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RELATED PARTY TRANSACTIONS UNDER THE COMPANIES ACT, 2013

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ABSTRACT

RPTs are governed by the Companies Act of 2013. The Companies Act of 2013 was unprecedented in terms of the power granted to minority shareholders to reject RPTs, as the Ministry of Corporate Affairs (hereinafter MCA) had devised stringent rules requiring several rounds of approval and disclosures for a wide range of transactions that companies entered into with relatives of promoters, entities controlled by promoters, and entities controlled by relatives of promoters. In its original version, Section 188 of the Act required firms with paid-up capital of more than one crore rupees to seek permission of its board of directors by a special majority, regardless of the company's share capital or the value of an RPT. To ensure independence in the way of voting on RPTs, Section 188 of the Act prohibited any linked parties from voting on RPTs. SEBI had also advanced the process of increasing shareholder engagement by requiring listed businesses to give E-voting capabilities to its shareholders in relation to business matters handled by listed companies through postal ballot. The availability of E-voting facilities is projected to increase shareholder engagement in corporate governance concerns. Due to company comments that such tight requirements impacted the efficiency of corporate operations, the MCA significantly reduced the provisions of the Companies Act, 2013 through two circulars. The First Circular stated that a shareholder under the second proviso to section 188(1) would be regarded a connected party solely with regard to a contract or arrangement for which the special resolution was being enacted. The Companies Act of 2013 and the Listing agreement with SEBI control RPTs In terms of the ability afforded to minority shareholders to reject RPT, the Companies Act of 2013 was unusual.

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INTRODUCTION

An RPT "is a transaction between two parties who had a prior special connection; the transaction might be a commercial agreement, a single or series of financial contracts, or an arrangement. A parent business and its subsidiaries or affiliates, workers, main owners, directors or management of the firm and its subsidiaries, or members of their immediate families, might be engaged on both sides of the transaction". According to Indian Accounting Standards (IAS-18), parties are connected "where one party has the potential to control or significantly influence the other in making financial and/or operating decisions in a certain reporting period."[2] . A related party's influence can be exercised directly or indirectly through one or more intermediaries or other businesses controlled by its senior management people or their families. RPTs are beneficial to the organisation since they reduce negotiating and transaction expenses due to the special relationship between the parties involved. In fact, there may be multiple such transactions that are inevitable because they make business sense for the company; prohibiting corporations from engaging in such transactions may operate against the notion of maximising shareholder value. RPT can also be used to save a company from financial crisis. When creditors are unable to give enough money to keep the firm running, related parties can provide financial support, allowing the company to continue operating as a going concern.However, not all RPTs are advantageous to investors. However, transactions between related parties are not regarded to be at arms' length. The complexities behind them are difficult to pinpoint. Corporations frequently use RPTs to control their revenues or to drain off assets from publicly traded companies to other linked organisations. Other RPTs include making loans, writing off loans and dues, selling assets to a linked corporation for a considerably lower price than the market price, and so on. Such RPTs are typically carried out by dominant owners who have large control rights in comparison to their cash flow rights, generating a strong incentive to confiscate the minority (absentee) stockholders. When control rights outnumber cash flow rights and enforcement procedures are inadequate, one should expect a high level of RPTs. " Corporate India, with its concentrated ownership in the hands of the founders, had immense potential for RPT misuse. According to the **Achuthan committee** on takeover restrictions, the average overall promoter ownership of 4,054 listed businesses was 48.9%, while the average promoter holding of 459 major companies with a market value of more than 10,000 crore was 55.2%"[3] The Companies Act, 2013 requires that all related party transactions be authorised by the audit committee, with independent directors constituting at least

[2] Padmini Srinivasan, *An Analysis of Related-Party Transactions in India* 402 IIM BANGALORE (2013).
[3] Report of the Takeover Regulations Advisory Committee, Annexure 2 - Promoter Holding in Listed Companies July 19, 2010,

two-thirds of the audit committee. The Act also mandated the deployment of 'E-VOTING’21 enabling increased shareholder engagement in CEO compensation and board nominations.

RPT Under Companies Act

The legal provisions governing RPT's were further diluted by the Companies Amendment Act, 2015, which envisaged that “RPT's would only require shareholder approval through a 'ordinary resolution,' i.e. 50% of disinterested shareholders, rather than a 'Special resolution,' which required approval of 75% of disinterested shareholders (majority of minority), further reducing minority shareholders' power to block abusive RPT's due to a higher threshold. The Companies amendment also included a change to Section 177(4) of the Companies by inserting a proviso allowing the audit committee to seek omnibus approval subject to certain conditions. The Companies Amendment Act, 2015 was laudable because the requirement of a special majority of disinterested shareholders would have been an obstacle to doing business in India; however, the law regarding RPTs as it stands today, if construed entirely, could encourage abusive self-dealing transactions by organisers, which could be detrimental to the interests of minority shareholders”.

The Companies Act of 2013 established a new structure requiring disinterested or independent clearance for many RPTs, putting India in line with international standards. However, there are still problems with the Companies Act, 2013, since the role of independent directors in reviewing the company's corporate governance compliance is restricted, and some critical transactions remain beyond the scope of the board of directors' supervision. The audit committee is in charge of reviewing and approving RPTs, as well as assessing financial accounts and the auditor's report. As a result, guaranteeing the independence and attractiveness of the post of independent director is critical, as the audit committee must have a majority of independent directors.In light of the related obligations and hazards, the payment (usually merely sitting fees) may be deemed inadequate. As a result, it is critical to develop a remuneration structure for an independent director that is acceptable but not excessive, as too high compensation may weaken an independent director's independence and make them less willing to criticise management. Independent directors' compensation must be tied to long-term success. Granting long-term vesting of equity shares may be an effective way of providing a sufficient pay package to independent directors. Independent directors should be awarded a portion of their yearly fees in the form of company shares, with these shares vesting over a 3-5 year period. Independent directors have an interest in ensuring that value is produced, sustained, and not destroyed by abusive related party transactions in this situation. The Companies Act of 2013 states that an independent director is not entitled to stock options, but it does allow for the payment of fees, reimbursement of expenses, and profit-related commissions, which is insufficient to effectively incentivize skilled professionals to serve as independent directors. As a result, changes to the rules governing independent director remuneration must be made to allow stock options to be used to incentivize independent directors.

RPTs are reported to stock exchanges on a regular basis. This reduces the efficacy of the disclosure because the information is available to investors much later than when the transactions were completed. It is advised that RPTs be published on a continual basis in order to encourage better examination of transactions by investors, the public, and regulators, therefore minimising the opportunity for abusive RPTs.[4] The MCA should specify that disclosure of substantial RPTs shall contain all relevant data regarding the transaction that a reasonable investor or shareholder could consider important for the purpose of voting at the meeting. To provide clarity on the RPT, the disclosure should include a "description of the main terms of the transaction, the name of the controlling shareholder who has a personal interest in the transaction, the reasons of the audit committee and the board of directors for approving the transaction and the reasons of the directors opposing it, the method by which the consideration was determined, and the name of each director who has a personal interest in the transaction as well as the kind of one's interest The Companies Act, 2013 requires, among other things, the formation of an audit committee comprised of a majority of independent directors". It also necessitates the audit committee's approval or modification of transactions involving connected parties. The committee is obligated to explain why it classified a transaction as extraordinary or material, or non-extraordinary or nonmaterial. The effectiveness of any legislation is primarily determined by the quality of its enforcement. To ensure effective implementation, the monitoring and inspection capabilities of both the MCA and SEBI must be significantly strengthened and synchronised, as the amendments to Section 188 of the Companies Act, 2013, through the issuance of circulars regarding RPTs have not been aligned with clause 49 of the listing agreement, which is the primary clause governing the relationship between SEBI and the listed issuer. However, if the goal was to moderate the legislation, it would have been more practical to propose an amendment to the Companies Act, 2013, including numerous amendments brought forth by the MCA through ratifications and clarifications to build a favourable corporate environment.[5]

[4] Related Party Transactions and Minority Shareholder Rights, OECD, 28-29, *available at:* *http://www.oecd.org/daf/ca/50089215.pdf*

[5] OECD Corporate Governance Series: Guide on Fighting Abusive Related Party Transactions in India, *available at*: www.Oecd.org/daf/ca/corporategovernanceprinciples/43626507.pdf

CONCLUSION

We can conclude that the regime governing RPTs should promote transparency and safeguards against abusive RPTs without imposing an undue administrative burden on companies; however, the law as it stands today is prone to abuse because it allows ill-intentioned dominant shareholders ample room to manoeuvre in order to evade the law, as the regulations exempt transactions with wholly owned subsidiaries, as they have the subsidiary to move assets at the levy rate.As a result, it is critical that financial intermediaries connected with a firm play an active part in qualitative transaction evaluation in order to prevent abusive RPTs that may dramatically destroy shareholder value

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