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INTERPRETATION OF "ORDINARY COURSE OF BUSINESS" UNDER SECTION 188 OF THE COMPANIES ACT, 2013

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Abstract

The meaning of the term "ordinary course of business" under Section 188 of the Companies Act, 2013, has been a persistent issue of controversy in corporate law scholarship. Section 188, which addresses related party transactions (RPTs), is a significant legislative effort to balance the conflicting goals of business agility and shareholder protection. The law aims to control transactions that would otherwise be vulnerable to conflicts of interest and self-dealing. Still, the wording has provided considerable room for judicial discretion and corporate leeway. This paper situates the phrase within the broader context of corporate governance reforms in India, which over the last two decades have evolved in response to global corporate scandals, domestic failures in transparency, and recommendations from expert committees.

The primary research problem addressed herein is the ambiguity surrounding the term "ordinary course of business" and the inconsistent approaches in its application by companies, regulators, and courts. The research aims to critically analyze the dual tests of arm's length and ordinary course of business and to examine whether the existing legal framework effectively protects shareholder interests while allowing proper business freedom. Against the backdrop of Indian jurisprudence, comparisons are also drawn with practices in foreign jurisdictions such as the United States, the United Kingdom, and Singapore, to present possible lessons for reform.

Methodologically, the research embraces a comparative and doctrinal methodology. Statutory interpretation, judicial precedents, regulatory reports, and academic scholarship are used to examine the development and interpretation of Section 188.

The preliminary conclusion is that the term "ordinary course of business" should be more clearly defined by statute or regulation, as its vagueness makes effective enforcement impossible. The study advocates a hybrid approach to the problem, blending principle-based guidance with sector-specific explanations to provide both transparency and business realism.

Keywords

Related Party Transactions (RPTs), Ordinary Course of Business, Companies Act, 2013, Corporate Governance, Arm's Length Principle

Introduction

Corporate governance has undergone a profound transformation over the last two decades, reflecting the evolving demands of transparency, accountability, and stakeholder protection. The rapid growth of global business, increased cross-border investment, and high-profile corporate scandals have underscored the need for robust mechanisms to prevent conflicts of interest and ensure ethical business practices. In India, the Companies Act, 2013, was

a watershed moment in the codification of corporate governance principles, especially regarding related party transactions. These trends reflect the transition away from strictly compliance-based towards substantive ethical monitoring and operational excellence.

In this changing context, related party transactions (RPTs) have been a focal point of concern. Basically, they have two potential outcomes: transactional efficiency and strategic resource allocation, which, in turn, provide companies with an efficient mechanism for meeting their goals.[1204] However, they possess inherent risks of conflicts and misuse. Frameworks of regulation, therefore, need to be carefully structured and sanctioned to safeguard the interests of shareholders, creditors, and the broader corporate environment. Section 188 of the Companies Act, 2013 illustrates this strategy, requiring advance approval for certain RPTs and granting exemptions only if transactions are on an arm's-length basis and in the course of ordinary business.[1205]

Even with the explicitness regarding the arm's-length principle, "ordinary course of business" is legally vague. This uncertainty has created practical challenges for boards and management, putting companies at risk of regulatory scrutiny, controversies, and reputational damage. Realizing the significance of addressing this uncertainty, this paper attempts to critically analyze the ambit, interpretation, and enforceability of the "ordinary course of business" requirement under Section 188[1206]. The research is driven by a desire to close the gap between statutory compliance, corporate governance norms, and operational reality.

Research Objectives

The following objectives guide this research:

1. To examine the evolution of corporate governance standards in India over the last two decades, highlighting the increasing regulatory focus on related party transactions.
2. To explore the legal and regulatory framework governing RPTs under Section 188[1207] of the Companies Act, 2013, including the dual requirement of arm's length and ordinary course of business.
3. To examine the difficulties arising from the unstated notion of "ordinary course of business" in statutory and regulatory interpretation.
4. To formulate a systematic analytical tool for determining whether a transaction can be considered in the ordinary course of business.
5. To place the Indian approach within a wider comparative corporate governance perspective, utilising common law jurisdictions to derive lessons on best practices and reforms.

By setting these goals, the paper will make a theoretical and practical contribution. The theoretical contribution is found in clarifying an unclear statutory definition and connecting it to principles of corporate governance.

Methodology

This study takes a doctrinal and analytical approach, relying mainly on statutory provisions, judicial decisions, regulatory circulars, professional advice, and secondary academic sources. The main sources are the Companies Act, 2013, connected MCA notifications, and circulars.[1208], and leading judgments of Indian courts interpreting the ambit of Section 188 and connected ideas. Secondary sources include academic articles and professional body guidance notes, such as the ICAI.[1209] and ICSI[1210], and specialist

[1204] Padmini Srinivasan, Working Paper No. 402: An Analysis of Related-Party Transactions in India 1 (Indian Inst. of Mgmt. Bangalore, Sept. 2013), https://www.iimb.ac.in/sites/default/files/2018-07/WP_No._402_0.pdf.\
[1205] Companies Act, No. 18 of 2013, § 188 (India).
[1206] Supra note 2

[1207] Id
[1208] Ministry of Corporate Affairs, General Circular No. 30/2014, Clarifications on Matters Relating to Related Party Transactions, (July 17, 2014), https://ibclaw.in/clarifications-on-matters-relating-to-related-party-transactions-mca-general-circular-no-30-2014-dated-17-07-2014/
[1209] *Institute of Chartered Accountants of India, FAQs on Companies Act, 2013, https://www.icai.org/new_post.html?post_id=12345* (Use actual URL of FAQs used)

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commentary on corporate governance and RPT compliance.

The research then uses a case study methodology to illustrate the pragmatic application of the analytical model. Through analysis of a typical corporate transaction, office premises lease from a director, the paper demonstrates the complexity and issues surrounding assessing whether a transaction can be considered ordinary. This empirical component provides contextual insight that supplements the doctrinal framework, thereby filling the gap between legal abstraction and commercial reality.

The analytical structure is designed in three tiers:

Primary tests, which comprise consistency with the Memorandum of Association of the company and the past practice of comparable transactions.

Secondary considerations, e.g., transaction frequency, size, relationship to revenue generation, and support from industry conventions.

Comparative insights, which identify the approaches elsewhere and underpin the interpretation of "ordinary course of business" and provide directions for harmonization and reform. This research paper intends to answer a long-standing area of doubt in corporate law regarding the conditions for RPTs, providing clarity for boards, management, auditors, and regulators alike, and prioritizes governance over compliance, emphasizing the fiduciary and ethical obligations entailed in RPTs. Also, by introducing comparative insights, the paper contextualizes Indian corporate practice globally and provides insights into harmonized governance standards.

[1210] Institute of Company Secretaries of India, Guidance Note on Related Party Transactions, GN 5, 2019, https://www.icsi.edu/media/webmodules/GN5_Guidance_Note_on_Related_Party_Transactions.pdf

Part I – The Legal Framework in India

Regulation of transactions between firms and their connected parties has traditionally remained a complicated issue in Indian corporate law. Before the Companies Act, 2013, came into force, regulation of such transactions was limited, and the main thrust of the legislation under the Companies Act, 1956, was on disclosure and auditing norms rather than preventive regulation.[1211] In the lack of express statutory definitions of "related parties" or guidelines to provide fairness and transparency, conflicts of interest routinely occurred.[1212] Such a regulatory gap, combined with the rapid expansion of companies and market liberalisation during the 1990s and early 2000s, left stakeholders vulnerable to self-dealing and financial mismanagement.[1213]

Anticipating these weaknesses, the Companies Act, 2013, established a comprehensive statutory framework to regulate related party transactions. Section 2(76) of the Act defines related parties comprehensively to encompass directors, key managerial staff, their relatives, and firms in which such individuals exercise significant control.[1214] Section 188 regulates contracts or arrangements with related parties, mandating obligatory approval by the board of directors and, for some large transactions, by shareholders by means of a special resolution.[1215] This two-tiered approval mechanism is intended to avoid conflicts of interest and protect minority shareholders.

Section 188 also lays down two key conditions for exemption from advance approval: transactions must be on an arm's-length basis and in the ordinary course of business.[1216] The arm's-length requirement is based on long-standing principles of corporate finance and transfer pricing, precluding related parties from obtaining an unfair benefit.[1217] The "ordinary

[1211] Companies Act, 1956, §§ 295–297 (India).
[1212] Supra note 1
[1213] Id. at 3–6.
[1214] Companies Act, 2013, § 2(76) (India).
[1215] Id.
[1216] Supra note 2
[1217] Id.

course of business," by contrast, is less clearly defined, creating scope for interpretation and necessitating clarification by regulatory bodies and the courts.[1218]

The Ministry of Corporate Affairs (MCA) has issued significant clarifications in General Circular No. 30/2014[1219], reiterating that ordinariness applies to the company's working practices rather than universal industry standards.[1220] The circular further establishes procedural requirements, voting limitations, and documentation standards to ensure transparent shareholder and board decision-making.[1221] Professional associations like the Institute of Chartered Accountants of India (ICAI) and the Institute of Company Secretaries of India (ICSI) have issued guidelines recommending in-depth documentation of RPTs, including evaluating MOA provisions, past practice, frequency, size relative to operations, and revenue relationship.[1222]

Judicial interpretation also came to define Section 188. In Seksaria Biswan Sugar Factory Ltd. v. CIT, the Bombay High Court explained that transactions need to have a bona fide nexus with day-to-day business to qualify as ordinary.[1223] Bharti Televentures Ltd. v. Addl./Jt. CIT stressed that frequency and integration within the firm's day-to-day activities determine ordinariness.[1224] The Supreme Court, in Anuj Jain, Interim Resolution Professional for Jaypee Infratech Ltd v. Axis Bank Ltd., reaffirmed the principle through the "undistinguished common flow of business" test, illustrating that ordinariness demands regularity and systemic integration rather than an ad hoc requirement.[1225]

Recent NCLT judgments, including Ms Golden Tree Hotels Pvt. Ltd. v. ROC and LSI India Research & Development Pvt. Ltd.[1226], offer real-life examples of how tribunals analyze RPT compliance, prioritizing company-specific practice over industry-wide assumptions. These judgments highlight that even transactions typical in an industry may not constitute ordinary transactions if a company lacks historical precedent or integration with its operational model.

The development of regulation on related party transactions in India, from limited supervision under the Companies Act, 1956, to an all-encompassing regime under Section 188 of the Companies Act, 2013, is an indication of the general movement towards transparency, accountability, and corporate governance.[1227] Statutory requirements, supplemented by MCA circulars, professional advice, and judicial pronouncements, together try to balance company independence with the protection of stakeholders.[1228] The subsequent sections of this paper formulate a systematic analysis framework to determine whether transactions qualify as in the "ordinary course of business," providing day-to-day guidance on compliance and governance.

Part II – Arm's Length and Ordinary Course: Dual Criteria

The Indian regulation of Related Party Transactions (RPTs) is primarily based on two interconnected ideas: the "ordinary course of business" and "arm's length" transactions. These standards act as a sieve, separating normal transactions from those requiring more critical

[1218] Vinod Kothari, *Ordinary Course of Business in Related Party Transactions* 4–6 (2017), https://vinodkothari.com/wp-content/uploads/2017/03/Ordinary_course_of_business_in_the_context_of_related_party_transactions.pdf.
[1219] MCA General Circular No. 30/2014 (July 17, 2014).
[1220] Id
[1221] Institute of Chartered Accountants of India (ICAI), FAQs on Companies Act, 2013, Sec. 188 (RPTs), https://www.icai.org/new_post.html?post_id=11654.
[1222] Institute of Company Secretaries of India (ICSI), Guidance Note on Related Party Transactions 5–8 (2018), https://www.icsi.edu/media/webmodules/GN5_Guidance_Note_on_Related_Party_Transactions.pdf.
[1223] *Seksaria Biswan Sugar Factory Ltd. v. CIT*, (Bombay HC, 1998) 230 ITR 835 (India).
[1224] *Bharti Televentures Ltd. v. Addl./Jt. CIT*, (Delhi HC, 2007) 293 ITR 291 (India).
[1225] *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Ltd v. Axis Bank Ltd.*, (Supreme Court of India, 2020) 8 SCC 579.
[1226] *Ms Golden Tree Hotels Pvt. Ltd. v. ROC*, NCLT Order, https://archive.nclt.gov.in/sites/default/files/final-orders-pdf/Ms%20Golden%20Tree%20Hotels%20Pvt%20Ltd%20%20vs%20ROC.pdf; *LSI India Research & Development Pvt. Ltd.*, NCLT Order, https://archive.nclt.gov.in/sites/default/files/final-orders-pdf/LSI%20India%20Research%20%26%20Development%20Pvt.%20Ltd.pdf.
[1227] Id.
[1228] Companies Act, 1956, §§ 295–297; Companies Act, 2013, §§ 2(76), 188 (India).

scrutiny and approval under Section 188 of the Companies Act, 2013.[1229]The dual framework aims to promote operational flexibility for companies while safeguarding minority shareholders and other stakeholders against potential abuse.[1230]

An "ordinary course of business" transaction is customary, routine, and congruent with the company's main line of business.[1231] This is not a determination made solely by the Memorandum of Association (MOA), but by a mix of factors, including frequency, materiality, and congruence with industry practices.[1232] Courts have consistently held that singular or standalone transactions are not part of the ordinary course, even if they fall within the MOA's aims.[1233] In CIT v. Motilal Haribhai Spinning & Weaving Co. Ltd., the court explained that the MOA is revealing but not determinative, and that continuity and regular transactional conduct are the foremost indicia.[1234] Likewise, in Seksaria Biswan Sugar Factory Ltd. v. CIT, a one-time loan by a sugar company to a connected business was found to be outside the normal course of business, as the company had no prior history of making such loans.[1235]

The Institute of Company Secretaries of India (ICSI) guidelines also define the circumstances for determining ordinary-course transactions, including consistency with the company's goals, the frequency of the activity, and whether the transaction is business revenue-generating or part of regular operations.[1236] Other factors under consideration include the transaction's financial size relative to the company's general operations and whether similar practices are industry norms.[1237] These guidelines ensure that RPTs do not become a tool for avoiding governance principles in the guise of regular business activities.[1238]

The second standard, the "arm's length" principle, mandates that transactions with related parties be conducted as if the parties were unrelated, with no personal benefit or undue influence imposed on the terms. Ensuring that pricing, terms of credit, and other contractual terms are in line with fair market standards. The Companies Act, 2013, defines arm's length in Explanation (b) to Section 188(1) as transactions conducted "as if unrelated parties were involved," but does not specify any specific measurement techniques.[1239] The Income Tax Act, 1961 (Section 92C) provides methodologies for determining arm's-length pricing in tax-oriented situations, yet these remain transaction-specific and based on industry conventions.

Judicial interpretation emphasizes that arm's length valuations need to pay attention to substance over form. In Madhu Ashok Kapur & Ors. v. Rana Kapoor, the court considered the reasonableness of a managing director's appointment on terms that deviated from industry norms, rather than strictly adhering to procedure.[1240] Likewise, in A.K. Roy v. Voltas Ltd., the court emphasized that transactions at arm's length must be free of favoritism or extraneous personal relationships, and that the contract terms must be fair. is the overarching consideration.[1241] The Iljin Automotive Pvt. Ltd. v. Asst. The Commissioner of Income Tax tribunal underscored that the arm's-length price is what independent parties would contract for under similar circumstances.[1242]

Regulatory guidance follows judicial interpretation. The ICSI manual offers practical examples, such as comparing prices or credit terms granted to related and unrelated parties, to ascertain whether a transaction satisfies the arm's-length requirement.[1243] Commercial

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[1229] Supra note 1.
[1230] Abdul Rasheed et al., *Promoter Ownership, Related Party Transactions and Firm Performance: A Study Among Select Companies in India*, 8 FIIB Bus. Rev. 1 (2019).
[1231] Supra note 18.
[1232] MANU/GJ/0014/1977, *CIT v. Motilal Haribhai Spinning & Weaving Co. Ltd.*
[1233] Supra note 20
[1234] MANU/MH/1038/2015, *Madhu Ashok Kapur & Ors. v. Rana Kapoor.*
[1235] Supra note 20.
[1236] MANU/IX/0171/2011, *Iljin Automotive Pvt. Ltd. v. Asst. Commissioner of Income Tax*
[1237] (2014) 30 ITR 349, *CIT v. Nimbus Communication Ltd.*
[1238] (2011) 9 ITR 596, *A.C.I.T. v. W.S. Industries (India) Ltd.*
[1239] Supra note 2.
[1240] Supra note 31.
[1241] (1973) AIR 225, *A.K. Roy v. Voltas Ltd.*
[1242] Supra note 33.
[1243] Supra note 19

convenience and business justification are also taken into account, provided that the transaction does not extend preferential treatment to affiliated parties. Examples include CIT v. Nimbus Communication Ltd.[1244] and A.C.I.T. v. W.S. Industries (India) Ltd.[1245] demonstrate that even beneficial transactions can be arm's length if they are commercially reasonable and entered into for the purpose of furthering legitimate business goals.

The twin tests of ordinary course and arm's length are complementary. A transaction would need to meet both requirements to be exempt from board or shareholder approval under Section 188. This approach encourages companies to remain transparent and fair in RPTs while providing operational flexibility to meet normal business requirements. However, an absence of specific statutory definitions makes it difficult for auditors and regulators, and provides scope for variable interpretations. Stringent enforcement, judicial oversight, and adherence to global best practices will remain critical to preventing these exemptions from becoming anti-governance practices.[1246]

Part III – Developing an Analytical Framework

The determination of whether a transaction constitutes the "ordinary course of business" under Section 188 of the Companies Act, 2013, is increasingly understood as an exercise with multiple dimensions, requiring companies to transcend textbook or mechanical interpretations of the statutory provisions.[1247] The phrase "ordinary course of business" is, by nature, contextual and company-specific, conferring significant latitude on boards, auditors, and regulators in its application.[1248] Previous judicial observations, Ministry of Corporate Affairs (MCA) circulars, and professional advice offer helpful signposts, as there is no prescriptive definition. Therefore, companies need a structured analytical framework to ensure that related-party transactions (RPTs) are compliant, defensible, and in accordance with corporate governance principles.

I. Operational Alignment

One of the core principles of this model is assessing operational alignment, which means considering whether a transaction is part of the company's day-to-day operational and strategic processes.[1249] Ordinariness is not just about legal power or sectoral norms; it is about whether the transaction is part of the company's day-to-day business model.[1250]

For instance, a software firm that habitually outsources server maintenance might rightfully enter into the same kind of arrangement with an affiliate that offers such services. In contrast, sporadic real estate acquisitions for speculation, though approved by the Memorandum of Association (MOA), are generally outside the usual run of business due to their strategic nature and lack of precedent within the firm.[1251]

Operational consistency also requires that the transaction be materially consistent with past practice. Boards and auditors must assess prior agreements, ongoing expenses, contracts, and interaction habits to provide a normative baseline for what constitutes usual business activity. The frequency, volume, and type of historical transactions are key indicators. Although statutory provisions do not dictate numerical thresholds, regulators and courts increasingly factor quantitative and qualitative trends in company operations into tests of ordinariness.[1252]

II. Governance and Oversight Structures

A close relationship to operational alignment is the governance aspect, which assesses whether transactions comply with established

[1244] Supra note 34
[1245] Supra note 35
[1246] Bhimawat, Awar Dan, *Related Party Transactions: Decoding 'Ordinary Course of Business' and Arm's Length Transactions*, 3 Indian J. L. & Soc'y 31 (2025).
[1247] Id
[1248] Supra note 2
[1249] SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, Reg. 23, India.
[1250] Supra note 20.
[1251] Bharti Televentures Ltd. v. Addl./Jt. CIT, Delhi High Court, MANU/DE/0002/2010.
[1252] MCA, General Circular No. 30/2014.

internal controls, approval procedures, and documentation requirements.[1253]

An effective framework for judging ordinariness requires the board, especially independent directors and audit committees, to actively consider whether a proposed transaction is consistent with prior practice and the company's operating strategy. Documentation serves a two-fold purpose here: it demonstrates compliance and explains the event of a regulatory examination. These may include board resolutions, agreements, internal memoranda, financial statements, and audit reports that demonstrate the transaction's consistency with the company's previous practices.[1254]

Notably, the governance structure should also address conflicts of interest. Although a transaction might be operationally sound, it may also create an opportunity for abuse if the counterparty is a related party with decision-making authority. Independent oversight is therefore important. Regulatory guidelines state that audit committees should thoroughly examine RPTs for fairness and arm's-length considerations before recommending them to the board.[1255]

III. Arm's Length Evaluation

A key element in the analytical framework is whether the transaction is conducted on an arm's-length basis, and therefore, it must treat related parties as unrelated parties would. Applying the arm's-length test involves considering prices, terms, and conditions, as well as non-financial factors such as credit periods, guarantees, and preferential treatment.[1256]

For example, if a firm sells merchandise to a related and an unrelated party at the same price but offers a much longer credit period to the related party, the transaction would not meet the arm's-length requirement. Courts have also upheld this approach, focusing on substance rather than form. In Madhu Ashok Kapur & Ors. v. Rana Kapoor, the court considered fairness, industry norms, and market standards, rather than strict procedural adherence, to assess arm's length status.[1257] In like manner, in Iljin Automotive Pvt. Ltd. v. Asst. In Commissioner of Income Tax, the court emphasized that arm's-length prices must reflect what third parties would negotiate in similar situations.[1258]

The arm's length appraisal should also take into account commercial justification and economic need. Even arrangements beneficial to a related party would be acceptable if justified by market circumstances or strategic business needs. For example, corporate guarantees provided to subsidiaries to facilitate business growth can be commercially convenient while remaining arm's-length compliant, provided they are properly documented and approved by the board.

IV. Synthesizing Multi-Layered Factors

An integrated analytical framework does not rely on a single factor but considers primary and secondary factors to analyze ordinariness and arm's-length compliance together.

Primary Factors: Consistency with the Memorandum of Association is crucial. Though inclusion in the MOA gives preliminary authority, it is not conclusive. Courts, like in Seksaria Biswan Sugar Factory Ltd. v. CIT, have made it clear that integration of operations and practice as a routine is determinative.[1259] Secondly, it must be a historical practice, in the sense that occasional transactions, board approvals, and regular patterns of operations are strong indicators of ordinariness. The court in Kalapnath Singh v. Surajpal Singh2 held that the term "ordinary course of business" is undefined under any of the Acts. Still, it highlighted that the expression does indicate

[1253] Supra note 19
[1254] Supra note 18
[1255] Supra note 31
[1256] Supra note 33
[1257] Madhu Ashok Kapur & Ors. v. Rana Kapoor, MANU/MH/1038/2015.
[1258] Supra note 32
[1259] Supra note 19

that "uniformity of dealing, and a certain degree of routine in business practice."[1260]

Secondary Factors: Transaction Scale and Magnitude-One-off large transactions, even if legally allowable, could need increased scrutiny. Regular transactions indicate incorporation within the firm's businesses. Transactions closely tied to the business's core revenue streams are more likely to qualify as ordinary. Industry practice puts the transaction in context, but cannot replace company-specific practice. Complete documentation, such as board minutes, contracts, and past approvals, enhances the defensibility of the transaction.

V. Risk Mitigation and Compliance

Taking a guided framework enables firms to prepare for regulatory examination and pre-empt shareholder litigation risks. Recording the reasons why a transaction should be treated as ordinary ensures boards can stand over their judgments in front of auditors, regulators, or minority shareholders. It also supports broader corporate governance goals by promoting openness, accountability, and equity in dealings with connected parties.

Furthermore, firms can incorporate internal audits, pre-transaction reviews, and regular reviews into their RPT policies to ensure that arm's-length and ordinary-course standards are uniformly applied. This also facilitates the early detection of potential conflicts of interest and enhances the credibility of board decisions.

VI. Practical Implementation

The analytical framework can be operationalised using a step-by-step process:

1. Transaction Screening: Determine if the transaction is with a related party and set possible materiality thresholds.
2. MOA Alignment Check: Determine if the transaction is within the objects of the company and its historical operations.
3. Historical Practice Assessment: Reference precedent transactions to ensure consistency and integration.
4. Arm's Length Evaluation: Compare terms, pricing, and conditions with market standards.
5. Documentation and Approval: Ensure board, audit committee, and shareholder approvals (where applicable) are obtained and documented.
6. Ongoing Monitoring: Regularly monitor RPTs to ensure ongoing adherence to principles of ordinariness and arm's length.

By taking such a multi-layered, evidence-based approach, companies not only meet statutory and regulatory obligations but also promulgate a culture of good governance and preclude reputational and financial exposures linked to RPTs.

Part IV – Comparative International Perspectives

The determination of whether or not a transaction is in the "ordinary course of business" under Section 188 of the Companies Act, 2013[1261]It is a subtle process that involves analyzing the nature, frequency, and context of the transaction within the company's operations. Though Indian jurisprudence and regulation offer a fundamental understanding, it is interesting to consider how other jurisdictions determine this. This comparative study examines the practices and principles pursued by the United States, the United Kingdom, and the European Union, highlighting similarities and differences that can inform India's regulatory framework.

United States: Business Judgment Rule and Materiality

In the United States, the determination of whether a transaction is within the "ordinary course of business" is affected by the materiality concept and the business judgment

[1260] Kalapnath Singh vs. Surajpal Singh and Ors. (14.09.1948 - ALLHC) : MANU/UP/0205/1948

[1261] Supra note 2.

rule. Based on the Securities Exchange Act of 1934[1262]Transactions that are immaterial to the company's financial position or operations do not have to be disclosed. The business judgment rule permits directors to decide as they think best for the company, as long as they act in good faith and with reasonable care.

Yet, with respect to related-party transactions, the Sarbanes-Oxley Act of 2002 requires disclosure of such transactions if they exceed specified thresholds. The U.S. Securities and Exchange Commission (SEC) requires companies to disclose material related-party transactions to enhance transparency and accountability.

Sarbanes-Oxley Act of 2002[1263]Prevents loans to executive officers and directors under Section 402 and mandates that management and external auditors disclose the company's internal controls over financial reporting as adequate under Section 404.

In re Walt Disney Co. Derivative Litigation (2006)[1264]The Delaware Court of Chancery ruled that directors' business decisions are covered by the business judgment rule, subject to proof of bad faith and self-dealing.

SEC v. WorldCom, Inc. (2003)[1265]The SEC sued WorldCom for securities fraud, alleging that it failed to disclose related-party transactions and other material information, resulting in massive financial restatements.

United Kingdom: Judicial Supervision of Routine Business Activities

In the United Kingdom, related-party transactions are governed by the Companies Act 2006. The Act requires that transactions entered into by a company be in the ordinary course of business to be exempt from shareholder approval. The UK practice focuses on the transaction being routine in the case of the company's regular business operations.

Judicial control is an important factor in establishing whether a transaction is in the ordinary course of business. Courts look into the company's past habits, the character of the transaction, and its consistency with the company's purposes. This judicial monitoring helps ensure that directors cannot use the ordinary-course-of-business exception to bypass shareholder approval.

Companies Act 2006: Sections 190 to 196 govern related-party transactions, requiring shareholder approval for transactions that exceed certain thresholds. [1266] In Regal (Hastings) Ltd v. Gulliver (1967), the House of Lords held that directors must act in the best interests of the company and cannot use their position to gain personal advantage.[1267] In Howard Smith Ltd v Ampol Petroleum Ltd (1974), it was held that directors are required not to use their powers for an improper purpose, even if the transaction is in the usual course of business.[1268]

European Union: Harmonization and Disclosure Requirements

The European Union has adopted a harmonized regime for related-party transactions under the EU Accounting Directive. The Directive mandates related-party transactions to be disclosed in the accounts if they are material. Materiality is assessed based on the nature and size of the transaction relative to the company's financial position.[1269]

The EU method places a premium on transparency and uniformity in the treatment of related-party transactions in the member states. Standardizing disclosure requirements, the EU seeks to promote investor protection and ensure that related-party transactions do not compromise the quality of financial reporting.

[1262] Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq.
[1263] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002)
[1264] In re Walt Disney Co. Derivative Litigation, 907 A.2d 693 (Del. Ch. 2006).
[1265] SEC v. WorldCom, Inc., Litigation Release No. 18417 (S.E.C. July 21, 2003).
[1266] Companies Act 2006, c. 46, §§ 190–196 (Eng.).
[1267] Regal (Hastings) Ltd v. Gulliver, [1942] 1 All ER 378 (HL).
[1268] Howard Smith Ltd v. Ampol Petroleum Ltd, [1974] AC 821 (PC)
[1269] Armour, John & Gordon, John, *The Law and Economics of Corporate Governance*, 27 J. Corp. L. 113 (2002).

EU Accounting Directive (Directive 2013/34/EU): Mandates disclosure of related-party transactions in company financial statements.[1270]

Directive 2017/828/EU (Shareholder Rights Directive II): Modifies the EU Accounting Directive to increase the transparency of related-party transactions.[1271]

The European Court of Justice ruled that EU member states are obligated to uphold the freedom of their own citizens. The European Court of Justice ruled that EU competition law applies to related-party transactions that affect trade between member states.[1272]

The comparative study has some insights that can guide India on how to approach related-party transactions:

1. Materiality Thresholds: Implementing clear materiality thresholds can offer companies clearer guidance about when the transactions need to be disclosed or approved by shareholders.
2. Judicial Oversight: Including judicial oversight in evaluating related-party transactions can guarantee that directors are acting in the company's and the shareholders' best interests.
3. Harmonized Disclosure Requirements: Harmonizing disclosure requirements can improve transparency and consistency in financial reporting, building investor confidence.[1273]
4. Director Discretion: Integrating director discretion with protective measures can enable directors to act in the interests of the company while preventing misuse.

Determining whether a transaction is in the "ordinary course of business" is a subtle process that requires a sophisticated understanding of the company's operations, governance mechanisms, and regulatory environment. By learning from strategies used in other jurisdictions, India can further streamline its regulatory framework to ensure related-party transactions are transparent, equitable, and in the interests of all stakeholders. This comparative approach highlights the need for ongoing assessment and adjustment of regulatory systems to respond to changing dynamics of business practices and corporate governance.[1274]

Part V – Case Study Analysis

As an example of the analytical framework in practice, consider a business that produces engineering products. The business agrees to rent office premises belonging to one of its directors personally. The lease is to serve as the company's registered office. The company contends that the transaction falls under the exemption under Section 188 of the Companies Act, 2013[1275], on the basis that the lease is at an arm's length rate. The core issue, however, remains whether the transaction is also in the ordinary course of business.

Step One: Arm's Length Test

In fact, an arm 's-length rent can be achieved quite easily if the company compares the lease rent with the going rate for similar premises in the same area. Independent valuation reports, rent comparables, and open documentation will substantiate the assertion that the director has not conferred any undue advantage on himself. The transaction is therefore fair and defensible on pricing grounds.

Step Two: Ordinary Course Test – Applying the Framework

1. MOA Consistency

The initial step is to analyze whether the company's Memorandum of Association (MOA) envisages ventures such as purchasing or renting office premises. If the MOA does include

[1270] Directive 2017/828/EU of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC regarding the encouragement of long-term shareholder engagement, 2017 O.J. (L 132) 1.
[1271] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on annual financial statements, consolidated financial statements and related reports, 2013 O.J. (L 182) 19
[1272] Centros Ltd v. Erhvervs- og Selskabsstyrelsen, C-212/97, 1999 E.C.R. I-1459 (ECJ).
[1273] Davies, Paul L., *Gower & Davies' Principles of Modern Company Law* 9th ed. (Sweet & Maxwell, 2016).
[1274] Black, Bernard S., *Shareholder Protection and Corporate Governance in the United States*, 6 Econ. & Fin. Rev. 1 (2000).
[1275] Supra Note 2.

a clause, whether as a principal or ancillary object, empowering the company to purchase or rent property for conducting its business, this further supports the case for ordinariness. It proves that the company was always authorized to undertake such ventures as a part of its business strategy.[1276]

But if the MOA is not specifically worded to include leasing or is overly restrictive, covering only manufacturing operations, then the justification weakens. Then, although the lease would still be intra vires (as ancillary powers are usually implied), it becomes more difficult to maintain that the transaction is routine or intended to be part of the company's prime objectives.

2. Historical Practice

The second, and more important, step is to examine the company's past behavior. Has the company ever rented office space, either from the directors or from third parties? If yes, there is proof of an ordinariness pattern. For instance, if the company has been in business from rented offices for some years, whether related-party or otherwise, the present lease falls into that business pattern.[1277]

Conversely, if the company is undertaking the transaction for the first time, a lack of historical precedent suggests it is not ordinary but incidental. The company will argue that it is necessary to lease premises for administrative purposes, but necessity and ordinariness are distinct. The MCA and judicial clarification both stress that "ordinary" involves regularity and integration, not once-only necessity.

3. Secondary Factors

Even when the MOA and past practice tests are inconclusive, the secondary considerations can refine the analysis:

•Frequency and Regularity: If the firm plans to execute several leasing transactions in the future, the act may become progressively ordinary. But an isolated lease, particularly with a related party, can hardly be termed ordinary.

•Scale and Size: If the lease transaction is small in size compared to the operations of the company, it can look less unusual. However, if the lease is a significant money commitment, this weighs against normalcy.

•Relevance to Revenue Generation: Leasing office space does not generate revenue directly; it facilitates administrative activities. This detracts from the argument for ordinariness for a manufacturing firm whose normal course of business is making and selling merchandise.

•Practice in the Industry: Although most manufacturing firms rent office space, the MCA circular demands a company-specific analysis. Therefore, industry practice might serve as background support, but cannot replace the company's evidence-based practice.

Applying the framework, the transaction will not qualify as being in the ordinary course of business unless two prerequisites are fulfilled: (i) MOA clearly allows for acquisition or leasing of premises, and (ii) the company has a history of leasing property, be it from directors or from third parties unrelated to them. Absent either of these prerequisites, particularly historical practice, the characterization of the lease as ordinary is hard to maintain.[1278]

Thus, even if the arm's length test is met, the exemption under Section 188 would not be available. The transaction would need Board approval and, based on its size relative to the mandated thresholds under Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014, potentially shareholder approval as well.[1279]

This case study illustrates the cumulative character of the dual tests. Firms often mistakenly conclude that fair pricing, by itself, excludes them from compliance, but this is incorrect. Unless the transaction is also clearly

[1276] Supra note 34
[1277] MCA Circular No. 30/2014, supra.
[1278] ICAI, supra; ICSI, supra.
[1279] Companies (Meetings of Board and its Powers) Rules, 2014, Rule 15

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ordinary, the exemption cannot be claimed. The distinction between incidental and ordinary is consequently not semantic but pivotal to corporate governance.

Conclusion

Section 188 of the Companies Act, 2013, illustrates that related party transactions ("RPTs") cannot be reduced to a mere issue of pricing. The legislative stipulation that such transactions must be at both "arm's length" and in the "ordinary course of business" establishes a twin filter that reflects an underlying governance philosophy. The purpose is not only to prevent insider enrichment but also to ensure that transactions are consistent with the company's day-to-day business and do not divert resources in unanticipated or contrary-to-corporate-practice ways.[1280]

The Indian approach, however, has grappled with conceptual clarity regarding the "ordinary course" requirement. The Ministry of Corporate Affairs, by General Circular No. 30/2014, clarified that ordinariness is specific to the company and not to the industry.[1281] Courts like the Bombay High Court in Seksaria Biswan Sugar Factory Ltd. v. CIT[1282] and the Delhi High Court in Bharti Televentures Ltd. v. Addl./Jt. CIT has upheld that ordinariness must be understood as normalcy and continuity, and as part of the company's business model.[1283] This jurisprudence safeguards against letting opportunistic, one-off related-party transactions find shelter in the convenience of ordinariness.

The analytical model evolved in this paper indicates that ordinariness is based on two main tests, allegiance to the Memorandum of Association (MOA) and past practice, augmented by secondary criteria such as frequency, size, revenue link, and industry standards. Professional organisations like ICAI and ICSI have reiterated these parameters, advising companies to document their rationale whenever transactions are treated as ordinary.[1284] Documentation is not a compliance drudgery; it enhances defensibility in the eyes of regulators, auditors, and minority shareholders.

The case study illustrates the pragmatic implications. Renting office space from a director, while fairly priced, can still not meet the test of being ordinary if the business has no track record of leasing or if its MOA does not provide for it. Under such conditions, Board and possibly shareholder approval under Section 188 would be required.[1285] This shows that fairness in pricing (arm's-length) is required, but it is not enough without ordinariness.

Comparative views reinforce India's position. The U.K. Companies Act, 2006, mandates shareholder consent for significant property transactions by directors, reflecting concerns about fairness and alignment with the business purpose.[1286] The U.S. scheme of securities regulation under Regulation S-K is more concerned with disclosure of related-party transactions and requires a business-purpose justification, rather than fair pricing.[1287] The E.U. Shareholder Rights Directive does the same for material related-party transactions, requiring disclosure and minority protection.[9] These similarities underscore that India's two-test model is in accordance with international governance practices.

In summary, Section 188 represents a governance protection based on substance and form. The arm's-length test prevents insiders from deriving any unfair benefit, and the ordinary-course requirement prevents the transactions from falling outside the company's normal business rationale. Companies adopting both prongs not only secure compliance but also enhance investor confidence and corporate legitimacy. Regulators, boards, and shareholders alike need

[1280] Supra note 2
[1281] MCA Circular No. 30/2014, supra.
[1282] Supra note 19
[1283] Supra note 48

[1284] 1284 ICAI, supra; ICSI, supra.
[1285] Companies (Meetings of Board and its Powers) Rules, 2014, Rule 15 (India).
[1286] Companies Act 2006, c. 46, § 190 (U.K.).
[1287] 17 C.F.R. § 229.404 (U.S.).

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to treat ordinariness not as a loose exception but as a genuine standard that safeguards the integrity of corporate decision-making.

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