



## Recent SEBI Consultation Paper A Step in the Right Direction on Founder ESOPs

The recent consultation paper dated March 20, 2025 issued by SEBI (“**Consultation Paper**”) proposes an amendment to the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 (“**SEBI SBEB & SE Regulations**”) that permits employee stock options granted to founders to remain outstanding post filing of a draft red herring prospectus (“**DRHP**”) in respect of a proposed IPO, demonstrating the regulatory intent in promoting a facilitative environment for the listing of new age technology companies. This alert summarizes the key takeaways in respect of the extant legal landscape and proposed amendments contemplated in the Consultation Paper. Please note that any comments/ suggestions on the proposals in the Consultation Paper are required to be submitted to SEBI latest by April 10, 2025.

- Pursuant to Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014 that is applicable to unlisted companies, ESOPs may not be granted to promoters or members of the promoter group, *except* ESOPs granted by a ‘startup’ as defined by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, in respect of which such restriction is not applicable for up to 10 years from their date of incorporation or registration, subject to certain conditions. In the case of many new age tech companies (“**NATCs**”), ESOPs have been granted as an incentive for founders to have long-term alignment and compensate for the founder shareholding being diluted over multiple funding rounds. Such ESOPs have been granted under the legal umbrage that the founders were not ‘promoters’ at the time of grant of ESOPs and accordingly there was no bar on issuing such options.
- When NATCs decide to pursue an IPO, they are inevitably at a crossroads where the facilitative benefit of ESOPs to promoters of ‘start-ups’ under the Companies Act, 2013 regime is no longer available as a listed company, and at the same time, the founders of such NATCs are typically required to be identified as ‘promoters’ in the DRHP based on their collective holding, which means that pursuant to the position under the SEBI SBEB & SE Regulations that is applicable to listed companies, the promoters cannot be granted ESOPs, irrespective of the nature of the company (*i.e.* startup or otherwise). In this regard, do note that the current regulatory and stock exchange guidance on IPOs requires the following persons to be mandatorily identified as a “promoter” at the stage of filing a DRHP with SEBI: founder(s) of a company that (i) hold a position or have the right to be nominated, as a director/key managerial personnel/ member of senior management, and (ii) have a collective shareholding of 10% or more of the issued and paid-up share capital of the company on a fully diluted basis (*i.e.*, including vested options), either directly or through any legal entities or persons controlled by such founders or their immediate relatives. For purposes of the analysis on shareholding, the founders are considered together in relation to the aforementioned test.
- The SEBI SBEB & SE Regulations as they currently stand neither specifically allow nor disallow exercise of granted ESOPs (vested/ unvested) when employees holding such ESOPs that were granted to them prior to DRHP filing, are subsequently categorized as promoters. Accordingly, there is an ambiguity on whether such founders that are subsequently categorized as promoters can exercise their granted ESOPs.
- The proposal contemplated in the Consultation Paper is to include an explanation in the SEBI SBEB&SE Regulations to the effect that an employee identified as a “promoter” or “promoter group” in the DRHP filed in relation to an IPO, who was granted options, stock appreciation rights or other benefits under any scheme prior to being identified as a “promoter” or “promoter group”, shall be eligible to continue to hold, exercise or avail any such option, stock appreciation rights, or benefit, in accordance with its terms, provided these are granted prior to one year from the date on which the board of directors of the company has decided to undertake the IPO.



- While the Consultation Paper is a welcome step from a start-up/ NATC perspective, do note that the proposal currently does not extend to permitting fresh grants to be made to promoters of listed companies. A regulatory move in this direction would incentivize founders as well as the regulator – one is likely to see more founders voluntarily be identified as promoters and more NATCs seriously consider exploring the public market, and at the same time enhanced corporate governance, compliance and disclosure requirements become applicable to such NATCs, thereby contributing to better regulatory oversight in the functioning of such entities. Further, the current proposal for a one year look-back period for founder ESOPs does not clarify whether such period needs to be calculated from the date of the in-principle fund raising resolution or a formal IPO approval resolution, or the approach for cases where there is a delay or prolonged gap between board approval for the IPO and filing of the DRHP with the regulator. Accordingly, it may be more suitable to count the period from the date of DRHP filing to avoid ambiguity.

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