

---

# **RELATED PARTY TRANSACTIONS: THE REGULATORY FRAMEWORK AND CHANGING LANDSCAPE IN VIEW OF PROMOTER DRIVEN COMPANIES IN INDIA**

---

Deepanshu Verma, O. P. Jindal University

## **ABSTRACT**

A related-party transaction (RPT) is an arrangement between two parties having a preexisting business relation, regulated in India under the ambit of Companies Act, 2013.

While some of these have the potential for creating a conflict of interest, misuse of related-party transactions, if left unchecked, can lead to fraud and financial catastrophe for all parties involved. The Act also defines "arm's length transactions" as an exception to such transactions, which is conducted between two related parties as if they are unconnected. The notion was included in the legislation to ensure that both parties in a transaction behave in their own best interests and are not influenced by the other. This article thereby attempts to examine the regulatory framework of RPTs from the perspective of promoter driven companies in India, and makes note of recent amendment in the regime by the Securities and Exchange Board of India (SEBI) as a way forward.

## Introduction

A related-party transaction (RPT) refers to a transaction or exchange wherein the two parties are bound by a pre-existing relationship. The parties forming part of such a transaction, on either side of the deal, can be a parent company and its subsidiaries, the principal owners, the employees, the director or management of the company, or members of their immediate families. In India, there are about 6000 listed companies on the two primary stock exchanges. Most of these companies are family-owned, or ‘promoter-driven’, meaning a significant amount of control and dominance is exercised by age-old family groups or promoters of such companies. There is significant pyramiding and tunnelling among Indian business groups, owing to the concentrated ownership and family control in India, where enforceable legal protection of minority property rights is relatively weak. As a result of this, the framework of corporate governance in India requires diligent monitoring of transactions connected to or involving such. Controlling shareholders, i.e. “promoters”.<sup>1</sup> The Companies Act, 2013 in India places heavy reliance on literature and regulations taken from the Sarbanes Oxley Act of the United States, and the Cadbury Committee Report of the United Kingdom while implementing measures of effective corporate governance.<sup>2</sup> However, the Anglo-American mechanisms of regulation often fail to tackle the complexities of relations pertaining to companies in India, which are dominantly owned and controlled by promoters or family-owned businesses, having years and generations of family capital and reputation at stake.<sup>3</sup>

A landmark development in India’s corporate governance landscape, highlighting the malpractices pertaining to the issue was the infamous Satyam scandal.<sup>4</sup> The chairman of Satyam Computer services, Ramalinga Raju, set up two companies, Maytas Infrastructure Ltd and Maytas Properties Ltd which were managed and owned by Ramalinga’s family. Satyam then decided to buy out the companies for a whopping \$1.6 billion, thereby tunnelling the wealth back to Ramalinga’s family. When the news broke, Satyam’s share fell to the extent that they had to be withdrawn, and Ramalinga Raju along with other key managerial executives

---

<sup>1</sup> OECD, *Related Party Transactions And Minority Shareholder Rights* (OECD Publishing, 2012) <http://dx.doi.org/10.1787/9789264168008-en> (last visited 17 November, 2021).

<sup>2</sup> Velmurugan Palaniappan Shanmugam, R. Veeraraghavan and Rinku Champramary, *Corporate Governance Abuses and the Ownership Structure of Indian Companies*, SSRN Electronic Journal (2017).

<sup>3</sup> Dan W. Puchniak and Umakanth Varottil, *Related Party Transactions in Commonwealth Asia Complexity Revealed* in Luca Enriques and Tobias H Tröger (eds), *The Law and Finance of Related Party Transactions* (2019).

<sup>4</sup> Charu Singhal, *Satyam Scandal: The Biggest Issue Revolving Around Corporate Governance* LexForti (2020) <https://lexforti.com/legal-news/satyam-scandal-the-biggest-issue-revolving-around-corporate-governance/#FACTS> (last visited 17 November, 2021).

of the company, was arrested. Ramalinga Raju confessed the gross violation of corporate governance practices on his part, with the fraud adding up to a colossal \$276 million. In a recent development pertaining to the case, SEBI imposed a two year ban on all firms in the network of PricewaterhouseCoopers (PWC), the auditors of Satyam, from auditing of listed companies in light of being held guilty in the scam.<sup>5</sup>

### **Regulatory Framework of Related-Party Transactions**

Evidently, the law makers of our country latched on to the inadequacies of the existing legislation in light of the Satyam debacle, and went on to bring forth concrete changes in the landscape of corporate governance in India. Henceforth, the Companies Act, 2013 incorporated provisions to protect shareholders against abusive transactions by directors, wherein Section 188 of the Act was enacted to provide a three-layered protection against related-party transactions. At the first step, it blocks off related-party transactions from proceeding further without the consent of the shareholder, requiring a resolution to be passed and ratification of the same upon sufficient justification. Secondly, members related to the concerning parties in such a transaction are not permitted to vote in the said resolution. Lastly, the company's Board is liable to incorporate any such related-party transactions entered into and justify the same, in its report to the shareholders.<sup>6</sup>

Global standards on the subject of related-party transactions were catalogued by OECD's report titled "Related Party Transactions and Minority Shareholder Rights" in 2012<sup>7</sup>, which observed that the Board of the company was commonly responsible for decision making with regard to related parties, in the interest of all shareholders. The report suggested that there should be a harmonized definition of RPTs that can be used uniformly across all laws. It also observed the pivotal role played by independent board members in consideration of related-party transactions, and emphasized on the fiduciary responsibility of controlling shareholders in preventing abusive related-party transactions.

---

<sup>5</sup> Jayshree P Upadhyay, *Sebi bars Price Waterhouse: What is the firm's role in the Satyam scam?*, Hindustan Times, January 11, 2018.

<sup>6</sup> Vanshaj Jain, *Who Will Watch the Watchmen – A Study of the Law on Self-Dealing Transactions by Company Directors*, NLS Business Law Review (2016) <https://heinonline.org/HOL/LandingPage?handle=hein.journals/nlsblr2016&div=9&id=&page> (last visited 17 November, 2021).

<sup>7</sup> OECD, *Related Party Transactions And Minority Shareholder Rights* (OECD Publishing, 2012) <http://dx.doi.org/10.1787/9789264168008-en> (last visited 17 November, 2021).

According to the Companies Act, 2013, a ‘related party’ is defined under Section 2 (76)<sup>8</sup>, and includes:

- i. a director, a key managerial personnel or their relatives;
- ii. a firm, having a director, manager or his relative as a partner
- iii. a private company having a director, or his relative, or his manager as a member or director;
- iv. a public company having a director or manager, wherein the director holds along with his relatives, more than two per cent of its paid-up share capital;
- v. a body corporate having its Board of Directors, managing director or manager accustomed to act in accordance with the advice, directions or instructions of a director or manager;
- vi. an individual on whose instructions or advice, a director or manager is accustomed to act upon;
- vii. a body corporate which is a holding, subsidiary or an associate company of such company, a subsidiary of a holding company to which it is also a subsidiary, or a company which is investing, or a venturer.

Furthermore, according to the Indian Accounting Standards (AS-18), parties are considered to be related to each “if one party has the ability to control or significantly influence the other in making either financial, or operating decisions in a specific reporting period”.<sup>9</sup> Thus, control is an instrumental and distinguishing factor for such transactions, and the related party may exercise it either directly or indirectly through one or more intermediaries or other entities having interest in the company.

Section 188 of the Companies Act, 2013 read along with the Companies (Meetings of Board and its Powers) Rules, 2014 govern the framework of compliance required for related-party transactions. Major arrangements regulated in light of the legislative provision include sale, purchase or supply of goods or materials, selling or disposing of, or buying, property of any sort, leasing of property and availing or rendering any services.<sup>10</sup> Audit committees established in accordance with the legislation further carry out the role of a watchdog in regulation of related-party transactions. Section 177 of the Companies Act, 2013 mandates the requirement

---

<sup>8</sup>Ashima Obhan and Vrinda Patodia, *Related Party Transactions: How Close is Too Close*, Mondaq, (2 December, 2019) <https://www.mondaq.com/india/shareholders/870562/related-party-transactions-how-close-is-too-close>.

<sup>9</sup>Padmini Srinivasan, *An Analysis of Related-Party Transactions in India*, SSRN Electronic Journal (2013).

<sup>10</sup> Ashima Obhan and Vrinda Patodia, *supra* note 8.

of an audit committee consisting of minimum three directors, with independent directors forming the majority within it. Directors forming part of the audit committee act as the first gatekeepers in preventing abusive related-party transactions. All related party transactions require an approval of the Audit committee, and such a committee is entitled to grant omnibus approval upon satisfaction of maximum value, extent, manner, and other aspects of the transaction. In addition to this, listed companies are also required to act in compliance with the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR). Implementing the recommendations of the Birla Committee, the enactment of Clause 49 under SEBI's LODR has been a milestone in the regime of corporate governance in India, and bears resemblance to the spirit of Sarbanes-Oxley measures in the United States.<sup>11</sup> Clause 49 stipulates mandatory and specific disclosure of related-party transactions, and every material related-party transaction is required to be approved by the shareholders through special resolution. Material transactions with regard to RPTs herein refer to those exceeding 10% of the annual turnover of the company.

Related-party transactions have been embedded under the practice of corporate law and regulation of securities, and the mandate of such transactions aims at enhancing interest of minority shareholders, and to discourage those which reduce the company's value thereby resulting in tunneling of wealth.<sup>12</sup> While Companies Act, 2013 does not prohibit related-party transactions altogether, it puts into place a system of checks and balances when dealing with such tricky transactions. All related-party transactions are not necessarily abusive or detrimental, as some may play an advantageous role in saving transaction costs and increasing operating efficiency of a company.<sup>13</sup> At times, it is unavoidable to regulate such transactions in view of the greater interest of maximising shareholder wealth. For instance, Keister distinguished the effect of group affiliation in improving productivity and financial performance among Chinese firms during the 1980s in his work.<sup>14</sup> The idea behind stricter regulation of related-party transactions finds its roots in the notion that such transactions reduce wealth per se, and are of utmost value in regulating economic development and growth of equity markets. The World Bank observes that related-party transactions are, "one of the most

---

<sup>11</sup> Rajesh Chakrabarti, Pradeep K. Yadav and William L. Megginson, *Corporate Governance in India*, SSRN Electronic Journal (2007).

<sup>12</sup> John Armour and Luca Enriques., *The Anatomy of Corporate Law* (Oxford 2017).

<sup>13</sup> Padmini Srinivasan, *supra* note 9.

<sup>14</sup> Lisa A. Keister, *Engineering Growth: Business Group Structure and Firm Performance in China's Transition Economy*, American Journal of Sociology (1998).

serious breaches of good corporate governance around the world.”<sup>15</sup>, and suggests that jurisdictions with loosely regulated RPT legislation often witness reluctant investors unless such investors become controlling shareholders. Empirical evidence suggests that in India, 24% of related-party transactions by size are conducted in the form of loans and deposits, while 21% of related-party transactions are observed in the form of income from sale of goods and materials or interest income or dividend income from a related party. 18% of such transactions are also represented by expense related transactions, which account for purchase of goods and materials from a related party.<sup>16</sup>

### **Judicial Developments pertaining to RPTs in India**

Public shareholders and institutional investors are now beginning to exert their influence through attributable activism. Development in the Indian corporate ecosphere is rapidly growing, with radical changes being brought about in corporate governance practices. Promoter-driven companies are witnessing substantial dilution of promoter stake, as observed in fresh instances of abusive related-party transactions too.<sup>17</sup>

In *Chanda Deepak Kochhar v. ICICI Bank Ltd. Mumbai*<sup>18</sup>, also referred to as the ICICI Bank-Videocon dispute, the case revolved around allegations of a quid-pro-quo loan deal arrangement between Venugopal Dhoot, a promoter of Videocon and Deepak Kochhar, husband of Chanda Kochhar. The scam most recently came into spotlight as the former CEO of ICICI Bank, Chanda Kochhar, derived incidental benefits from a substantial loan lending to Videocon, which cited that the Kochhar’s and Dhoot had business relations prior to the grant of loan by ICICI to Videocon, and the information was kept concealed from the bank’s board by Chanda Kochhar. A whistleblower and an investor in both ICICI Bank and Videocon, Arvind Gupta affirmed Chanda Kochhar’s sanction on Videocon Group’s ₹3250 crore loan carried out in 2012 in exchange for a contract with NuPower Renewables and Supreme Energy, a renewable energy venture owned by Deepak Kochhar. Dhoot thereafter enabled the transfer of Supreme Energy to Deepak Kochhar through indirect and problematic set of transactions. It was observed that between Chanda Kochhar’s appointment as the CEO of ICICI Bank in 2009, and 2011, six high value loan transactions were carried out towards several Videocon group

---

<sup>15</sup> World Bank, *Protecting Minority Shareholders: Frequently Asked Questions*, <https://www.doingbusiness.org/en/data/exploretopics/protecting-minority-investors/faq> (last visited 17 November, 2021).

<sup>16</sup> Padmini Srinivasan, *supra* note 9.

<sup>17</sup> Umakanth Varottil, *Shareholder activism is growing in India. But it faces some hurdles*, The Indian Express, 2 November, 2021.

<sup>18</sup> Chanda Deepak Kochhar v. ICICI Bank Ltd. Mumbai, (2020) SCC OnLine 374.

companies. Videocon eventually ended up as a non-performing asset in 2017. The Enforcement Directorate (ED) lodged a criminal case of money laundering against Chanda Kochhar, Deepak Kochhar, and Venugopal Dhoot under the Prevention of Money Laundering Act. The issue pertaining to the case highlighted discrepancies in effective corporate governance, and closely escaped from the ambit of violation of related-party transactions. While examining the scam in light of the RPT regulations, the gaps observed in the existing law have thereby led SEBI to amend the leaky legislation. For instance, ingenious parties would steer clear of liabilities by weaving a complex web of transactions to deny direct relationship<sup>19</sup>, and thereby exploit the restriction borne out of the very definition of ‘related party’ under the legislation.

More recently, in the dispute between *Yes Bank and Dish TV*<sup>20</sup>, Dish TV’s largest shareholder, Yes Bank, with a 24.78 per cent equity stake in the company, made a requisition in 2020 to the Board holding that the Dish TV’s board was not complying with standards of corporate governance, and the lender has further claimed that Dish TV failed to report certain related-party transactions, labelling the act as dubious. In a recent development in the case, the bank has sought removal of four directors, and the managing director of the company by way of an extraordinary general meeting (EGM) of shareholders. The bank is aiming to dissolve the entire board of Dish TV and remove the promoter family, which is believed to be functioning against the interests of the company, and it is an ongoing matter.

### **Amendment to the RPT Framework in India: Imposition of Meticulous Norms by SEBI**

In light of the recent judicial developments under the landscape of corporate governance in India, SEBI proposed a shift in the practice of related-party transactions through its Working Group report, submitted in January, 2020. The suggested amendments were approved much recently on September 28, 2021, with a few meant to come into force from April 1, 2022 and the remaining from April 1, 2023. Firstly, SEBI has widened the definition of ‘related parties’, intending to ensure that no class of related party can escape from the ambit of classification by manipulation of the existing legislation.<sup>21</sup> The amended definition as per the report<sup>22</sup> is now

---

<sup>19</sup> Gautami Govindrajan, *Analysing The Chanda Kochhar Scam Through The Lens Of Related Party Transactions* (WordPress, 2 May 2019).

<sup>20</sup> Ritu Singh, *Yes Bank wants to look into Dish TV Books, says some deals “dubious”*, CNBC TV 18, 16 September, 2021.

<sup>21</sup> Vinita Nair, *SEBI approves stricter norms for RPTs*, <https://vinodkothari.com/2021/09/sebi-stricter-norms-rpts/#> (last visited 17 November, 2021).

<sup>22</sup> SEBI, *Report Of The Working Group On Related Party Transactions* (2020) [https://www.sebi.gov.in/reports-and-statistics/reports/jan-2020/report-of-the-working-group-on-related-party-transactions\\_45805.html](https://www.sebi.gov.in/reports-and-statistics/reports/jan-2020/report-of-the-working-group-on-related-party-transactions_45805.html) (last visited 17 November, 2021).

drafted to regard 'related party' as: -

- a. All such persons or entity belonging to the promoter or promoter group, irrespective of shareholding in the listed entity;
- b. All such persons or entity, directly or indirectly holding 20% or more of the equity shareholding in the listed entity, with effect from April 1, 2022;
- c. All such persons or entity, directly or indirectly holding 10% or more of the equity shareholding in the listed entity, with effect from April 1, 2023.

Going forward, the Working Group report has laid down stringent compliance thresholds of determining the material related-party transactions, and an additional requirement of prior approval of shareholders for such transactions. Furthermore, enhanced disclosure before the audit committee has been incorporated, wherein tenure of proposed RPTs cannot be indefinite

Value of proposed RPTs must necessarily be defined with respect to upper limit, aggregate value and time period for recurring transactions. Such transactions have been elucidated as those entered into by an individual or jointly with preceding transactions during a financial year, when exceeding the following prescribed limits: -

- ₹1000 crore; or
- 5% of the annual total revenues on a consolidated basis; or
- 5% of net worth on a consolidated basis; or
- 5% of total assets on a consolidated basis

Along with the related-party transactions, any subsequent material modification to the same would also require a prior approval by the audit committee. Furthermore, SEBI has approved implementation of tighter timelines for disclosure of RPTs by listed entities under Regulation 23(9) with effect from April 1, 2022, thereby reducing it from 30 days to within 15 days, from the date of publishing consolidated or standalone financial results of the company for half the year. A listed entity acting in violation of Section 188 of the Companies Act, 2013 is liable for a fine ranging from ₹25000 to ₹5 lakhs, or imprisonment up to one year or both.

## **Conclusion**

The 'Transplant' Effect states that the existing corporate governance norms in India, having been transplanted or picked from jurisdictions such as the US and the UK, are not suitable for addressing India's problems directly. Solutions need to be 'Indianized', or customized in order

to mitigate the complexity of corporate issues exclusive to the Indian jurisdiction. Increased shareholder activism is the need of the hour, while “arm’s length” and squeeze out transactions still need to be patched. While the Anglo-American approach is likely to be functional in an environment where there is a separation of management and control, measures in India are on the right track with SEBI’s latest amendments to adapt and address every possible loophole in the legislation and tackle the issue of related-party transactions.