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BALANCING COMMERCIAL AUTONOMY AND GOVERNMENT CONTROL IN INDIAN PUBLIC SECTOR UNDERTAKINGS: A LEGAL ANALYSIS OF CORPORATE GOVERNANCE REFORMS

~ *Utkarsh Yadav & Akanksha Choudhary*

Abstract

Public Sector Undertakings (PSUs) occupy a unique position within India's constitutional and economic framework. Conceived as instruments of socio-economic transformation after independence, PSUs were expected to combine commercial efficiency with public accountability. However, their dual character as corporate entities incorporated under company law and as "State" instrumentalities under Article 12 of the Constitution has created persistent tensions between managerial autonomy and governmental control. This paper examines the constitutional, statutory, and regulatory framework governing Indian PSUs and analyses how judicial interpretation, corporate governance reforms, and market-oriented restructuring have attempted to reconcile these competing objectives. Through an examination of landmark judicial decisions, committee-based governance reforms, and the interaction between the Companies Act, 2013 and SEBI regulations, the paper argues that Indian PSU governance remains constrained by constitutional accountability despite significant liberalization efforts. While reforms have improved transparency and professionalism, excessive governmental interference and regulatory overlap continue to undermine commercial flexibility. The paper concludes by proposing a balanced governance framework that preserves public accountability while enabling PSUs to compete effectively in liberalized markets.

Introduction

Public Sector Undertakings have historically played a central role in India's economic development. In the decades following independence, the Indian state adopted a mixed economic

model in which PSUs were entrusted with controlling the “commanding heights” of the economy. Heavy industries, infrastructure, telecommunications, energy, transportation, and banking sectors were strategically placed under public ownership to promote industrialization, reduce economic inequality, and protect national interests.

Unlike ordinary private corporations, however, PSUs were never designed solely for profit maximization. Their objectives extended beyond commercial performance to include social welfare, employment generation, regional development, and strategic sovereignty. Consequently, PSUs developed within a complex legal framework where constitutional accountability coexisted with commercial objectives.

The most distinctive feature of Indian PSUs is their dual legal identity. On one hand, they are corporate entities incorporated under the Companies Act with separate legal personality, boards of directors, and commercial functions. On the other hand, they are treated as “State” instrumentalities under Article 12 of the Constitution of India and therefore remain subject to constitutional limitations, judicial review, and public law obligations.

This duality creates a structural governance dilemma. Commercial entities require managerial discretion, speed, confidentiality, and operational flexibility to compete in markets. Constitutional governance, however, imposes obligations of transparency, fairness, non-arbitrariness, and public accountability. As a result, PSU governance constantly oscillates between the logic of the market and the logic of constitutional administration.

This paper analyses the constitutional foundations of PSU regulation, the impact of Article 12 jurisprudence on commercial functioning, the evolution of corporate governance reforms, and the continuing challenges posed by overlapping regulatory frameworks. It argues that although governance reforms have modernized PSU administration, the persistence of excessive governmental control and regulatory duality continues to restrict genuine commercial autonomy.

I. Constitutional Status of PSUs and the “Article 12 Trap”

Meaning and Scope of Article 12

The constitutional status of PSUs originates from the expansive interpretation of the term “State” under Article 12 of the Constitution of India. Article 12 defines the State for the purposes of Part III of the Constitution, which guarantees Fundamental Rights. It includes the Government and

Parliament of India, State Governments, local authorities, and “other authorities” within Indian territory or under the control of the Government of India.

The phrase “other authorities” became the basis for judicial expansion of constitutional accountability over statutory corporations, government companies, and public enterprises. The Supreme Court adopted a purposive interpretation to prevent governments from bypassing constitutional obligations merely by creating separate corporate entities.

Thus, the legal inquiry shifted from the formal structure of an entity to the substance of governmental control exercised over it.

Evolution of the Instrumentality Doctrine

The doctrine governing PSU constitutional status evolved significantly through judicial interpretation.

In *Ajay Hasia v. Khalid Mujib Sehravardi*, the Supreme Court formulated the “Instrumentality or Agency Test” to determine whether an entity qualifies as part of the State under Article 12. The Court held that an organization may be considered an instrumentality of the State if it is financially, functionally, and administratively dominated by the government.

The Court identified several indicative criteria:

- Entire or majority government shareholding
- Deep and pervasive governmental control
- Performance of public or governmental functions
- State-conferred monopoly status
- Origin through governmental department transformation

These principles were refined in *Pradeep Kumar Biswas v. Indian Institute of Chemical Biology*, where the Court clarified that no single factor is conclusive. Instead, courts must examine the cumulative effect of governmental control.

This jurisprudence effectively expanded constitutional accountability across much of India’s public sector.

Consequences of Article 12 Status

The inclusion of PSUs within Article 12 significantly alters their legal obligations.

As constitutional entities, PSUs must comply with:

- Article 14 of the Constitution of India
- Article 16 of the Constitution of India
- Principles of natural justice
- Judicial review standards applicable to administrative bodies

This enables employees, contractors, and citizens to challenge PSU decisions through writ jurisdiction under Articles 32 and 226.

While such protections enhance accountability, they also create what scholars describe as the “Article 12 Trap.” Unlike private corporations, PSUs cannot rely solely on commercial discretion because virtually every managerial action may be scrutinized under constitutional standards of fairness and non-arbitrariness.

As a result, commercial risk-taking and rapid business decision-making become legally constrained.

II. Impact of Constitutional Accountability on Commercial Functioning

Constraints on Commercial Contracting

One of the most significant consequences of PSU constitutional status arises in procurement and contractual matters.

Private corporations generally enjoy broad freedom to choose contracting parties and terminate commercial relationships according to business considerations. PSUs, however, must ensure that every contractual decision satisfies constitutional requirements of transparency, fairness, and procedural reasonableness.

For example, before blacklisting contractors or denying future business opportunities, PSUs must comply with principles of natural justice by providing notice and an opportunity to be heard. Judicial precedents such as *S.L. Kapoor v. Jagmohan* strengthened procedural fairness obligations even in administrative matters.

Although these safeguards protect against arbitrariness and corruption, they also increase procedural complexity and reduce managerial agility.

Employment Relations and Judicial Intervention

The constitutionalization of PSU employment relationships has further restricted managerial autonomy.

In *Central Inland Water Transport Corporation Ltd. v. Brojo Nath Ganguly*, the Supreme Court invalidated a service rule permitting termination of permanent employees through three months' notice without assigning reasons. The Court held the clause unconscionable and contrary to public policy.

This decision reflected the judiciary's broader approach of treating PSU employees not merely as contractual workers but as individuals entitled to constitutional protection against arbitrary treatment.

Consequently, employment disputes involving promotions, transfers, disciplinary actions, and service conditions frequently become subjects of constitutional litigation.

While such judicial oversight protects workers' rights, it often restricts the ability of PSU management to restructure operations, rationalize labor costs, or adapt workforce arrangements according to market demands.

III. Corporate Governance Reforms and the Committee Paradigm

Background to Governance Reforms

Economic liberalization in 1991 exposed Indian PSUs to increasing market competition. It became evident that bureaucratic control structures were incompatible with efficient corporate functioning in liberalized markets.

To improve competitiveness, India initiated extensive corporate governance reforms aimed at transforming PSU boards from extensions of government ministries into professional decision-making bodies guided by fiduciary principles.

A committee-based reform process emerged as the principal mechanism for governance modernization.

Kumar Mangalam Birla Committee (2000)

Kumar Mangalam Birla chaired the first major corporate governance committee constituted by SEBI.

The committee recommended:

- Optimum balance between executive and non-executive directors
- Mandatory audit committees
- Greater board accountability

- Enhanced disclosure obligations

These recommendations became the basis of Clause 49 of the Listing Agreement and marked the beginning of modern corporate governance regulation in India.

Naresh Chandra Committee (2002)

The Naresh Chandra Committee focused on strengthening institutional integrity through:

- Auditor independence
- Clarification of independent directors' responsibilities
- Improved financial disclosure standards

The committee emphasized that governance failures often originate from conflicts of interest between management and oversight mechanisms.

Narayana Murthy Committee (2003)

The committee chaired by Narayana Murthy proposed stronger standards for board independence and ethical governance.

Its recommendations included:

- At least 50% independent directors where the chairman is executive
- Enhanced regulation of related-party transactions
- Stronger whistleblower protections

The reforms sought to create professionally autonomous boards capable of resisting both managerial misconduct and excessive governmental interference.

Kotak Committee (2017)

The Uday Kotak Committee further strengthened governance standards by recommending:

- Separation of Chairman and CEO positions
- Increased board diversity
- Enhanced disclosure norms
- Improved whistleblower mechanisms

The committee recognized that governance quality directly affects investor confidence and long-term institutional sustainability.

IV. The Companies Act, 2013 and SEBI Regulatory Framework

Companies Act, 2013

The Companies Act, 2013 represented a major transformation in Indian corporate regulation.

Key governance innovations included:

- Independent directors
- Mandatory audit and nomination committees
- Corporate Social Responsibility (CSR)
- Expanded disclosure obligations
- Enhanced minority shareholder protections

The Act marked a shift from promoter-centric governance toward stakeholder-centric governance. For PSUs, however, implementation remained complicated because ministerial influence continued to shape board appointments and strategic decision-making.

SEBI LODR Regulations, 2015

The Securities and Exchange Board of India introduced the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to strengthen governance among listed companies.

The regulations imposed:

- Detailed disclosure standards
- Board composition requirements
- Related-party transaction oversight
- Risk management obligations
- Timely market disclosures

Listed PSUs became subject to these market-oriented governance standards alongside constitutional and governmental controls.

Regulatory Duality and Compliance Burdens

One of the most significant governance challenges facing PSUs today is regulatory duality.

Listed PSUs must simultaneously comply with:

- The Companies Act, 2013
- SEBI LODR Regulations
- Department of Public Enterprises (DPE) Guidelines

- Constitutional obligations under Article 12
- Parliamentary oversight mechanisms
- Comptroller and Auditor General (CAG) audits

This overlapping framework often generates conflicting obligations and institutional inefficiencies.

For instance, a PSU board may be legally expected to prioritize shareholder value under corporate governance norms while simultaneously pursuing social welfare objectives imposed by governmental directives.

Similarly, decisions that are commercially rational may become vulnerable to judicial review under constitutional standards.

The result is a fragmented governance structure where accountability mechanisms frequently overlap rather than complement one another.

V. Governmental Oversight versus Commercial Independence

Role of the Government as Majority Shareholder

The Indian government typically functions as the dominant shareholder in PSUs. This ownership structure enables ministries to influence appointments, strategic planning, and policy direction.

While state oversight is justified on grounds of public accountability and national interest, excessive interference often undermines board independence.

Appointments to PSU leadership positions are frequently influenced by bureaucratic and political considerations rather than purely professional criteria. Consequently, boards sometimes function less as autonomous fiduciary bodies and more as administrative extensions of government ministries.

CAG Audits and Parliamentary Oversight

PSUs are also subject to scrutiny by the Comptroller and Auditor General of India and the Parliamentary Committee on Public Undertakings.

These oversight institutions strengthen transparency and financial accountability. However, they may also create a risk-averse administrative culture where managers prioritize procedural compliance over innovation and commercial experimentation.

Fear of future investigations often discourages aggressive business strategies and timely commercial decision-making.

VI. Disinvestment and the Future of PSU Governance

Liberalization and Strategic Disinvestment

Post-1991 liberalization fundamentally altered the role of PSUs within the Indian economy. Increasing privatization and strategic disinvestment reflected a shift from state-led production toward market-driven growth.

The government introduced classifications such as:

- Maharatna
- Navratna
- Miniratna

These categories granted varying degrees of financial and operational autonomy to commercially successful PSUs.

Nevertheless, autonomy remains conditional and limited because ownership and political control continue to reside with the state.

Emerging Governance Challenges

As PSUs compete with private corporations in global markets, governance challenges are becoming increasingly complex.

Contemporary concerns include:

- Independence of independent directors
- ESG compliance
- Cybersecurity governance
- AI-driven risk management
- Balancing commercial profitability with public obligations

The future success of PSUs depends on whether governance structures can evolve beyond bureaucratic control while retaining constitutional accountability.

Conclusion

The governance of Indian Public Sector Undertakings reflects a continuing constitutional struggle between commercial autonomy and governmental control. PSUs were historically designed as instruments of national development rather than purely profit-oriented corporations. However, economic liberalization and market competition have increasingly required them to function according to corporate efficiency principles.

The constitutional expansion of Article 12 jurisprudence ensured that PSUs remain accountable to fundamental rights and public law standards. While this protects transparency and fairness, it simultaneously restricts managerial flexibility and commercial discretion.

Corporate governance reforms introduced through expert committees, the Companies Act, 2013, and SEBI regulations have modernized governance standards and strengthened institutional accountability. Yet, regulatory overlap, bureaucratic interference, and excessive governmental control continue to undermine genuine operational independence.

A sustainable governance framework for Indian PSUs must therefore strike a careful balance. Constitutional accountability cannot be abandoned because PSUs manage public resources and perform public functions. However, governance structures must also recognize that commercial enterprises require flexibility, professional management, and strategic autonomy to remain competitive.

The future of PSU reform in India ultimately depends on transforming the state's role from direct controller to strategic shareholder—one that ensures accountability without suffocating enterprise.

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