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# **REVERSE MERGERS AND REGULATORY ARBITRAGE IN INDIAN CAPITAL MARKETS**

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## **ABSTRACT**

Reverse mergers have historically functioned as an alternative route for private companies to access public capital markets without undergoing the rigors of an initial public offering. In India, regulatory interventions by the Ministry of Corporate Affairs and the Securities and Exchange Board of India (SEBI) have sought to curtail the use of reverse mergers as instruments of regulatory arbitrage. This paper critically examines the legal framework governing reverse mergers in India, analyses the persistence of arbitrage opportunities despite regulatory tightening and evaluates comparative approaches adopted in foreign jurisdictions. It argues that while India has substantially reduced the scope of abuse, structural and procedural gaps continue to permit selective circumvention of listing norms.

## STATEMENT OF PROBLEM

Despite multiple regulatory reforms, reverse mergers remain a contested mechanism in Indian capital markets due to their potential to bypass disclosure centric IPO regulations. The core problem lies in whether the existing regulatory architecture sufficiently neutralizes incentives for regulatory arbitrage or whether sophisticated corporate actors continue to exploit the intersection of company law and securities regulation to obtain de facto benefits without equivalent investor protection safeguards.<sup>1</sup>

## INTRODUCTION

A reverse merger, commonly referred to as a backdoor listing, occurs when a private company merges with a listed company, resulting in the private company acquiring control over the listed entity. Unlike a traditional IPO, this process historically allowed access to capital markets with reduced scrutiny, minimal public participation and limited regulatory oversight.<sup>2</sup>

The Companies Act, 2013 marked a decisive shift in India's approach by explicitly providing that an unlisted company merging into a listed company does not automatically acquire listed status. Instead, the resulting entity must separately comply with SEBI's listing requirements.<sup>3</sup> This legislative intervention was designed to curb backdoor listing and align reverse mergers with the market integrity norms.

Regulatory arbitrage, in this context, refers to structuring transactions to exploit inconsistencies between corporate restructuring laws and securities regulations. The conflict between acceptable corporate strategies and exploitative evasion has been a consistent issue in Indian legal cases, as demonstrated in *McDowell & Co. Ltd. v. CTO*, where the Supreme Court warned against deceptive tactics intended to undermine statutory purposes.<sup>4</sup>

## REGULATORY FRAMEWORK GOVERNING REVERSE MERGERS IN INDIA

The statutory basis for mergers and amalgamations is contained under in Sections 230-232 of the Companies Act, 2013 which require National Company Law Tribunal (NCLT) approval for

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<sup>1</sup> SEBI, Views of Stock Exchange on Reverse Mergers (Circular, 1996)

<sup>2</sup> Gower & Davies, Principles of Modern Company Law (Sweet & Maxwell, 10<sup>th</sup> edn)

<sup>3</sup> Companies Act, 2013, section 232(3)(h)

<sup>4</sup> *McDowell & Co Ltd v. CTO* (1985) 3 SCC 230

schemes of arrangement. While the NCLT's role is primarily procedural and stakeholder oriented, it does not substitute securities market oversight.<sup>5</sup>

SEBI regulates reverse mergers through a combination of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2018. These regulations mandate stock exchange approval, minimum public shareholding norms and enhanced disclosure obligations for schemes involving listed entities.<sup>6</sup> SEBI's jurisdiction over market integrity remains independent of NCLT approval, as clarified in *SEBI v. Sterlite Industries (India) Ltd.*, where the Supreme Court held that compliance with company law does not immunise entities from securities regulations.<sup>7</sup>

## REGULATORY ARBITRAGE DIMENSION

Regulatory arbitrage in the context of reverse mergers arises from the structural dissonance between corporate restructuring law and securities market regulation in India. The regulatory seams that may be created due to the divergence can be exploited by sophisticated corporate actors to achieve outcomes functionally equivalent to public listings without undergoing the scrutiny mandated under the IPO regime as the schemes of arrangement under Sections 230-232 of Companies Act, 2013 are primarily assessed by NCLT.

The Supreme Court's jurisprudence on schemes of arrangement reinforces this limited scope of judicial scrutiny. In *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, the court held that judicial bodies must not interfere with the commercial wisdom of shareholders so long as statutory requirements are satisfied and the scheme is not manifestly unfair.<sup>8</sup> This principle was reaffirmed in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.*, confined the NCLT's role largely to procedural oversight rather than substantive evaluation of valuation or disclosure adequacy.<sup>9</sup> While this approach preserves corporate autonomy, it also creates an environment in which reverse mergers may escape rigorous scrutiny at the scheme approval stage.

Regulatory arbitrage is further facilitated by valuation asymmetries in schemes of arrangement. Unlike IPOs, which require market determined pricing mechanisms and extensive disclosure

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<sup>5</sup> Companies Act, 2013 Section 230-232

<sup>6</sup> SEBI (LODR) Regulations, 2015; SEBI (ICDR) Regulations, 2018

<sup>7</sup> *SEBI v. Sterlite Industries (India) Ltd* (2003) 113 Comp Cas 273 (SC)

<sup>8</sup> *Miheer H. Mafatlal v. Mafatlal Industries Ltd* (1977) 1 SCC 579

<sup>9</sup> *Hindustan Lever Employees' v. Hindustan Lever Ltd* (1995) 83 Comp Cas 30 (SC)

under the SEBI (ICDR) Regulations, share exchange ratios in reverse mergers are typically derived from private valuation reports. The Supreme Court in *Hindustan Lever Ltd v. State of Maharashtra* acknowledged that valuation in amalgamations need only to be fair and reasonable, not arithmetically precise.<sup>10</sup> Although, doctrinally sound, this standard may inadvertently enable valuation manipulation in reverse mergers involving dormant or shell listed entities, thereby undermining minority shareholder interests.

Another dimension of regulatory arbitrage lies in the strategic avoidance of takeover obligations. Reverse mergers structured as amalgamations may result in an effective change of control without triggering open offer requirements under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The Supreme Court's purposive interpretation of takeover regulations in *Clariant International Ltd v. SEBI* underscores that substance, rather than form, must guide regulatory enforcement.<sup>11</sup> However, in the absence of explicit regulatory thresholds tailored to reverse mergers, enforcement remains largely *ex post*, increasing the risk of arbitrage.

SEBI's investor protection mandate has sought to address these concerns through enhanced disclosure and stock exchange scrutiny. In *SEBI v. Sterlite Industries (India) Ltd.*, the Supreme Court clarified that compliance with company law does not preclude SEBI from exercising its powers to protect market integrity.<sup>12</sup> This principle was further strengthened in *Sahara India Real Estate Corporation Ltd. V. SEBI*, where the court emphasised that regulatory obligations cannot be diluted through formalistic corporate structuring.<sup>13</sup> Nonetheless, the reliance on post-transaction enforcement rather than *ex ante* substantive scrutiny continues to limit the effectiveness of regulatory responses to arbitrage.

Finally, the tension between legitimate corporate planning and abusive regulatory circumvention remains a persistent challenge. While the Supreme Court in *Vodafone International Holdings BV v. Union of India* recognised the legitimacy of complex corporate structuring absent clear abuse, it simultaneously acknowledged the need to examine the substance of transactions where regulatory objectives are defeated.<sup>14</sup> In the context of reverse mergers, this jurisdiction suggests that a calibrated approach, focusing on intent, economic

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<sup>10</sup> *Hindustan Lever Ltd v. State of Maharashtra* (2004) 9 SCC 438

<sup>11</sup> *Clariant International Ltd v. SEBI* (2004) 8 SCC 524

<sup>12</sup> *SEBI v. Sterlite Industries (India) Ltd* (2003) 113 Comp Cas 273 (SC)

<sup>13</sup> *Sahara India Real Estate Corp Ltd v. SEBI* (2013) 1 SCC 1

<sup>14</sup> *Vodafone International Holdings BV v. Union of India* (2012) 6 SCC 613

substance and investor impact may offer a more effective response to regulatory arbitrage than blanket prohibitions or purely procedural oversight.

## **COMPARATIVE ANALYSIS**

### **United States**

In the United States, reverse mergers emerged as a prominent alternative listing mechanism during 1990s, particularly for small and medium sized enterprises seeking expedited access to capital markets. This practice expanded further with proliferation of shell companies and more recently, Special Purpose Acquisition Companies (SPACs). Concerns relating to inadequate disclosures, accounting irregularities and investor fraud prompted the Securities and Exchange Commission (SEC) to significantly tighten its regulatory oversight. The SEC responded by mandating disclosure obligations that are substantially equivalent to those applicable to traditional IPOs, including detailed prospectus level information, audited financial statements and enhanced civil and criminal liability for material misstatements. Consequently, reverse mergers in the United States no longer function as regulatory shortcuts but operate within a disclosure intensive and enforcement driven framework that substantially limits regulatory arbitrage.<sup>15</sup>

### **United Kingdom**

The United Kingdom adopts a substance over form approach to reverse mergers by classifying them as “reverse takeovers” under its listing framework. United Kingdom securities regulation treats such transactions as fundamentally altering the nature of the listed company, thereby warranting treatment comparable to a fresh public offering. The Financial Conduct Authority (FCA) and the United Kingdom Listing Authority (UKLA) impose stringent disclosure and investor protection requirements, including mandatory shareholder approval, temporary suspension of trading and the preparation of a prospectus where the transaction constitutes an offer to the public. This regulatory approach ensures that reverse acquisitions do not dilute disclosure standards or undermine market integrity, effectively neutralizing the scope for

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<sup>15</sup> SEC, Shell Company Restrictions and Reverse Mergers, Release No. 33-8873 (2007); SEC, Special Purpose Acquisition Companies, Shell companies and Projections, Release No. 33-10825 (2020)

regulatory arbitrage.<sup>16</sup>

## Singapore

Singapore's regulatory framework for reverse mergers places strong emphasis on qualitative scrutiny and regulatory gatekeeping. The Singapore Exchange (SGX) treats backdoor listings as high risk transactions and subjects them to enhanced oversight, including mandatory sponsor supervision, extensive due diligence requirements and a tripartite accountability structure involving the issuer, sponsor and exchange. Particular focus is placed on the integrity, competence and track record of directors and controlling shareholders, reflecting Singapore's governance centric regulatory philosophy. By integrating suitability assessments alongside disclosure obligations, the SGX framework adopts a preventive approach that significantly curtails regulatory arbitrage while maintaining investor confidence in the market.<sup>17</sup>

## Lessons for India

A comparative examination of the United States, United Kingdom and Singapore reveals that regulatory regimes combining clear statutory definitions, disclosure equivalence with IPOs and strong enforcement mechanisms are more effective in mitigating regulatory arbitrage in reverse mergers. While the United States relies on disclosure parity and enforcement intensity, the United Kingdom emphasises on substantive reclassification of reverse mergers as new listings and Singapore prioritises sponsor accountability and suitability screening. India's regulatory framework incorporates elements of these models but remains fragmented due to jurisdictional overlap between company law administered by NCLT and securities regulations enforced by SEBI. The absence of a unified, substance based regulatory trigger continues to permit interpretive gaps, underscoring the need for harmonized oversight to balance corporate restructuring flexibility with investor protection.<sup>18</sup>

## RECOMMENDATIONS

A primary step towards curbing regulatory arbitrage in reverse mergers is the introduction of clear statutory definitions within Indian corporate and securities law. The absence of an explicit

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<sup>16</sup> Financial Conduct Authority, Listing Rules, LR5 (Reverse Takeovers); FCA, Prospectus Regulation Rules (UK)

<sup>17</sup> Singapore Exchange, Listing Manual, Chapter 10 (Backdoor Listings and Reverse Takeovers)

<sup>18</sup> OECD, Principles of Corporate Governance (2015); SEBI, Master Circular on Schemes of Arrangement (2023)

definition of “reverse merger” or “reverse takeover” under the Companies Act, 2013 or SEBI regulations has resulted in inconsistent regulatory treatment and interpretive uncertainty. Codifying these concepts, particularly by recognizing transactions that effect a de facto change of control or business identity would allow regulators to apply substance over form principles more consistently and prevent the circumvention of IPO and listing requirements through complex restructuring mechanisms.<sup>19</sup>

The need for an integrated regulatory compliance framework is particularly acute in the Indian context, where jurisdiction over reverse mergers is divided between company law adjudication and securities market regulation. Schemes of arrangement involving listed companies are primarily examined by the NCLT under Sections 230-232 of the Companies Act, 2013 while SEBI exercises parallel oversight through listing regulations and circulars. This fragmented approach creates regulatory gaps that facilitate arbitrage. A harmonized compliance pathway incorporating coordinated scrutiny by the NCLT, SEBI and stock exchanges would ensure that corporate restructuring does not dilute securities law objectives and would enhance regulatory coherence without imposing unnecessary transactional friction.<sup>20</sup>

Strengthening disclosure obligations and minority shareholder protection is essential to address the structural information asymmetry inherent in reverse mergers. Unlike conventional IPOs, reverse mergers often result in significant changes to control and business operations without equivalent disclosure standards. Expanding mandatory disclosures to include, valuation methodologies, control shifts and post-merger governance structures would align reverse mergers with investor protection principles embedded in securities law. Additionally, enforceable appraisal and exit rights for minority shareholders would safeguard against coercive restructurings and reflect the evolving jurisprudence recognizing shareholder democracy and fairness in corporate transactions.<sup>21</sup>

Effective regulation also requires continuous monitoring and credible enforcement mechanisms. SEBI’s surveillance capabilities must evolve to identify reverse mergers that function as disguised backdoor listings, particularly through abnormal valuation differentials,

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<sup>19</sup> Companies Act, 2013; SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015; Vodafone International Holdings BV v. Union of India (2012) 6 SCC 613

<sup>20</sup> Companies Act, 2013, sections 230-232; SEBI, Master Circular on Schemes of Arrangement, SEBI/HO/CFD/DIL1/CIR/P/2023/21; Securities and Exchange Board of India v. Satyam Computer Services Ltd (2018) 13 SCC 449

<sup>21</sup> SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015; Miheer H Mafatlal v. Mafatlal Industries Ltd (1997) 1 SCC 579; OECS, Principles of Corporate Governance (2015)

rapid shareholding changes or post-merger price manipulation. Enhanced real time monitoring, combined with stringent penalties for misleading disclosures or valuation manipulations, would strengthen deterrence and reinforce market discipline. A balanced approach that integrates preventive oversight with post transaction enforcement would significantly curtail regulatory arbitrage while preserving legitimate corporate flexibility.<sup>22</sup>

Finally, sustained judicial guidance and precedent development is crucial to establishing doctrinal clarity in reverse merger regulation. While Indian courts and tribunals have acknowledged the importance of commercial wisdom in corporate restructuring, there remains a need for clearer judicial articulation of substantive tests relating to business purposes, fairness and investor impact. Detailed reasoning by the NCLT, NCLAT and the Securities Appellate Tribunal on when restructuring arrangements cross into regulatory circumvention would provide much needed interpretive guidance and reduce uncertainty. A robust body of jurisprudence would also promote consistency and reinforce investor confidence in capital markets.<sup>23</sup>

## CONCLUSION

Reverse mergers occupy a complex and evolving position within Indian capital markets, operating at the intersection of corporate restructuring and securities and regulation. While such transactions can serve legitimate commercial objectives such as facilitating efficient access to capital and enabling strategic reorganisations. The absence of a clearly articulated regulatory framework has allowed reverse mergers to be employed as instruments of regulatory arbitrage. The Indian legal regime, characterised by overlapping jurisdiction between the Companies Act, 2013 and SEBI's regulatory authority continues to rely heavily on procedural compliance rather than substantive economic impact, thereby creating opportunities for circumvention of IPO norms and disclosure obligations.<sup>24</sup>

At a doctrinal level, Indian courts and tribunals have historically shown deference to corporate autonomy and commercial wisdom in restructuring transactions. However, jurisprudence also

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<sup>22</sup> SEBI Act, 1992 sections 11 and 11B; Sahara India Real Estate Corp Ltd v. SEBI (2013) 1 SCC 1; SEBI, Annual Report (Latest edition)

<sup>23</sup> Swiss Ribbons Pvt Ltd v Union of India (2019) 4 SCC 17; ArcelorMittal India Pvt Ltd v. Satish Kumar Gupta (2019) 2 SCC 1; Insolvency Law Committee, Report (2018)

<sup>24</sup> Companies Act, 2013; SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015; SEBI, Master Circular on Schemes of Arrangement (2023)

reflects an increasing recognition that formal legality cannot shield arrangements that undermine investor protection or market integrity. Judicial interventions in cases involving schemes of arrangement and market abuse demonstrate a gradual shift towards substance based scrutiny, particularly where shareholder interests or disclosure standards are compromised. Yet, in the specific context of reverse mergers, judicial guidance remains fragmented and underdeveloped, contributing to regulatory uncertainty and inconsistent enforcement.<sup>25</sup>

Comparative analysis reveals that jurisdictions such as United States, United Kingdom and Singapore have effectively constrained regulatory arbitrage by integrating disclosure equivalence, suitability screening and coordinated regulatory oversight into their treatment of reverse mergers. These systems recognise that reverse mergers can be functionally equivalent to public offerings and therefore subject them to comparable investor protection standards. India's regulatory framework incorporates elements of these approaches but lacks cohesive implementation, particularly due to misalignment between company law adjudication and securities market regulation.

Ultimately, the persistence of regulatory arbitrage in Indian reverse mergers is not a failure per se, but a consequence of fragmented governance and the absence of clearly articulated substantive thresholds. Addressing this challenge requires statutory clarification, harmonized regulatory processes, enhanced disclosure, vigilant enforcement and sustained judicial engagement. By adopting a coherent, substance oriented regulatory approach, India can preserve the legitimate utility of reverse mergers while safeguarding market integrity and investor confidence, thereby strengthening the credibility and resilience of its capital markets.

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<sup>25</sup> *Miheer H Mafatlal v. Mafatlal Industries Ltd* (1997) 1 SCC 579; *Securities and Exchange Board of India v. Satyam Computer Services Ltd* (2018) 13 SCC 449