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RELATED PARTY TRANSACTIONS LAW: WHETHER GOVERNANCE OR BURDEN ON LISTED ENTITIES AND ITS IMPACT ON EASE OF DOING BUSINESS

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ABSTRACT

The concept of Related Party Transactions (“RPTs”) is not a subject matter that has attracted the minds of lawmakers for the first time under the Companies Act, 2013 (1 of 2013), hereinafter referred as “Act 2013” or under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR”). From time immemorial, across several jurisdictions world over, this subject has drawn significant attention. The provisions of RPTs indirectly in the form of “Interested Party Transactions” were present under the Companies Act, 1956 (1 of 1956), hereinafter referred as **Act 1956** and directly in the Listing Agreement with the Stock Exchanges, both since repealed with Act 2013 and LODR respectively. Similarly, Accounting Standard (**AS**) 18 and Indian AS (IndAS 18) issued by the Institute of Chartered Accountants of India (**ICAI**) also prescribes disclosure of Related Party and relationships with them coupled RPTs in the Financial Statements of the Company. This Article outlines the law relating to RPTs applicable to **Listed Entities** (i.e. whose Shares and/ or Debentures are listed on Indian Stock Exchanges) and whether such law is a step towards better Governance of the Indian companies or has become burden for such companies coupled with increase in compliance cost. Listed companies in addition the Act 2013 and Rules made thereunder are also required to comply the provisions of **LODR** and the relevant Circulars issued by Securities and Exchange Board of India (**SEBI**) from to time. The recent amendments carried out in the LODR through SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021, with effect from 1st April 2022, no doubt is another step of the Market Regulator to improve the standard of Corporate Governance of Listed Entities, but such Entities at the same time are also facing the practical and interpretational issues to comply these amended norms and directly or indirectly becoming a challenge to comply the amended norms, thereby in some manner affecting the Government of India’s mission of improve the Indian’s rank in the world for ‘Ease of Doing Business’. Partially, these amendments have breached the boundaries of India and travelled beyond India to become applicable indirectly to the entities incorporated outside India and thus, raises a question whether these amendments are constitutional or not?

I. Act 2013

The relevant provisions of the Act 2013 relating to RPTs are reproduced hereunder:

Section 2(76) of the Act 2013 defines Related Party as under:

²⁷⁵“related party”, with reference to a company, means—

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

²⁷⁵ Section 2(76) of the Companies Act, 2013

(v) a public company in which a director or manager holds is a director or holds along with his relatives, more than two per cent. of its paid-up share capital;

(vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any company which is—

(A) a holding, subsidiary or an associate company of such company; or

(B) a subsidiary of a holding company to which it is also a subsidiary;

(C) an investing company or the venturer of the company;";

Explanation.—For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

(ix) such other person as may be prescribed;

For the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than an independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party."

Section 177 of the Act 2013 defines the role and responsibilities of the Audit Committee with reference RPTs, relevant extracts of which are reproduced hereunder:

177. Audit Committee

²⁷⁶(4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include,—

(iv) approval or any subsequent modification of transactions of the company with related parties;

Provided that the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed;

Provided further that in case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board:

Provided also that in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

Provided also that the provisions of this clause shall not apply to a transaction, other than a transaction referred to in section 188, between a holding company and its wholly owned subsidiary company.

(8) The Audit Committee shall have authority to investigate into any matter in relation to the items specified in sub-section (4) or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to

²⁷⁶ Section 177 of the Companies Act, 2013

information contained in the records of the company.”

Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014 prescribes the mechanism of Omnibus Approval for Related Party Transactions on an Annual Basis. The Omnibus Approval is given for routine transactions undertaken by the Company in the ordinary course of business in its day to day of its transactions. Omnibus Approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company. The relevant extracts of Rule 6A are reproduced hereunder:

²⁷⁷“(1) The Audit Committee shall, after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which shall include the following, namely:-

- (a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;
- (b) the maximum value per transaction which can be allowed;
- (c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;
- (d) review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;
- (e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

(2) The Audit Committee shall consider the following factors while specifying the criteria for making omnibus approval, namely: -

- (a) repetitiveness of the transactions (in past or in future);
- (b) justification for the need of omnibus approval.

(3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

(4) The omnibus approval shall contain or indicate the following: -

- (a) name of the related parties;
- (b) nature and duration of the transaction;
- (c) maximum amount of transaction that can be entered into;
- (d) the indicative base price or current contracted price and the formula for variation in the price, if any; and
- (e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.”

Section 188 of the Act 2013 prescribes the provisions related to RPTs, relevant extracts of which are reproduced hereunder:

²⁷⁸“(1) Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to—

- (a) sale, purchase or supply of any goods or materials;
- (b) selling or otherwise disposing of, or buying, property of any kind;
- (c) leasing of property of any kind;
- (d) availing or rendering of any services;
- (e) appointment of any agent for purchase or sale of goods, materials, services or property;

²⁷⁷ Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014

²⁷⁸ Section 188 of the Companies Act, 2013 (18 of 2013)

(f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and

(g) underwriting the subscription of any securities or derivatives thereof, of the company.

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution:

Provided further that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

Provided also that nothing contained in the second proviso shall apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties:

Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis:

Provided also that the requirement of passing the resolution under first proviso shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Explanation.— In this sub-section,—

(a) the expression "office or place of profit" means any office or place—

(i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he

is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(b) the expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

(2) Every contract or arrangement entered into under sub-section (1) shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.

(3) *****

(4) *****

(5) *****."

Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 prescribes the thresholds limits for taking the Board and Shareholders' approval for RPTs, relevant extracts of which are reproduced hereunder:

279 "Contract or Arrangement With a Related Party"

A company shall enter into any contract or arrangement with a related party subject to the following conditions, namely:—

(1) The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose—

(a) the name of the related party and nature of relationship;

(b) the nature, duration of the contract and particulars of the contract or arrangement;

²⁷⁹ Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014

(c) the material terms of the contract or arrangement including the value, if any;

(d) any advance paid or received for the contract or arrangement, if any;

(e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;

(f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and

(g) any other information relevant or important for the Board to take a decision on the proposed transaction.

(2) Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement-

(3) For the purposes of first proviso to sub-section (1) of section 188, except with the prior approval of the company by a resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into,-

(a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mention below-

(i) sale, purchase or supply of any goods or material, directly or through appointment of agent, amounting to ten percent or more] of the turnover of the company, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188:

(ii) selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, amounting to ten percenter more of net worth of the company, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;

(iii) leasing of property any kind 6[amounting to ten percent or more of the turnover of the company, as mentioned in clause (c) of sub-section (1) of section 188:

(iv) availing or rendering of any services, directly or through appointment of agent, amounting to ten percent or more of the turnover of the company as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188:

Explanation.- It is hereby clarified that the limits specified in sub-clause (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

(b) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and a half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188.

(c) is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one percent. of the net worth as mentioned in clause (g) of sub-section (1) of section 188.

Explanation.- (1) The turnover or net worth referred in the above sub-rules shall be computed on the basis of the audited financial statement of the preceding financial year.

(2) In case of wholly owned subsidiary, the resolution is passed by the holding company shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

(3) The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars, namely:-

(a) name of the related party;

(b) name of the director or key managerial personnel who is related, if any;

(c) nature of relationship;

(d) nature, material terms, monetary value and particulars of the contract or arrangements;

(e) any other information relevant or important for the members to take a decision on the proposed resolution.”

Section 134 of the Act 2013 prescribes the provisions relating to disclosure of RPTs as part of the Board’s Report, the relevant extract of which is reproduced hereunder:

²⁸⁰“134. Financial Statement, Board’s Report, etc.

(3) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors. which shall include-

(h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;”

Rule 8 of the Companies (Accounts) Rules, 2014 prescribes the provisions for disclosure of RPTs in the Board’s Report, the relevant extract of which is reproduced hereunder:

²⁸¹“Matters to be Included in Board’s Report

(2) The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2.”

II. Ind AS 24

As per Section 133 of the Act 2013 read with relevant Companies Accounting Standard Rules, certain specified class of companies are required to comply the Ind AS and the remaining class of companies (residuary companies) are required to comply the AS, while preparing their Financial Statements. The relevant IndAS for RPTs is IndAS 24 which contains the provisions related to definition of related party, identifying related party relationships and transactions. As per Para 9 of the IndAS 24, A **related party** is a person or entity that is related to the entity that is

preparing its financial statements (in this Standard referred to as the ‘reporting entity’).

(a) A person or a close member of that person’s family is related to a reporting entity if that person: (i) has control or joint control of the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

(viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity. A related party transaction is a transfer of resources, services or obligations between a

²⁸⁰ Section 134 of the Companies Act, 2013 (18 of 2013)

²⁸¹ Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014

reporting entity and a related party, regardless of whether a price is charged. Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity including:

(a) that person's children, spouse or domestic partner, brother, sister, father and mother;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

III. Summary (Act 2013 and AS)

Corporate sector has witnessed a sea change in the Act 2013 with reference to regulations for dealing with RPTs, compared to Act 1956. In comparison to Act 1956, Act 2013 contains more exhaustive and detailed procedure for dealing with RPTs. Act 2013 defines the Related Party which was defined earlier only in the AS 18. Act 2013 introduced the provisions related to approval of transactions with Related Parties and RPTs by the Audit Committee, Board and Shareholders, as the case may be, with certain exceptions and disclosure of RPTs in the Board's Report. The transactions with Related Party and RPTs are different concepts as the former includes all the transactions with Related Party such as Loans, investments, etc. whereas RPTs contains the specific transactions as prescribed under Section 188 of the Act 2013 which is narrower in scope compared to the former. The basic philosophy of the Act 2013 is 'comply and disclose' instead 'comply and approve' which is evident from the fact that no Central Government's approval is required for RPTs (akin to Interested Party Transactions as prescribed in Act 1956). Also, certain specified transactions with Related Parties are exempt from approval of the Audit Committee, Board and Shareholders too, which support the objective of Government of India's mission 'Ease of Doing Business'. Act 2013 prescribes the

mechanism of obtaining Omnibus Approval from the Audit Committee once in a year in respect of RPTs which are repetitive in nature, instead of going to the Audit Committee for approval every time before undertaking the routine RPTs. As a further step towards strengthening the corporate governance practices in the Indian industry, the Act 2013 prescribes that the concerned Related Party in respect of transaction with such Related Party shall not vote to approve the Resolution in the General Meeting which was limited to Board Meeting only in the Act 1956. Act 2013 mandates certain class of companies to comply with IndAS 24 for disclosure of Related Party, relationship with Related Party and RPTs, which is more exhaustive compared to AS18.

IV. LODR

As mentioned in **Abstract** above, every company whose Shares and / or Debentures are listed on the Stock Exchanges, shall in addition to the Act 2013, also need to comply the provisions of LODR (akin to Listing Agreement with Stock Exchanges). The relevant provision of LODR related to RPTs are reproduced hereunder:

Regulation 2(1) of LODR contains the definitions of Related Party and RPTs which are reproduced hereunder:

²⁸²(zb) "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards:

Provided that:

(a) any person or entity forming a part of the promoter or promoter group of the listed entity; or

(b) any person or any entity, holding equity shares:

(i) of twenty per cent or more; or

(ii) of ten per cent or more, with effect from April 1, 2023;

²⁸² Regulation 2(1) of SEBI (listing Obligations and Disclosure Requirements) Regulations, 2015

in the listed entity either directly or on a beneficial interest basis as provided under section 89 of the Companies Act, 2013, at any time, during the immediate preceding financial year; shall be deemed to be a related party.

Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);

(zc) “related party transaction” means a transaction involving a transfer of resources, services or obligations between:

(i) a listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or

(ii) a listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023; regardless of whether a price is charged and a “transaction” with a related party shall be construed to include a single transaction or a group of transactions in a contract.

Provided that the following shall not be a related party transaction:

(a) the issue of specified securities on a preferential basis, subject to compliance of the requirements under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(b) the following corporate actions by the listed entity which are uniformly applicable/offered to all shareholders in proportion to their shareholding:

i. payment of dividend;

ii. subdivision or consolidation of securities;

iii. issuance of securities by way of a rights issue or a bonus issue; and

iv. buy-back of securities.

(c) acceptance of fixed deposits by banks/Non-Banking Finance Companies at the

terms uniformly applicable/offered to all shareholders/public, subject to disclosure of the same along with the disclosure of related party transactions every six months to the stock exchange(s), in the format as specified by the Board:

Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);”

Regulation 18(3) read with Schedule II (Corporate Governance), Part C, Para A of LODR contains the role of Audit Committee with reference to RPTs, the relevant extract of which is reproduced hereunder:

²⁸³A. The role of the audit committee shall include the following:

(4) reviewing, with the management, the annual financial statements and auditor’s report thereon before submission to the board for approval, with particular reference to:

(f) disclosure of any related party transactions;

(8) approval or any subsequent modification of transactions of the listed entity with related parties;”

Regulation 23 of LODR contains the exhaustive provisions related to RPTs, relevant extracts of which are reproduced hereunder:

²⁸⁴ “**Related party transactions**

(1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly.

Provided that a transaction with a related party shall be considered material, if the

²⁸³ Regulation 18 of SEBI (listing Obligations and Disclosure Requirements) Regulations, 2015

²⁸⁴ Regulation 23 of SEBI (listing Obligations and Disclosure Requirements) Regulations, 2015

transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds rupees one thousand crore or ten per cent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.

(2) All related party transactions and subsequent material modifications shall require prior approval of the audit committee of the listed entity:

Provided that only those members of the audit committee, who are independent directors, shall approve related party transactions.

Provided further that:

(a) the audit committee of a listed entity shall define “material modifications” and disclose it as part of the policy on materiality of related party transactions and on dealing with related party transactions;

(b) a related party transaction to which the subsidiary of a listed entity is a party but the listed entity is not a party, shall require prior approval of the audit committee of the listed entity if the value of such transaction whether entered into individually or taken together with previous transactions during a financial year exceeds ten per cent of the annual consolidated turnover, as per the last audited financial statements of the listed entity;

(c) with effect from April 1, 2023, a related party transaction to which the subsidiary of a listed entity is a party but the listed entity is not a party, shall require prior approval of the audit committee of the listed entity if the value of such transaction whether entered into individually or taken together with previous transactions during a financial year, exceeds ten per cent of the annual standalone turnover, as per the last audited financial statements of the subsidiary;

(d) prior approval of the audit committee of the listed entity shall not be required for a related party transaction to which the listed subsidiary is a party but the listed entity is not a

party, if regulation 23 and sub-regulation (2) of regulation 15 of these regulations are applicable to such listed subsidiary.

Explanation: For related party transactions of unlisted subsidiaries of a listed subsidiary as referred to in (d) above, the prior approval of the audit committee of the listed subsidiary shall suffice.

(3) Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity **[the complete sub-rule (3) – sub clauses ‘a’ to ‘c’] is not repeated here for the sake of brevity since procedural in nature and broadly the same as prescribed in Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014 mentioned at Para I above]**

(d) the audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.

(e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year.

(4) All material related party transactions and subsequent material modifications as defined by the audit committee under sub-regulation (2) shall require prior approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not.

Provided that prior approval of the shareholders of a listed entity shall not be required for a related party transaction to which the listed subsidiary is a party but the listed entity is not a party, if regulation 23 and sub-regulation (2) of regulation 15 of these regulations are applicable to such listed subsidiary.

Explanation: For related party transactions of unlisted subsidiaries of a listed subsidiary as referred above, the prior approval of the

shareholders of the listed subsidiary shall suffice.

(5) The provisions of sub-regulations (2), (3) and (4) shall not be applicable in the following cases:

(a) transactions entered into between two government companies;

(b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

(c) transactions entered into between two wholly-owned subsidiaries of the listed holding company, whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

(6) *****.

(7) [***]

(8) *****.

(9) The listed entity shall submit to the stock exchanges disclosures of related party transactions in the format as specified by the Board from time to time, and publish the same on its website:

Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year.

Provided further that the listed entity shall make such disclosures every six months on the date of publication of its standalone and consolidated financial results with effect from April 1, 2023."

To implement the above provisions of Regulation 23 of LODR, SEBI has issued a Master Circular No. SEBI/HO/CFD/PoD2/CIR/P/2023/120 dated July 11, 2023, the relevant extracts of which are reproduced hereunder:

²⁸⁵Section III-B: Disclosure and other obligations of listed entities in relation to Related Party Transactions

1. *****.

2. Accordingly, listed entities shall make RPT disclosures in the format specified in Annexure 13 to this circular.

3. Further, it has been decided to specify the information to be placed before the audit committee and the shareholders for consideration of RPTs. The same is detailed in the following paragraphs.

(A) Information to be reviewed by the Audit Committee for approval of RPTs

4. The listed entity shall provide the following information, for review of the audit committee for approval of a proposed RPT:

a. Type, material terms and particulars of the proposed transaction;

b. Name of the related party and its relationship with the listed entity or its subsidiary, including nature of its concern or interest (financial or otherwise);

c. Tenure of the proposed transaction (particular tenure shall be specified);

d. Value of the proposed transaction;

e. The percentage of the listed entity's annual consolidated turnover, for the immediately preceding financial year, that is represented by the value of the proposed transaction (and for a RPT involving a subsidiary, such percentage calculated on the basis of the subsidiary's annual turnover on a standalone basis shall be additionally provided);

f. If the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary:

i. details of the source of funds in connection with the proposed transaction;

²⁸⁵ Master Circular No. SEBI/HO/CFD/PoD2/CIR/P/2023/120 dated July 11, 2023 issued by SEBI

- ii. where any financial indebtedness is incurred to make or give loans, interoperate deposits, advances or investments,
- o nature of indebtedness;
 - o cost of funds; and
 - o tenure;
- iii. applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured; if secured, the nature of security; and
- iv. the purpose for which the funds will be utilized by the ultimate beneficiary of such funds pursuant to the RPT.
- g. Justification as to why the RPT is in the interest of the listed entity;
- h. A copy of the valuation or other external party report, if any such report has been relied upon;
- i. Percentage of the counter-party's annual consolidated turnover that is represented by the value of the proposed RPT on a voluntary basis;
- j. Any other information that may be relevant.
5. The audit committee shall also review the status of long-term (more than one year) or recurring RPTs on an annual basis. Further, an RPT for which the audit committee has granted omnibus approval shall continue to be placed before the shareholders if it is material in terms of regulation 23(1) of the LODR Regulations.
- (B) Information to be provided to shareholders for consideration of RPTs**
6. The notice being sent to the shareholders seeking approval for any proposed RPT shall, in addition to the requirements under the Companies Act, 2013, include the following information as a part of the explanatory statement:
- a. A summary of the information provided by the management of the listed entity to the audit committee as specified in paragraph 4 of this Section;
- b. Justification for why the proposed transaction is in the interest of the listed entity;
- c. Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary, the details specified under para 4(f) above; (The requirement of disclosing source of funds and cost of funds shall not be applicable to listed banks/NBFCs.)
- d. A statement that the valuation or other external report, if any, relied upon by the listed entity in relation to the proposed transaction will be made available through the registered email address of the shareholders;
- e. Percentage of the counter-party's annual consolidated turnover that is represented by the value of the proposed RPT, on a voluntary basis;
- f. Any other information that may be relevant.
7. The explanatory statement contained in the notice sent to the shareholders for seeking approval for an RPT shall provide relevant information so as to enable the shareholders to take a view whether the terms and conditions of the proposed RPT are not unfavourable to the listed entity, compared to the terms and conditions, had similar transaction been entered into between two unrelated parties. The information so provided shall include but not be limited to the information specified above.
8. Transparency, accountability and shareholder empowerment are the bedrock of robust corporate governance, therefore listed entities shall ensure compliance with the spirit of the law and endeavour to provide relevant and detailed information to the shareholders in order to enable and empower the latter for taking an informed decision."
- Regulation 34 and 54(f)** read with Schedule V (Annual Report), Part C(10)(a) contains the provision for disclosure of RPTs in the Corporate Governance Report, forming part of the Annual Report, which is reproduced hereunder:

286^a(10)

Other Disclosures:

(a) disclosures on materially significant related party transactions that may have potential conflict with the interests of listed entity at large;"

Summary

The listed entities too have witnessed a sea change in the regulations with reference to RPTs prescribed in the then Listing Agreement vis-à-vis current LODR for the reasons explained in the Summary of Act 2013 mentioned above. SEBI has constituted various committees since 2013 to suggest the changes to be made for regulating the RPTs and consequentially, Working Papers were released by SEBI from time to time inviting comments from the Industry on the changes proposed in the Regulations governing the RPTs. With the aim of strengthening regulatory norms in relation to RPTs undertaken by listed entities in India, the then SEBI's Chairman, Mr. Ajay Tyagi constituted Working Group on RPTs on 4th November 2019 to make recommendations on the following issues:

The Working Group submitted its Report dated 22nd January 2020 to SEBI and consequently, the latest changes in the Regulations pertaining to RPTs were made in LODR through SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021, with effect from 1st April 2022.

(Source: Report of the Working Group on Related party Transactions available on SEBI's Website: www.sebi.gov.in; last visited on 7th April 2024)

Similar to Act 2013, LODR also defines the role of Audit Committee with reference to RPTs, Related Party and RPTs. It also contains the provisions for obtaining Omnibus Approval of the Audit Committee and specific approval of Shareholders (in certain cases) for RPTs. At the same time, similar to Act 2013, LODR too contains provisions for exemptions from approval of the Audit Committee and

Shareholders for transactions entered into with specified Related Parties. Thus, to a great extent, the provisions regulating the RPTs are aligned between the Act 2013 and LODR.

However, the LODR provisions are more stringent compared to Act 2013 in few areas, which are explained hereunder:

- (a) Definitions of Related Party and RPTs are more exhaustive compared to Act 2013. For example, Related Party means a related party as defined in the Act 2013 or under applicable AS. Similarly, RPTs includes transactions with unrelated parties as well, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries. It also includes transactions to which listed entity is not a party but its subsidiary is a party on one hand and related party of the subsidiary on the other hand.
- (b) Unlike Act 2013, all RPTs, material RPTs and material modifications therein requires prior approval of the Audit Committee and Shareholders in certain cases. Unlike Act 2013, post facto approval of Audit Committee is not permitted.
- (c) Formulation of Policy for dealing with RPTs and disclosure of the same on the Company's Website and its weblink in the Corporate Governance Report, forming part of the Annual Report. The Policy is required to be reviewed by the Board at least once every three years.
- (d) In addition to disclosure in the Board' Report, the listed entity shall submit to the stock exchanges details of RPTs on half yearly basis along with its Financial Results in the format as specified by SEBI and publish the same on its website.
- (e) While granting approval for Material RPTs and subsequent material modifications therein, no related party shall vote to approve such resolutions in the General Meeting, whether the entity is a related party to the particular transaction or not. In Act 2013, only concerned Related Party is prohibited from voting on the Resolutions.

²⁸⁶ Regulation 34 and 54(f) of SEBI (listing Obligations and Disclosure Requirements) Regulations, 2015

(f) Compared to Act, 2013, as per the SEBI's Circular, detailed disclosures to be given to the Audit Committee and Shareholders while seeking their approval for proposed RPTs.

V. Challenges faced by Indian Industry to comply the Law pertaining RPTs²⁸⁷

RPTs have always remained a key monitoring agenda for regulators, given the nuances in how it is used for the personal gains of people in control or say Promoters of the Company. The revised RPTs regime brought in by the SEBI undoubtedly will give more teeth to the capital market regulator to monitor such transactions.

However, to ensure the holistic implementation of the RPT regime, the interpretational and practical challenges, few of which are mentioned below, should be addressed:

(i) Related Party now includes persons belonging to the promoter group of a listed company and any person holding equity shares of 20% or more (10% from 1 April 2023) in the listed company. Such high stake is generally owned by large Institutional Investors. With such a widening of scope, along with the existing voting restrictions on Related Parties, obtaining Shareholders' approval, even for genuine RPTs, may become difficult. As both the promoters and large Institutional Investors can't vote, the onus to analyse and approve RPTs would fall on small Institutional Investors, who may look at RPTs from a short-term profitability perspective rather than from the business needs, and on retail investors, who either don't vote or lack the skills to make a judicious decision.

(ii) The definition of RPTs has been widened to include transactions entered into by the listed company or by its unlisted subsidiary with the Related Party of either the listed company or of its unlisted subsidiary. Foreign subsidiaries have not been excluded, perhaps to prevent the listed company from transferring assets/value overseas. However, expecting a foreign subsidiary to follow Indian laws and make it

subject to penal consequences seems to be far-fetched and may be challenged before the court of law, being unconstitutional in nature.

(iii) From 1st April 2023, a transaction with unrelated parties, the "purpose and effect" of which is to benefit the Related Party would also be construed as an RPT. The absence of any explanation as to what construes "purpose and effect" leaves the scope for different interpretations, which may lead to litigation.

(iv) Corporate actions like rights or bonus issues have been kept out of RPTs as these are offered to all shareholders. Preferential issuances are excluded if it is compliant with ICDR Regulations. As an unlisted subsidiary isn't required to comply with these, preferential issues made by it to a Related Party may be subject to RPT provisions. The rationale for such differential treatment is unclear. Thus, unlisted subsidiaries may face a challenge in raising funds, particularly from Institutional Investors that are classified as Related Parties, because they are holding a 20% or 10% stake in the listed parent.

(v) Approval from the listed company's Shareholders is required for all "material" RPTs. With the expanded definition, now the RPT entered into even by an unlisted subsidiary (to which the listed company is not a party), would require approval from the listed company's shareholders. A transaction is material when it individually (or when clubbed with previous transactions in a financial year) exceeds 10% of the last audited annual consolidated turnover of the listed company or ₹ 1,000 Crore, whichever is lower. The problem is that there is no clarity on how to club the transactions to determine the materiality threshold, and thus different approaches may be followed by different companies depending on their interests.

(vi) Prior approval of the audit committee is required for all RPTs, and subsequent "material modifications". The RPT to which an unlisted subsidiary is a party, but a listed company is not, would require approval of the audit

²⁸⁷ Source: <https://law.asia/key-challenges-ahead-new-related-party-regime/>

committee of the listed company if its value (individually or when clubbed with previous RPTs in a financial year) exceeds 10% of the listed company's consolidated turnover. From 1st April 2023, this 10% threshold would be computed based on the subsidiary's standalone turnover. The responsibility to define material modifications rests with the audit committee. This seems to be in line with the terms of reference for the audit committee provided under the Act 2013, where the committee's approval is required for all RPTs or subsequent modifications.

(vii) Another concern is that only Independent Directors (ID) forming part of the audit committee can vote. The IDs do not participate in day-to-day business affairs and rely on details shared during board meetings.

Thus, IDs may face tough challenges in reviewing transaction metrics, particularly at the subsidiary level (where they don't have a board seat). A revised regime is laudable, for it offers flexibility to enter into RPTs, with requisite approval and disclosure safeguards. However, existing challenges may overshadow the implementation of even genuine RPTs, which may otherwise contribute immensely to growth, and value enhancement.

VI. Conclusion

Today we are living in a virtual world and all economies of the world are inter-dependent on each other for growth and success of the country. Today, the growth of any country is not possible without attracting Foreign Direct Investment and Foreign Portfolio Investment, coupled with robust confidence of the investors in the capital market. The Promoters of the Company can bring their contribution for the growth of the Company to a limited extent only and therefore, the growth of the Industry is also contingent on raising funds from the Financial Institutions and Strategic & Retail Investors. To raise the funds quickly, efficiently and economically, the Corporate Governance Standards of the Industry should keep on rising without any frauds or scams which ultimately

affects the investors' confidence. Keeping all the above factors in mind, the Regulators are continuously updating the Corporate Laws to keep pace with the changing scenario, both domestically and internationally. Though in short run, Industry faces initial teething problems (including increase in cost of compliance and practical difficulties) to cope up with the changes in the Regulations, however, the Regulators are supportive in nature to address the Industry's concerns by inviting comments on the challenges faced by the Industry. If justified and convinced, the Regulators do modify the Regulations to meet the expectations of the Industry with the aim of improving the ranking of the country for 'Ease of Doing Business'.

With respect of Regulations regarding RPTs, the provisions introduced by Ministry of Corporate Affairs in the Act 2013 and recent changes made by SEBI in the LODR are welcome in nature to curb the malpractices adopted by handful of persons in control of the companies. This not only improves the standards of Corporate Governance of India in the international market, but also raises the investors' confidence in the Leadership Team of the Company. At the same time, the Regulators are to be careful to ensure that cost of compliance is not increased, compliance should not become the burden for the Industry, laws are not modified frequently and at the same time, the concerns of the Industry are addressed as explained above to remove practical difficulties in compliance of the amended Regulations. This approach of the Regulators will help the country cruising on the path with the objective to increase the India's ranking for 'Ease of Doing Business' in the world.