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## Whether related parties are prohibited to vote on resolution for rescinding material RPT?

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Voting by related parties on related party transactions ('RPTs') has been a controversial issue since Companies Act, 2013 ('the Companies Act') has been introduced. Such prohibition on voting was not there under Companies Act, 1956. This article is an analysis of a case wherein the provisions under the Companies Act and Regulation 23 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('SEBI Listing Regulations') were interpreted with respect to prohibition on voting on resolution for rescinding material RPTs.

#### **Board approval under the Companies Act for RPTs:**

Primarily, the consent of board of directors is required at a board meeting (i.e. not Circular Resolution) for a company to enter into certain transactions with related parties. The prescribed transactions are defined in section [188\(1\)](#) of the Companies Act and related parties are defined in section [2\(76\)](#) of the Companies Act. Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

#### **Shareholders' approval under the Companies Act for RPTs:**

A company shall obtain prior approval of the shareholders by ordinary resolution for entering into contract or arrangement that exceeds prescribed thresholds (as provided in corresponding Rules). According to the Companies Act, member of the company shall not vote on such ordinary resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party. However, such prohibition shall not apply to a company in which 90% or more members, in number, are relatives of promoters or are related parties. Also, the said prohibition is not applicable to private companies.

The requirement of approval of shareholders is not required for the transactions entered into between a holding company and its wholly owned subsidiary (whose accounts are consolidated with such holding company and placed before shareholders at general meeting for approval).

The provisions of section [188](#) of the Companies Act are not applicable to any transactions entered into by the company in its ordinary course of business other than transactions which are not on arm's length basis. The Act has not defined 'ordinary course of business', therefore, this decision is to be taken by the board of directors/Audit Committee. The expression 'transactions on arm's length basis' has been defined to mean a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

#### **Requirement of shareholders' approval under SEBI Listing Regulations:**

According to the extant Regulation 23 of the SEBI Listing Regulations, a transaction with a related party (as defined in Regulation 2(1) (zb) of the SEBI Listing Regulations) shall be considered 'material', if transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds Rs. 1,000 crore or 10% of annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.

A transaction involving payments made to a related party w.r.t. to brand usage or royalty shall be considered 'material' if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceed 5% of annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

### **Voting under SEBI Listing Regulations:**

All material RPT and subsequent material modifications (as defined by the audit committee) shall require prior approval of the shareholders through ordinary resolution. Further, the related party shall not vote to approve such resolutions, whether the entity is a related party to the particular transaction or not.

This article is summary and analysis of the observations of the SEBI, Securities Appellate Tribunal and Supreme Court in the case of R.T. Exports Limited, with respect to the prohibition on voting on resolution for rescinding material RPT.

### **Brief facts of the case:**

The Company – R.T. Exports Limited – proposed to enter into a transaction with Neelkanth Realtors Pvt. Ltd. for purchase of 40,000 sq.ft. of residential space. This proposal was treated as a 'material RPT' in view of clause 49 of the Listing Agreement and, accordingly, such proposal was required to be approved by the shareholders of the company. Accordingly, a special resolution was approved by R.T. Exports Limited on July 15, 2014 in relation to Memorandum of Understanding with Neelkanth Realtors Pvt. Ltd. In terms of Section 188 of the Act, the related parties abstained from voting on the special resolution.

Thereafter, an extra-ordinary general meeting was held on December 16, 2016 for rescinding the resolution. However, in this case, the related party entities voted on the resolution. Prior to voting, the related party entities took opinion from a company law expert (CS Dr. KR Chandratre) who had opined that related party entities could cast their votes in view of the fact that Section 188 of the Companies Act only prescribed that related parties shall not participate in the voting process only for entering into a RPT and not for rescinding a RPT. After written representations and hearing the parties, the SEBI Adjudicating Officer ('SEBI, AO') passed an order<sup>1</sup> and imposed a penalty of Rs. 35 lakhs on the company and its related parties for violating Regulation 23 of SEBI Listing Regulations.

### **SEBI's observations on the voting by related parties for rescinding the RPT:**

Based on a complaint, SEBI took up the matter and issued a notice alleging that the appellants had violated Regulation 23 of the SEBI Listing Regulations. In its order, SEBI, AO made the following observations "*If the arguments of the Noticee were to be accepted the purpose of the obligation under the said regulation would be defeated. It is pertinent to mention that the LODR Regulations were framed keeping in view that the related party transactions may pose potential or actual conflicts of interest and may raise questions whether such transactions are in the larger interest of the company as well as the stakeholders. Such allowance as resorted to by the Noticees would put related parties in position to influence the approval and vote against the resolution on rescinding the contract to ensure the continuation of the related party transaction in their favour. In this case, from the voting pattern noted hereinabove that the Noticees had dominance in voting against the resolution proposed in EGM on December 16, 2016 to rescind the earlier resolution dated July 15, 2014, thereby continuing the earlier resolution involving related party transaction. Had they abstained from voting on the resolution on December 16, 2016, the resolution dated July 15, 2014 could have been rescinded. I, therefore, find that by voting on the*

*resolution dated December 16, 2016 the Noticees have violated the provision of regulations of 23(4) and 2(7) of the LODR Regulations. Considering the facts and circumstance of the case I am of the view that the case deserves the imposition penalty under section 15HB of the SEBI Act."*

The appellants being aggrieved by the said order, filed an appeal with Securities Appellate Tribunal (SAT).

### **SAT's observations on the voting by related parties for rescinding the RPT:**

The short question before SAT<sup>2</sup> was – whether the appellants were justified in voting for rescinding the resolution dated July 15, 2014 in spite of being related party entities?

SAT perused section 188 of the Act and Regulation 23 of the SEBI Listing Regulations and observed that "*Section 188 of the Companies Act as well as Regulation 23 of the LODR does not prohibit related party entities from voting for recalling/rescinding resolution which was passed earlier by the Company. In the absence of any such prohibition it was open to the appellants to participate in the resolution of 16th December, 2016. The bar under Section 188 of the Companies Act and Regulation 23(7) of the LODR Regulations is that no related party can vote to approve any contract or arrangement in which he is a related party. In the light of the aforesaid clear provisions in Section 188 of the Companies Act and Regulation 23 of the LODR Regulations, we find that the appellants did not commit any violation. The AO committed an error in holding that they had violated Regulation 23 of the LODR Regulations."*

### **Supreme Court's observations on the voting by related parties for rescinding the RPT:**

SEBI moved Supreme Court against the order by SAT. After hearing the parties, the Supreme Court<sup>3</sup> observed that "*The view, as taken by the Appellate Tribunal, in the given set of facts and circumstances of the present case, appears to be a plausible view of the matter. In fact, nothing of ill-intent on the part of the respondents has been established in the present case. The hyper-technical stance of the appellant could have only been, and has rightly been, disapproved on the given set of facts and circumstances."*

### **Conclusion:**

Based on the above discussion and observation of Supreme Court, it can be concluded that shareholders can vote on the ordinary resolution for rescinding the material RPT. There are several provisions under the Companies Act and SEBI Listing Regulations which provide for 'approve' and not 'vote for', wherein the Supreme Court observations can be applied.

Irrespective of numerous amendments, there are many provisions relating to RPTs under the Companies Act and SEBI Listing Regulations which completely differ. In relation to the issue in the above case, it is interesting to note that under Companies Act – Member of the company shall not vote on the ordinary resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party. However, under the SEBI Listing Regulations – All material RPTs shall require prior approval of the shareholders through ordinary resolution and the related party shall not vote to approve such resolutions, whether the entity is a related party to the particular transaction or not.

Due to such different compliance requirements for RPTs under the Companies Act and SEBI Listing Regulations, the macro objective of 'avoiding or managing conflict of interest' is not achieved. RPT provisions under SEBI Listing Regulations needs a serious re-look (yet again!).

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1. SEBI Adjudication Order No.: Order/SS/VS/2019-20/4515-4521.
2. *R.T. Agro (P.) Ltd. v. SEBI* [2022] 136 taxmann.com 133/171 SCL 107 (SAT-Mum.)
3. *SEBI v. R.T. Agro (P.) Ltd.* [2022] 137 taxmann.com 496 (SC).