



## COMPANY LAW

[2016] 132 CLA (Mag.) 1

### **Companies (Amendment) Bill, 2016 – Proposed changes in related party transactions**

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*This article analyses the proposed amendments to the Companies Act, 2013 relating to 'related party' and procedural or approval process in related party transactions.*

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#### **Introduction**

With an objective of addressing and resolving the 'shoe-pinching' issues in Companies Act, 2013 ('the Act'), the Government on 4th June, 2015, constituted 8 members' Company Law Committee. The said Committee was headed by Secretary, Ministry of Corporate Affairs. On 1st February, 2016, Committee submitted 138-pages detailed Report and suggested 100 plus amendments to the Act. Based on the Company Law Committee Report, Government prepared the Companies (Amendment) Bill, 2016 ('Amendment Bill') and presented the same in Lok Sabha on 16th March, 2016. The Bill has suggested 87 amendments to the Companies Act, 2013. Such suggestion was in addition to the already issued clarifications, circulars, notifications, amendment in Company Rules, removal of difficulty orders and the Companies Amendment Act, 2015.

#### **Proposed amendments in the definition of 'related party'**

2. Clause (76) of section 2 of the Act defines 'related party'. With respect to

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the compliance of 'related party transactions' under section 188 of the Act, it is utmost important to determine and define a related party in relation to the company. Once, it is determined that the proposed transaction is with the 'related party', then it is necessary to confirm whether such 'transaction' is a prescribed 'transaction' within the meaning of sub-section (1) of section 188. *Vide* the Amendment Bill, one of the clauses in the definition of 'related party' is proposed to be amended along with allied definitions of 'holding company', 'subsidiary company' and 'associate company'. Sub-clause (viii) of clause (76) of section 2 is proposed to be substituted whereby a related party means any body corporate which is –

- (a) a holding, subsidiary or an associate company of such company;
- (b) a subsidiary of a holding company to which it is also a subsidiary; or
- (c) an investing company or the venturer of a company.

The scope of 'related party' is proposed to be expanded due to the inclusion of the words 'body corporate' in sub-clause (viii) of clause (76) of section 2, whereby the holding company, subsidiary company, associate company, fellow subsidiary company, investing company or venturer company would mean a company incorporated in India and company outside India. *Vide* the Amendment Bill, it is proposed to include an investing company or venturer of a company as 'related party'. However, the same have not been defined in the Act, which will bring in more ambiguity and uncertainty in identifying the 'related party' in relation to the company. This proposal of amending the definition of 'related party' is in line with the recommendations of the Companies Law Committee Report.

### *Associate company*

2.1 The Amendment Bill proposes to amend clause (6) of section 2 relating to 'associate company'. The proposed amendment relates to expanding the scope of the 'significance influence' and defining 'joint venture'. Pursuant to the proposed *Explanation*, following amendments are suggested :

- The expression 'significant influence' means control of at least 20 per cent of total voting power, or control of or participation in business decisions under an agreement.
- The expression 'joint venture' means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

One of the criteria for determining 'significant influence' has changed from control of at least 20 per cent of total share capital to 20 per cent of total voting power. Clause (89) of section 2 defines 'total voting power' in relation to any matter, to mean the total number of votes which may be cast in

regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes. The Amendment Bill proposes to define the expression 'joint venture' which means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

### *Holding company*

2.2 The proposal of amending the definition of 'holding company' is in line with the recommendations of the Companies Law Committee Report. *Vide* the Amendment Bill, it is proposed that an Explanation is inserted to clause (41) of section 2 (relating to 'holding company') of the Act. The proposed Explanation is "For the purposes of this clause, the expression 'company' includes any body corporate". The definition of 'holding company' is proposed to be expanded by including company incorporated outside India along with companies incorporated in India. This proposal of amending the definition of 'holding company' is in line with the recommendations of the Companies Law Committee Report.

### *Subsidiary company*

2.3 *Vide* the Amendment Bill, the proviso restricting the layers of subsidiaries beyond prescribed number is proposed to be eliminated. Considering the strategic decision making and with an objective of ease of doing business, the Government has proposed amendment of such provision. There are two tests for determining whether a company is subsidiary of another company, and on satisfaction of any one test, the holding-subsidiary relationship is defined. The two tests are as follows :

- ▶ Controlling the composition of the Board of directors ;
- ▶ Exercising or controlling more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

The Amendment Bill also proposes to amend the definition of 'subsidiary company' with respect to one of the criteria for determining holding-subsidiary relationship, i.e. the second criteria, wherein the 'total share capital' is proposed to be replaced by 'total voting power'. Therefore, the requirement of calculating the equity share capital and convertible preference shares is proposed to be eliminated *vide* the Amendment Bill. This is definitely a welcome move for the corporates, as the extant criteria of 'total share capital' acted an impediment in corporate restructuring and reorganizing the group companies. The proposal of amending the definition of 'subsidiary company' is in line with the recommendations of the Companies Law Committee Report.

### **Proposed amendments in the approval process of related party transactions**

3. Pursuant to sub-section (4) of section 177 the audit committee is required to approve the transactions of the company with related party including any subsequent modification in such transactions. The Audit Committee can also make an omnibus approval for the related party transactions proposed to be entered into by the company, subject to prescribed terms and conditions. The Amendment Bill amends clause (iv) of sub-section (4) of section 177 by inserting three provisos. Proposed amendment are as follows :

#### ***Role of audit committee in approving or recommendation of transaction with related party***

3.1 The Amendment Bill proposes to inserted second proviso to clause (iv) of sub-section (4) of that section, whereby the audit committee is under obligation to make recommendations to the Board of directors in case of transactions other than related party transactions referred to in section 188 and where audit committee does not approve such transaction. Due to the inclusion of the proposed proviso to sub-clause (iv), the precise role of the audit committee is made clear, *i.e.*, transactions requiring approval by the Committee or transactions requiring recommendations by the Committee to the Board of directors. Therefore, it also means that all transactions with the related parties ought to be reviewed or placed before the audit committee, either for approval or for recommendation. The proposal of amending the role of audit committee in approving or recommending of transactions with related party is in line with the recommendations of the Companies Law Committee Report.

#### ***Consequence of non-ratification of related party transactions by audit committee***

3.2 The Amendment Bill inserts third proviso to clause (iv) of sub-section (4) of section 177 whereby any transaction involving any amount not exceeding Rs. 1 crore is entered into by a director or company's officer without obtaining the approval of audit committee and the same is not ratified by committee within 3 months from the date of the transaction, then such transaction is voidable at the option of the audit committee. Further, if the related party transaction is entered by the company with a related party to any director or is authorised by any other director, is entered into without obtaining the approval of audit committee and the same is not ratified by Committee within 3 months from the date of the transaction, then the director concerned shall indemnify the company against any loss incurred by it. It is noteworthy that proposed provisions relating to non-ratification of related party transactions by audit committee is in addition to the non-ratification as

provided in sub-section (3) of section 188, however, under the proposed provisions, there is limit on the transaction value not exceeding Rs. 1 crore. The proposal of amending the role of Audit Committee in approving or recommending of transactions with related party is in line with the recommendations of the Companies Law Committee Report.

#### *Exemption from audit committee's approval*

3.3. In terms of the third proviso proposed to be inserted to clause (iv) of sub-section (4) of section 177, the provisions relating to Audit Committee's approval (including omnibus approval) are not applicable to a transaction, other than transactions, referred to in section 188, between a holding company and its wholly owned subsidiary company. The proposed amendment is in line with the recommendations of the Companies Law Committee Report.

#### **Exemption from prohibition of voting on resolutions proposing related party transactions**

4. Pursuant to the second proviso to sub-section (1) of section 188, 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. The Amendment Bill proposes to insert third proviso to sub-section (1) of section 188 which exempts the provision relating to prohibition on voting on the resolution approving related party transaction. Pursuant to the proposed amendment, the prohibition on voting is not applicable on the 'related party' if the company in which 90 per cent or more members, in number, are relatives of promoters or are related parties. The pre-requisites for taking the necessary benefits of the proposed amendments are as follows:

- ▶ Transaction proposed to be entered by a company (private company or public company) with its related party
- ▶ Such transaction is not in the ordinary course of business or not on arms' length basis
- ▶ The transaction value exceeds the prescribed threshold, and therefore requires shareholders' approval
- ▶ 90 per cent or more members (in number and not value) are relatives of promoters or are related parties.

The suggested amendment is in line with the recommendations of the Companies Law Committee Report.

#### *Ratification of related party transactions by Board of directors or shareholders*

5. The Amendment Bill proposes to amend sub-section (3) of section 188 by

substituting words “shall be voidable at the option of the Board or, as the case may be, of the shareholders” for the words “shall be voidable at the option of the Board. According to the proposed amendment, where any contract or arrangement is entered into by director or any other employee, without obtaining the consent of the Board or shareholders’ approval and if the same is not ratified by Board or shareholders at a meeting within 3 months from the date on which such contract or arrangement was entered into, then such contract or arrangement shall be voidable at the option of the Board or shareholders (earlier only, ‘Board’). The sub-section (3) to section 188 further states that if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it. *Vide* the proposed amendment, the contract or arrangement is voidable at the option of the Board of directors or shareholders of the company (earlier, such option was only with the Board of directors).

### Conclusion

5. With the proposed amendments discussed above, it is expected that there would be ease in identifying ‘related parties’ and complying with the provisions of ‘related party transactions’. However, it’s noteworthy that there are no provisions in the Companies Amendment Bill, that aligns with the provisions of the SEBI Listing Regulations. Therefore, the disparity in the provisions of Act and SEBI Listing Regulations will persist.