reached a fevered pitch. Narula eventually moved to court to prevent the PE firms' interference in the day–to-day activities of Lilliput and actively sought to prevent Bain or TPG from exiting their investments.[78] By 2012, the firms valued their investment in Lilliput at zero and accused Lilliput of accounting fraud. Eventually, the two sides reached a settlement in late 2012, with TPG and Bain selling back their stakes in the company to Narula with zero returns and Narula withdrawing his case against them.

IV. THE INDIAN PRIVATE EQUITY MODEL: STRUCTURE, CONTROL AND EXIT

Given some of the challenges they face as minority investors, PE investors have used innovative structures to protect their interests. As minority investors in companies with significant majority shareholder control, PE firms are often concerned about how to address the corporate governance issues and majority-minority shareholder agency costs that arise in Indian firms.[79] These concerns are increasingly being reflected in the terms of the shareholders' agreements between PE investors and the investee company. Section A summarises the types of structures used by PE investors, as well as their potential benefits and shortcomings. Section B then analyses some of the innovations used by PE firms in shareholders' agreements to address their corporate governance concerns.

A. The Structure of Private Equity Investments into Indian Firms

A variety of structures are employed in PE investments and acquisitions.[80] According to PE consultant Bain & Co., while straight equity purchases were often the norm, the use of convertible instruments has increased significantly

[77] Shruti, *supra* note 75.

[78] Aldred & Flaherty, *supra* note 76.

[79] While for publicly owned firms with diverse ownership, the governance concern is primarily about the agency costs of management vis-à-vis shareholders, for firms with controlling shareholders, the "fundamental concern that needs to be addressed by governance arrangements is the controlling shareholder's opportunism." For an overview of the differences between controlled and non-controlled companies, see Bebchuk & Hamdani, *supra* note 11. In controlled family-owned entities, various family members often serve in the executive management or on board positions. Thus, the minority shareholders of controlled entities are often concerned about self-dealing transactions and other types of expropriation or extraction of wealth (tunnelling) by majority stockholders. *See*, e.g., Johnson *et al.*, *supra* note 13 (defining tunnelling as the "transfer of resources out of a company to its controlling shareholder (who is typically also a top manager)").

[80] Raja & Vittalachar, *supra* note 26.

over the past several years.[81] In general, PE funds tend to invest using either equity or equity-linked instruments such as fully and compulsorily convertible preference shares ("CCPS") and fully and compulsorily convertible debentures ("CCD").[82] PE investors use these instruments to: (i) obtain dividend and/or liquidation preferences; (ii) achieve disproportionate voting rights on their investments in return for the strategic value that the foreign investor will add; and (iii) achieve potential liquidity in overseas markets and more flexibility in terms of exit options.[83]

According to experts, the recent trend in PE investment structures is for the PE firm to invest using a combination of equity and convertible preference shares or convertible debt. PE investors often subscribe to a combination of convertible instruments and a small number of equity shares so that they can vote in a shareholder meeting of the equity shareholders and exercise veto rights. The convertible instruments would then convert upon achievement of certain agreed-upon performance milestones—a useful feature "in cases where there is a mismatch between the valuations of the target company as ascribed by the promoter and the private equity investor."[84]

(a) Equity securities

Some PE investors obtain equity, i.e., common stock, in exchange for their investment in the company. Equity shares are the same ordinary equity shares held by the company's promoters. When PE firms invest in equity shares, their shares have the same rights as the existing shares of the company and have no special rights on the assets or the earnings of the company. Thus, if the company goes bankrupt, common shareholders are paid after debt holders, preferred shareholders, and other creditors of the company.

(b) Convertible preference shares

In addition to, and at times in place of, the use of equity common stock, PE investments into Indian companies can be structured through the issue of compulsorily convertible preference shares (i.e., preferred stock) or fully convertible debentures that are convertible into equity based on a specified conversion ratio upon maturity. Such preferential instruments get paid ahead of equity instruments

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81 Bain & Company, Inc., India Private Equity Report (2010).

82 Any investment instrument which is not fully and mandatorily convertible into equity is considered to be external commercial borrowing ("ECB") which is subject to significant limitations. *See* Nishith Desai Associates (2015), *supra* note 29, at 9-10; Raja & Vittalachar, *supra* note 26. According to experts, the need to comply with stringent ECB guidelines makes instruments that are not fully and mandatorily convertible in nature "not suitable" for PE investors. *See* Malik, Shankar & Gaur, *supra* note 28, at 233.

83 Vaibhav Parikh, *Private Equity Fund Investments in Indian Companies* in 1735 PLI/Corp 249, 282-83 (2009) (noting different ways to structure PE investment).

84 Malik, Shankar & Gaur, *supra* note 28, at 226.

if the company winds up, and they also enjoy the right to receive preferential dividend.[85]

Under Indian company law, convertible preference shares have no voting rights, with limited exceptions. Under Section 47 of the Companies Act, 2013, preference shareholders only have voting rights on resolutions placed before the company which directly affect the rights attached to their preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital.[86] PE investors generally overcome such voting obstacles through the use of shareholders' agreements (to which the company is also usually a party) that confer rights and impose obligations beyond those provided by company law.[87] Section III.B below provides an overview of the control provisions typically included in such agreements.

Mandatorily convertible preference shares are treated on a par with equity for purposes of FDI sector caps. Furthermore, only mandatorily convertible preference shares can be issued to foreign PE investors under the FDI scheme.[88] Adding to this hurdle, the RBI has prescribed that the dividend payable on all convertible preference shares issued to non-resident parties cannot be in excess of 300 basis points over the prime lending rate of the State Bank of India on an annual basis.[89]

One of the advantages of the preference share to a PE firm is avoiding the mandatory offer requirements of the Takeover Code.[90] This means that the PE firm can cash out part of its existing stake prior to acquiring more equity and exceeding the 5% or the 25% threshold limit.

(c) Convertible Debt

Under convertible debt instruments, the debt holder receives interest from the company until the maturity date, after which the debt converts into equity shares. Mandatorily convertible debt is treated the same as equity for determining an FDI sector cap. On the other hand, optionally convertible or

85 Under Indian company law, a preference share by definition gets a preference over the other shareholders as to dividends and recovery of capital in the event of liquidation. *See* Section 43, the Companies Act, 2013.

86 Under Section 47 of the Companies Act, if dividends are not declared on compulsory convertible preference shares for two consecutive years, then such shareholders have the same voting rights as that of the equity shareholders.

87 Umakanth Varottil, *Shareholders Agreements: Clauses and Enforceability*, IndiaCorpLaw Blog (December 31, 2010), *available at* http://indiacorplaw.blogspot.com/2010/12/shareholders-agreements-clauses-and.html.

88 *Supra* note 72.

89 Stewart & Shroff, *supra* note 60, at 93.

90 Shraddha Nair, *Private Equity Firms Prefer Convertibles to Direct Equity*, Mint (June 7, 2010), *available at* http://www.livemint.com/2010/06/07223811/Private-equity-firms-prefer-co.html (discussing exit from investment in parts as typically a PE investment has a one-year lock-in period).

non-convertible debentures will be construed as debt, and foreign investors will need prior approval from the FIPB and the RBI to invest via these instruments (RBI, 2007a).[91] Moreover, investment in optionally convertible or non-convertible debentures will require compliance with the restrictive guidelines for external commercial borrowings (RBI, 2007b).[92] Thus, a foreign PE investor must always invest in fully and compulsorily convertible instruments.

(d) Warrants

Warrants are instruments that can be converted into equity shares at the convenience of the holder by paying a conversion price. Outstanding warrants are not taken into consideration for evaluating FDI sector caps. This is the primary reason why foreign PE firms use warrants, i.e., as stopgap instruments to ensure that the investment does not exceed the sector caps. At the same time, warrants retain the right to acquire the underlying equity shares within a specified timeframe in the hope that the regulatory regime might change.

Warrants have their own limitations. Most obviously, a warrant is only a right to subscribe to shares at a later date, meaning that investors do not get any of the rights attached to shares (e.g., dividends, voting rights). A warrant makes sense only when used as a stopgap arrangement, with the investor obtaining compensation via other contractual arrangements with the company. If the company that the PE firm invests in chooses to have an IPO prior to any changes in the FDI sector caps, the investor would effectively have to forfeit the shares underlying the warrants. This is due to the SEBI's requirement that all convertible securities outstanding in a company should be converted into equity shares prior to an IPO. Therefore, warrants can be extremely risky.

In July 2014, the RBI issued a circular under which the issuance of warrants by Indian companies to foreign investors would be permitted under the automatic route. Under these new rules, in order for such warrants to be permissible, the pricing of the warrants, a price conversion formula to be determined upfront and also 25% of the consideration amount to be received upfront, with the balance of the consideration towards fully paid up equity shares to be received within 18 months. According to experts while the RBI's revised regulation "has opened the possibility for structuring PE investments through warrants," whether it will be an attractive and feasible option remains to be seen.[93]

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[91] Reserve Bank of India, *Foreign Investments in Debentures—Revised Guidelines*, RBI/2006-2007/435 A.P. (DIR Series) Circular Number 74 (2007).

[92] Reserve Bank of India, *Foreign Investments in Preference Shares—Revised Guidelines*, RBI/2006-2007/434 A.P. (DIR Series) Circular No. 73 (2007).

[93] Raja & Vittalachar, *supra* note 26.

B. Control and Exit Rights in the Indian Private Equity Model

In order to address their governance concerns as minority investors, PE firms typically insist on shareholders' agreements with specific contractual provisions to protect their interests. Many of the provisions of the shareholders' agreements found in Indian PE deals mirror those found in VC deals in the United States, where control and exit rights are central issues in the deal.[94] Both types of deals use similar forms of instruments. PE and VC transactions involve negotiations over board representation and staged financing, the use of protective provisions to maintain control over their investments, and the possible use of exiting through specific rights of exit.

These attributes in shareholders' agreements in India include liquidation preferences, conversion rights, anti-dilution protections, voting and information rights, share transfer restrictions (particularly with respect to promoters).[95] In addition, PE investors in India often seek the right to appoint representatives on the company's board of directors, as well as on board committees. Given that governance and regulatory problems may jeopardise the investment, PE investors often include extensive provisions relating to exit rights. PE investors usually make minority investments in the form of equity investments with put/call rights to existing shareholders (usually the promoters) and buybacks by the company over time.

(a) Control rights in shareholders' agreements

In India, shareholders' agreements typically give PE investors as minority shareholders rights such as:

1. a board seat and veto rights over certain transactions;
2. pre-emption rights to participate in future financing rounds by the company;
3. restriction on sales (e.g., right of first offer, right of first refusal) and co-sale or tag-along rights;
4. anti-dilution price protections for down rounds (where the company's valuation has dropped);
5. drag-along rights (although courts in India are opposed to forced sales and these rights, though contractually agreed to, may ultimately not be enforced);

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[94] Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 New York University Law Review 967, 987 (2006).

[95] Malik, Shankar & Gaur, *supra* note 28, at 229-230.

6. arbitration clause (especially as litigation is a weak enforcement mechanism in India) with neutral country arbitration.

The following sections address a few of these provisions, along with the impact of the Companies Act, 2013 on such provisions.

(b) Board representation

Shareholders' agreements typically include provisions on the maximum number of directors on the board, the number of nominee directors from each party, who will be the chairperson of the board meeting, the quorum required for a board meeting, whether the chairperson will have a casting vote, and other such matters pertaining to the board. PE investors in India often require the right to appoint at least one nominee director on the board of the company. The shareholders' agreement will also provide that the quorum cannot be constituted unless such nominee director is present at board meetings, and the investor as a shareholder is present at shareholder meetings.

The passage of the Companies Act, 2013 raises some important issues for such nominee directors, who are not considered to be independent directors under the Companies Act.[96] Under the Act and the rules promulgated thereunder, directors are charged with significantly increased duties and responsibilities. Section 166 of the Companies Act, 2013 includes a broad sweeping provision codifying the duties of directors. According to the Act a director of a company must:

- act in accordance with the articles of the company, subject to the provisions of the Act;
- act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.
- exercise his duties with due and reasonable care, skill and diligence and exercise independent judgment.
- not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
- not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such

[96] Section 149(6), the Companies Act, 2013, for a definition of Independent Director.

director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

- not assign his office and any assignment so made shall be void.

If a director commits a breach of the duties outlined, such director can be fined a minimum of Rupees 100,000 up to Rupees 500,000. Overall, the Companies Act imposes significant duties on directors, and in case of failure to perform such duties, gives recourse to members and depositors to file class action suits against them. However, the 2013 Act also grants reasonable immunity to an independent director or a non-executive director not being a promoter or key managerial personnel, whereby such a director will be held liable only (a) in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or (b) where he had not acted diligently.[97]

(c) Protective provisions and Voting Rights

In the West, VCs usually receive specific veto rights over major decisions.[98] These "protective provisions" are important to help VCs protect themselves from forced exit, whether through business combinations or forced IPOs, through the use of protective provisions.[99] Protective provisions are complementary when the VC has board control and are more important when it does not.[100] Protective provisions only create a right to block unfavourable transactions, i.e., they protect against opportunistic entrepreneurial behaviour but are not an affirmative grant of power.[101] The most common protective provisions include VC consent for business combinations and acquisitions, amendment of the corporation's charter, redemption of common stock, payment of common stock dividends, issuance of more preferred stock, a significant change in business conducted, and incurrence of debt. VCs also typically negotiate for a catch-all provision in addition to the list of provisions that explicitly require their consent. The catch-all provision allows VCs to veto any action that materially modifies their rights under the company.

Similar to Western VC investors, PE investors in Indian firms rely on protective provisions in their shareholders' agreements.[102] Often, if the PE investor has invested through the use of compulsorily convertible preference shares or fully convertible debentures, the shareholders' agreement will include provisions to

[97] Section 149(12), the Companies Act, 2013.
[98] *See* Robert P. Bartlett, III., *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA LAW REVIEW 37, 53 (2006).
[99] Smith, *supra* note 37, at 346-47.
[100] Ibrahim, *supra* note 37, at 1415.
[101] Brian J. Broughman, *The Role of Independent Directors in Startup Firms*, 2010 UTAH LAW. REVIEW 461, 987 (2010).
[102] Malik, Shankar & Gaur, *supra* note 28, at 229-230.

provide the PE investor with voting rights from day one at general meetings on an as-converted-to-common stock basis. With respect to voting rights, for example, a shareholders' agreement can specify matters that will require the consent of both promoters and PE investors in general meetings, such as changes in the capital structure of the company, fresh issue of capital, amendment of the memorandum and articles of the company, and a change in the auditors. Investors also require that the shareholders' agreement include provisions that provide the investor information rights, including the right to inspect records and premises, and to conduct an independent audit.[103]

Recently, PE firms have introduced new deal technologies in shareholders' agreements to further address corporate governance issues. PE firms, wary of Lilliput-like fiascos and eyeing favourable investment opportunities in other markets, have insisted on more stringent protective provisions. In particular, firms are looking for anti-bribery clauses, insurance against unauthorised use of funds, and mandatory arbitration in Singapore. In addition, PE acquirers are also pursuing third party insurance for tax matters and other representations and warranties. PE firms typically have a representative on the company's board, and recently have sought protections such as indemnity for their own board members against allegations of wrongdoing or control of important committees, such as the audit or compensation committees.[104] Given the challenges faced by PE firms in deals such as Lilliput, analysts expect that PE investors will introduce even greater corporate governance in target companies.[105]

One concern with the level of voting rights that PE investors have under a shareholders' agreement is whether such control will mean that a PE investor can be construed as a promoter under the statute's broad definition of promoter and control.[106]

(d) Investor Rights and Share Transfer Restrictions

Some of the most commonly negotiated-for rights in PE investments in India include share transfer restrictions on the sale or disposition of shares by the promoters such as a right of first offer (ROFO), right of first refusal (ROFR) and tag-along rights. Under the Companies Act, 2013, such restrictions on transfer are now permitted in all public companies. Section 58(2) of the Companies Act, 2013 stipulates that "any contract or arrangement between two or more persons in

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[103] Malik, Shankar & Gaur, *supra* note 28, at 230.

[104] Deepti Chaudhary & Harini Subramani, *PE Firms Widen Indemnity Clause Scope,* Mint (February 20, 2012), *available at* http://www.livemint.com/2012/02/20003959/PE-firms-widen-indemnity-claus.html?d=1.

[105] Rajesh Naidu & Suraj Sowkar, *Investors Should Not Base Their Investment Decisions Only on Private Equity Bets*, Economic Times(Mar. 5, 2012), *available at* http://articles.economictimes.indiatimes.com/2012-03-05/news/31124315_1_pe-players-pe-investments-pe-firms.

[106] *Supra* note 9 regarding definition of promoter; *See also* Raja & Vittalachar, *supra* note 26.

respect of transfer of securities shall be enforceable as a contract." Thus, there is greater possibility for PE investors in public companies to enforce share transfer restrictions such as rights of first offer or refusal.

(i) Exit options for PE investors

For PE investors, a smooth exit from the investment is imperative in determining the investment's overall success. Exit can be achieved via various means such a sale of securities by the PE investor into the stock markets in the case of listed securities, an IPO by the Indian company, a strategic sale to another operating company, or a private sale to another investor (in the case of both listed and unlisted securities). Some of the most common exit mechanisms used by PE investors in India to address exit are similar to those found in VC investment agreements in the West. For example, VC agreements typically involve contractual rights of exit such as redemption rights, which require the company to repurchase shares as specified in the contract.

(e) Buybacks

In India, PE investors negotiate for several alternative exit mechanisms in their shareholders' agreements. These mechanisms include a buyback by the company of the PE firm's stake or a put option against the company's promoters. In general, a company buyback of shares is less attractive than a put option due to significant restrictions placed on buybacks under the Companies Act. Under Section 68 of the Companies Act, 2013, a company can only buy back up to 25% of its paid-up equity share capital in a single year. Moreover, a buyback can only be made from either free reserves or proceeds of a fresh issue of securities. Section 68 also requires the affirmative vote of a special resolution of the shareholders unless the buy-back is 10% or less of the total paid-up equity capital and free reserves of the company.[107] Given these limitations, in general, PE investors prefer to negotiate for the right to put their shares to the company's promoters.[108]

(f) Put Options

While put options are often negotiated, they are not without risk. In the case of foreign PE investors, exit options such as put options are subject to Indian pricing guidelines for the transfer of shares from non-resident entities to resident Indian entities or vice versa. Under Indian exchange control laws, the price at which securities may be transferred from a resident to a non-resident entity

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[107] A Special Resolution is one where the votes cast in favor of the resolution (by members who, being entitled to do so, vote in person or by proxy, or by postal ballot) is not less than three times the number of the votes, if any, cast against the resolution by members so entitled and voting. *See* Section 114, the Companies Act, 2013.

[108] Raja & Vittalachar, *supra* note 26.

should be at or above the "fair value" calculated in accordance with the prescribed rules. The fair value issue does not present significant hurdles for foreign PE firms if the company is doing well; however, if the company is doing poorly, the application of the pricing guidelines results in a lower than expected return for the PE firm.[109]

For many years, the enforceability of put options was under significant debate due to the "stringent securities legislation that has been supported by strict judicial interpretation."[110] For example, in 2010, the SEBI outlawed all forward contracts[111], and in 2011, in two cases involving the shares of listed companies, the SEBI unequivocally ruled that put and call options are invalid and unenforceable, and will not be given effect by the regulator.[112]

SEBI's interpretations regarding put options came under attack by Indian corporate law experts who argued against a fragmented regulatory regime which unnecessarily restricted the investors' ability to enter into protective contracts. Both scholars and markets participants advocated for the recognition of pre-emption rights and options in investment agreements.[113]

After years of uncertainty, both SEBI and the RBI indicated that such put options would be permissible, subject to certain conditions. In the fall of 2013, SEBI issued a notification which allowed contracts for pre-emption, including right of first refusal, tag-along or drag-along rights contained in the shareholders agreements or articles of association of companies, as well as contracts containing an option for purchase or sale of securities.[114] Under SEBI's new rules such options are subject to three conditions intended to continue to curb speculation in securities:[115]

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109 If the put option is on a non-resident entity, such as a non-resident affiliate of the promoter, pricing restrictions would not apply.

110 Umakanth Varottil, *Investment Agreements in India: Is there and "Option"*, 4 NUJS Law Review 467, 467 (2011).

111 Securities and Exchange Board of India, Order Disposing of the Application Dated April 7, 2010 Filed by MCX Stock Exchange Limited, 56-57 (September 23, 2010), *available at* www.sebi.gov.in/cmorder/MCXExchange.pdf (Last accessed on July 15, 2013).

112 Letter of Offer to the Shareholders of Cairn India Limited(April 8, 2011), *available at* http://www.sebi.gov.in/takeover/cairnlof.pdf (Last accessed on July 15, 2013); and Securities and Exchange Board of India, Letter addressed to Vulcan Engineers Limited (May 23, 2011), *available at* http://www.sebi.gov.in/informalguide/Vulcan/sebilettervulcan.pdf (Last accessed on July 15, 2013).

113 Varottil, *supra* note 110, at 492-493.

114 SEBI Press Report No.: 98/2013 *available at* http://www.sebi.gov.in/sebiweb/home/list/4/23/0/0/Press-Releases; Securities and Exchange Board of India, Notification No.: LAD-NRO/GN/2013-14/26/6667(October 3, 2013).

115 Umakanth Varottil, *SEBI Notification on Pre-Emption Rights, Put and Call Options*, IndiaCorpLaw Blog (October 4, 2013), http://indiacorplaw.blogspot.com/2013/10/sebi-notification-on-pre-emption-rights.html.

(i) the title and ownership of the underlying securities is held continuously by the selling party to such contract for a minimum period of one year from the date of entering into the contract;

(ii) the price or consideration payable for the sale or purchase of the underlying securities pursuant to exercise of any option contained therein complies with all applicable laws; and

(iii) the contract is settled through actual delivery of the underlying securities.

SEBI's notification was not retrospective, and thus did not legitimate or affect agreements which had been entered into prior to the date of the notification. Moreover, SEBI's rules mandated compliance with the pricing guidelines under foreign exchange laws prescribed by RBI (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, SEBI Takeover Code, 2011, etc.

Following SEBI's move, the RBI also issued a notification relating to options and convertible instruments.[116] The amended RBI regulations now provide that equity shares, fully and mandatorily convertible preference shares and debentures containing an optionality clause can be issued to foreign investors, subject to certain conditions.[117] These conditions provide that:

(i) such instruments must be subject to a minimum lock-in period of one year or such higher lock-in period as prescribed under FDI regulations. The lock-in must be effective from the date of allotment of such shares/ debentures;

(ii) such instruments cannot include an option or exit right at an assured price;

(iii) the exit price must be determined as follows:

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[116] Foreign investors holding put options in the securities of Indian companies are subject to the Foreign Exchange Management Act, 1999 and RBI regulations. The RBI previously viewed such put options as constituting an external commercial borrowing (ECB) which is subject to significant restrictions. In addition, in September 30, 2011, the Indian Government stated that all investments in equity securities with in-built options or those supported by options sold by third parties would be considered as ECBs. After an uproar from industry experts, the Government reversed its stance by deleting the relevant clause regarding options within a month. *See* Umakanth Varottil, *Revised FDI Policy: Options Outlawed*, IndiaCorpLaw Blog (Oct. 2, 2011), *available at* http://indiacorplaw.blogspot.com/2011/10/revised-fdi-policy-options-outlawed.html; Umakanth Varottil, *Reversal of FDI Policy on Options*, IndiaCorpLaw Blog (Oct. 31, 2011), *available at* http://indiacorplaw.blogspot.com/2011/10/reversal-of-fdi-policy-on-options.html.

[117] Reserve Bank of India, Foreign Direct Investment- Pricing Guidelines for FDI instruments with optionality clauses RBI Circular No. RBI/2013-2014/436 A.P. (DIR Series) Circular No. 86 (January, 09 2014) *available at* http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/APDIR0901201486EN.pdf.

a. In case of listed company, at the market price determined on the floor of the recognized stock exchanges;

b. In case of unlisted equity shares, at a price not exceeding that arrived on the basis of return on equity;

c. In case of preference shares or debentures, at a price determined by a Chartered Accountant or a SEBI registered Merchant Banker per any internationally accepted methodology.

In 2015, the RBI indicated that it would consider greater flexibility with respect to the pricing of options in order to better meet FDI needs and to provide greater protections to investors against downside risks.[118] In its February 2015 statement, the RBI stated that "With a view to meeting the emerging needs of foreign direct investment in various sectors with different financing needs and varying risk perceptions as also to offer the investor some protection against downside risks, it has been decided in consultation with the Government of India to introduce greater flexibility in the pricing of instruments/securities, including an assured return at an appropriate discount over the sovereign yield curve through an embedded optionality clause or in any other manner. Guidelines in this regard will be issued separately."[119]

(i) Enforceability of shareholders' agreements

One of the most significant legal challenges for PE investments in Indian firms is the lack of clarity regarding the enforceability of the rights and obligations set forth in shareholders' agreements.[120] In fact, "[t]he process of enforceability of legal rights in India is among the slowest" in the world, with recent World Bank reports placing India near the bottom of all countries surveyed (186 out of 189) in ease of enforcing contracts.[121]

Shareholders' agreements in the context of PE investments have gained popularity only in the last few years in India. Indian courts have not had many opportunities to address the validity and enforceability of the various types of rights and clauses contained in such agreements. Given that litigation in India can take

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[118] Umakanth Varottil, *Pricing of Options to Foreign Investors,* IndiaCorpLaw Blog (Feb. 9, 2015), *available at* http://indiacorplaw.blogspot.com/2015/02/pricing-of-options-to-foreign-investors.html.

[119] Reserve Bank of India, Sixth Bi-Monthly Monetary Policy Statement, Press Release 2014-2015/1619 (February 03, 2015) available at: https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=33144.

[120] Sidharrth Shankar & Shantanu Jindel, *Towards an Investor Friendly Regime*, Financial Express (May 12, 2015), *available at* http://www.financialexpress.com/article/fe-columnist/towards-an-investor-friendly-regime/71505/.

[121] *Id.*; World Bank, Doing Business 2015: Going Beyond Efficiency (2014).

a significant amount of time[122], the parties involved usually provide for arbitration as the dispute settlement mechanism in the shareholders' agreement.[123]

In its one landmark decision on shareholders' agreements, the Supreme Court of India made explicit that the terms and conditions of a shareholders' agreement are not binding on the Indian company unless they are incorporated into the articles of association.[124] Accordingly, PE firms must push to have the agreement terms written into the articles of association. Despite this decision, lower Indian courts still disagree over whether there is complete freedom of contract when the provisions of shareholders' agreements appeared to be inconsistent with the tenor of company legislation.[125] However, in a 2010 case, the Bombay High Court recognised rights *inter se* among shareholders in a case where the validity of a right of first refusal in a shareholders' agreement was called to question.[126] While the Bombay High Court's decision provides some relief to PE investors regarding the enforceability of their rights under shareholders' agreements, it does not have the same force of precedent as a decision of the Indian Supreme Court.

Some provisions typically included in PE shareholders' agreements have proved particularly challenging under Indian law. For example, non-compete agreements with founders and management beyond the term specified in the contract are void and unenforceable. This may result in PE firms retaining the management rather than the typical U.S. practice of replacing the management.[127] Moreover, the Bombay High Court has declared unenforceable provisions of a shareholders' agreement curtailing the rights of directors if they are not included in the company's articles. The court also held that the shareholders can dictate terms to the directors only by the amendment of the articles of association.

V. CONCLUSION

Unable to undertake the traditional LBO-based PE model in India, PE investors in Indian firms have developed their own Indian PE Model. The Indian PE model is designed to address the regulatory and corporate governance challenges prevalent in India. Investors have relied on a hybridised and customised model

122 John Armour & Priya Lele, *Law, Finance and Politics: The Case of India*, 43 LAW & SOC'Y REVIEW 491 (2009).

123 Siddharth Raja & Neela Badami, *Private Equity: India* in GETTING THE DEAL THROUGH: PRIVATE EQUITY (2012).

124 See *V.B. Rangaraj* v. *V.B. Gopalakrishnan*, (1992) 1 SCC 160 : AIR 1992 SC 453; *See also* Vishal Gandhi, *Certain Legal Aspects* in PRIVATE EQUITY AND VENTURE CAPITAL INVESTMENTS IN INDIA 2-3 (2008).

125 Varottil (2010), *supra* note 110. *See*, e.g., *V.B. Rangaraj* v. *V.B. Gopalakrishnan*, (1992) 1 SCC 160 : AIR 1992 SC 453; *Shanti Prasad Jain* v. *Kalinga Tubes Ltd*., AIR 1965 SC 1535; *Mafatlal Industries Ltd*. v. *Gujarat Gas Co. Ltd*., (1999) 97 Comp Cas 301 (Guj); *Pushpa Katoch* v. *Manu Maharani Hotels Ltd*., (2006) 131 Comp Cas 42 (Del).

126 *Messer Holdings Ltd*. v. *Shyam Madanmohan Ruia*, (2010) 159 Comp Cas 29 (Bom).

127 Ketan Kothari, *Investments in India – Risks & Mitigation Strategies* in OUTLOOK ON INDIA 2010: DELIVERING ON THE PROMISE IN TURBULENT TIMES 337, 347 (2010).

to address the restrictions related to investment structure, investor control rights, and exit strategies. Some of these strategies—such as the use of protective provisions—have proven to be successful. Recent reforms in Indian company law and regulations may certainly be of benefit to PE investors, allowing for greater possibility for better structuring PE investments and less opportunity for minority oppression. Nevertheless, continuing concerns regarding the enforceability of contracts will continue to hamper PE investments in Indian firms.