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Board Observers in Indian Companies: The Investor's Seat Without a Vote, and the Risk of Crossing the Line into Control

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ABSTRACT

This blog examines the role of board observers in Indian companies and the boundary between investor oversight and legal control. It discusses Section 2(27) of the Companies Act, 2013, the SEBI takeover framework, and the reasoning considered in Subhkam Ventures and ArcelorMittal India. It explains how attending board meetings, receiving information, and commenting on proposals differ from rights that allow an investor to direct management or shape ordinary business decisions. The central point is that the label “observer” is not decisive: the actual contractual rights and how they operate in practice matter. The blog concludes that careful drafting can help preserve legitimate monitoring rights without unintentionally conferring control.

A board observer lets an investor sit in the boardroom without becoming a voting director. The observer may receive board notices and papers, attend meetings and, if the investment agreement allows it, speak during discussions. The investor gets information about how the company is being run, but the board remains responsible for taking the company's decisions.

The arrangement is useful for an investor that wants oversight without taking day-to-day management responsibility. SEBI's 2016 discussion paper on control specifically listed the appointment of a board observer with no voting or participation rights as a protective right.¹ The paper was a proposal for public comments, not a statutory safe harbour. SEBI later decided to continue with the existing case-by-case approach to control.²

1 Securities & Exchange Board of India, *Discussion Paper on “Brightline Tests for Acquisition of ‘Control’ Under SEBI Takeover Regulations”* 6 (Mar. 14, 2016).

2 Securities & Exchange Board of India, Press Release, *Acquisition of ‘Control’ Under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011* (Sept. 8, 2017).

The word “observer” is not the legal test

Section 2(27) of the Companies Act, 2013 defines “control” broadly. It includes the right to appoint a majority of directors and the power to control management or policy decisions, directly or indirectly, through shareholding, management rights, shareholders’ agreements, voting agreements or any other manner.³ The wording matters because an investor can exercise influence through a contract even without holding voting control.

The same concern appears under the SEBI Takeover Regulations. Regulation 2(1)(e) uses a broad definition of control, and Regulation 4 requires an acquirer to make a public announcement of an open offer when control over a listed target is acquired, even if there has been no acquisition of shares or voting rights.⁴ A contractual right that crosses into control can therefore create a regulatory consequence that the parties may not have intended.

The practical distinction is between watching a decision and having the power to make the company take it. An observer who receives documents, asks questions and gives comments is normally exercising an information or monitoring right. The position changes when the investor can direct senior officers, decide the company’s ordinary business strategy or make its approval necessary for routine management decisions.

What *Subhkam Ventures* adds to the discussion

In *Subhkam Ventures (I) Pvt. Ltd. v. SEBI*, the Securities Appellate Tribunal examined an investor’s rights under a shareholders’ agreement.⁵ The investor had a right to nominate a director, but the nominee was only one member of a ten-member board and did not have a veto. The Tribunal treated the investor’s rights as protective rather than as control over the company.

The Tribunal drew a useful distinction between a power to stop an action and a power to make the company act. It described control as a positive or proactive power. A right that only prevents a particular action does not necessarily mean that the investor can run the company.⁶ The Supreme Court later disposed of SEBI’s appeal in 2011 and directed that the SAT order should not be treated as a precedent.⁷

³ The Companies Act, 2013, No. 18 of 2013, § 2(27) (India).

⁴ Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, regs. 2(1)(e), 4 (India).

⁵ *Subhkam Ventures (I) Pvt. Ltd. v. SEBI*, Appeal No. 8 of 2009 (Securities Appellate Tribunal Jan. 15, 2010).

⁶ Id.

⁷ *SEBI v. Subhkam Ventures (I) Pvt. Ltd.*, Civ. App. No. 3371 of 2010 (Supreme Court of India Nov. 16, 2011) (directing that the SAT order not be treated as a precedent).

The reasoning in *Subhkam* still helps explain why observer rights are drafted carefully, but it should not be treated as the final word on the legal test. The Supreme Court's later judgment in *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta* considered the meaning of "control" in Section 29A of the Insolvency and Bankruptcy Code. It described de facto control in terms of the ability to positively influence management or policy decisions and approved the distinction between positive control and a mere blocking power.⁸ The context was the IBC, so the case should not be read as creating a universal rule for every use of the word "control".

Where a board observer can cross the line

Consider two investors. Investor A can attend board meetings, receive confidential papers and comment on proposals, but cannot vote or direct management. Investor B has the same observer seat but must approve the appointment of senior executives, changes to ordinary business plans and routine commercial contracts. Investor B has a much stronger ability to influence how the company operates. The agreement may still call the person an "observer", but the legal question will turn on the rights that person can actually exercise.

This is why drafting matters. A genuine observer clause should clearly state that the observer has no voting right, no casting vote and no authority to direct the company's officers. Consent or veto rights should be limited to matters that protect the investment, such as major structural changes, instead of extending to ordinary business decisions. SEBI's 2016 proposal made this distinction when it described protective rights as rights aimed at protecting an investment or preventing dilution, while excluding power over day-to-day management and policy-making.⁹

A board observer is therefore not automatically a person in control. The opposite is also true: calling someone an observer does not prevent a finding of control. The key question is simple: what can the investor actually make the company do? Once the answer moves from observing and protecting the investment to directing management or policy, the observer seat can become a control issue.

⁸ *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*, (2019) 2 SCC 1, 40–41 (India).

⁹ Securities & Exchange Board of India, *supra* note 1, at 6.