

Related Party Transactions: What is the Role of a Company Secretary?

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A critical test of good corporate governance for a company is how it deals with Related Party Transactions (RPTs). While the Companies Act, 2013 has laid down what should be done, it is the job of the Company Secretary to ensure that it gets done. Conceptually the Companies Act, 2013 identifies four basic aspects in monitoring RPTs and getting it approved:

1. Who is a related party?
2. What is in the ordinary course of business?
3. What is the meaning of arm's length basis?
4. Who should approve the transaction?

Related Party

The term related party is a subjective concept, which varies based on the nature of a company. While the definition of a related party is wide for public companies, the scope narrows when it comes to private companies. For instance, for a private company, holding company, subsidiary company, associate company and subsidiary of holding company to which it is also subsidiary company are not considered as related parties.

Ordinary Course of Business

The Companies Act has not defined the phrase 'ordinary course of business.' Black's Law Dictionary, 8th Edition, defines 'ordinary course of business' as 'the normal routine in managing a trade or business' and terms it as 'regular course of business', 'ordinary course', or 'regular course'. Given this definition, one can say that ordinary course of business means a transaction where the goods and services transacted and the commercial terms and conditions are the same or similar to what the business transacts with its regular customers, vendors and suppliers.

Arm's Length Basis

Explanation (b) to sub-section (1) of Section 188 defines the expression "arms' length transaction" as a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest. However, it is noteworthy that Section 188(1) contemplates 'arm's length basis' and not 'arm's length pricing'. Therefore, if a company is compliant with Domestic Transfer Pricing or International Transfer Pricing provisions (under the Income Tax Act), it may not amount to complete compliance of Section 188, as the concept of 'arm's length basis' is much wider than 'arm's length pricing'.

Approvals:

Pursuant to Section 177, Audit Committee is required to approve the RPTs, including subsequent modification in the RPTs. The Committee may also grant an omnibus approval for the RPTs on annual basis, subject to compliance of certain prescribed conditions. Shareholders' approval by ordinary resolution is required if the value of transaction(s) exceeds the prescribed monetary threshold.

Unlike public companies, where the related party is prevented from voting on RPT resolutions at the Members meeting, all members, including the related parties are eligible to vote on RPT resolution to approve the contract or arrangement which may be entered into by the private company.

Further, Shareholders approval is not required for transactions between a holding company and its 100% subsidiary. In addition, RPTs arising out of compromises, arrangements and amalgamations are dealt under the specific provisions of Companies Act and not under the specific requirements for RPTs.

A Checklist Compliance for RPT provisions:

1. Compile a list of all Related Parties from the declaration made by the Directors to the Board

2. Circulate the list to all function heads who enter into commercial transactions on behalf of the company asking them to check with the Company Secretary before they enter into any transaction with these parties
3. Once a transaction with a related party is identified, check for the following:
 - a. Whether the transaction is in ordinary course of business,
 - b. Whether the transaction is at arm's length basis
4. If the transaction is in the ordinary course of business, is at arm's length basis and within the monetary limits specified in the Rules, no further action.
5. If the transaction is not in the ordinary course of business, or not on arm's length basis or exceeds the monetary limits specified in the Rules, then obtain approvals as required under the Act by
 - a. Including in the Board and Audit Committee's agenda the following information:
 - i. Name of the related party and nature of relationship;
 - ii. Nature, duration of contract and particulars of contract/ arrangement;
 - iii. Material terms of the contract/arrangement including the value if any;
 - iv. Any advance paid/ received for the contract or arrangement, if any;
 - v. Manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of contract;
 - vi. Whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
 - vii. Any other information relevant or important for the Board/ Committee to take a decision on the proposed transaction.
 - viii. Justification for entering into the transaction
- b. Where the company has an Audit Committee check if the transaction is of a routine nature, if yes an omnibus approval of the RPT can be obtained,
 - i. If omnibus approval of Audit Committee is granted, check whether the conditions / factors on which the approval is granted are satisfied ,
- c. If Board approval is required, ensure that the approval is given at the Board meeting and not by circular resolution,
- d. If RPT is beyond the monetary threshold, then the members' approval is required and it is necessary to ensure that in case of public company the member, who is the 'related party' does not vote on the said resolution.