

Comprehending related party transactions under listing agreement

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For the regulation, compliance and disclosure for the related party transaction (RPTs), listed companies are under obligation to comply provisions of the Listing Agreement (amended vide SEBI Circular dated 17th April, 2014 and 15th September, 2014) along with the Companies Act, 2013. The author has elucidated only the provisions of the revised clause 49 of the Listing Agreement for compliance of RPTs and has not dealt with the provisions conflicting with that Act.

“Related party” under clause 49 of Listing Agreement

1. In accordance with the clause 49, ‘related party’ can be a person or entity. Parties (i.e., both, person or entity) are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions. Related Party as a ‘person’ includes the following if that person –

- (a) is a related party under clause (76) of section 2 of the Act, or
- (b) has control or joint control or significant influence over the company, or
- (c) is a key management personnel of the company or of a parent of the company.

Related party as an ‘entity’, if any of the following conditions applies :

- (a) such entity is related party under clause (76) of section 2 of the Act, or
- (b) such entity is related party under the applicable Accounting Standards.

The definition of ‘related entity’ was amended vide SEBI Circular dated 15th September, 2014 and made more comprehensive and practical. In spite of such clarification, the scope of ‘related parties’ under the Listing Agreement is very wide as compared to the list of related parties under the Act.

Meaning of ‘transaction’ under clause 49 of Listing Agreement

2. Transaction means –

- (a) transfer of resources, or
- (b) transfer of services, or
- (c) transfer of obligations

between a listed company and related party. Further the price of such transfer is irrelevant. The price can be nil, nominal value, fair market value, arms length price or an exorbitant price. A ‘transaction’ with related party shall be construed to include single transaction or a group of transactions in a contract.

Basic ingredients for a transaction to qualify as RPT

3. A transaction will qualify as RPT under clause 49 of the Listing Agreement, if all the following four conditions are satisfied:

- (a) it is a listed company,
- (b) enters into any prescribed transaction [as provided in clause 49],
- (c) with prescribed related party [as provided in clause 49],
- (d) and pricing is irrelevant [whether charged or not]

If all these conditions are satisfied, then we need to refer other provisions of clause 49 for further compliance and disclosures. Prescribed transaction under clause 49 means a transaction where there is transfer of resources, services or obligations regardless of whether a price is charged. Compliance of RPT provisions is not contemplated in following situations :

- Listed company enters into transaction with its holding company incorporated in India for rendering some facilities, which do not fall under the prescribed ‘transaction’ as laid down in clause 49. RPTs provisions are not applicable for transactions between two companies for non-prescribed transaction.
- Listed company enters into transaction with a party (which is not a ‘related party’) under clause 49 but falls under prescribed ‘transaction’. Then, such transaction does not contemplate the compliance under clause 49, as not all conditions are satisfied. RPT provisions are not applicable for transactions between two non-prescribed parties.

Transitory RPTs provisions for listed companies

4. SEBI Circular dated 17th April, 2014, states that the provisions of clause 49(VII), Part-B [relating to ‘RPTs’] is applicable to all prospective transactions. All existing material RP contracts or arrangements (as on the date of the circular) which are likely to continue beyond 31st March, 2015 shall be placed for approval of the shareholders in the first general meeting (i.e., annual general meeting or extraordinary general meeting) subsequent to 1st October, 2014. However, the listed company had an option to get such contracts / arrangements approved by the shareholders even before 1st October, 2014.

‘Material’ RPT

5. Under the revised clause 49, the concept of 'material RPT' is introduced, which has certain disclosures and compliances. A transaction with a related party shall be considered 'material' if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10 per cent of the annual consolidated turnover of the company as per the last audited financial statements of the company. The threshold for 'material RPT' were amended vide SEBI Circular dated 15th September, 2014 and made more comprehensive and practical. Earlier threshold was 5 per cent of annual turnover or 20 per cent of net worth of the company as per last audited financial statements, whichever is higher. The listed company is under obligation to formulate Policy on materiality of RPTs and dealing with RPTs. The policy relating to dealing with RPTs shall be disclosed on company's website and in the annual report.

Audit committee's approvals to RPTs

6. Listed companies are under obligation to obtain prior approval of the Audit Committee for all RPTs (whether 'material' RPT or not). Vide SEBI Circular dated 15th September, 2014, the audit committee may now grant omnibus approval for RPTs proposed to be entered into subject to the following conditions :

- Audit committee prescribes the criteria for granting omnibus approval in line with RPTs policy and such approval is applicable for transactions which are repetitive in nature.
- Audit committee shall satisfy itself the need for such omnibus approval and that such approval is in the company's interest.
- Omnibus approval specifies prescribed parameters like (i) name/s of related party, nature of transaction, period of transaction, maximum amount of transaction that can be entered into, (ii) indicative base price/current contracted price and formula for variation in the price if any and (iii) such other conditions as audit committee may deem fit.

SEBI has restricted the audit committee's omnibus approval, where the RPTs cannot be foreseen. SEBI has also prescribed maximum monetary limit for audit committee's omnibus approval i.e., value not exceeding Rs.1 crore per transaction. With respect to audit committee's omnibus approval, the committee shall review such transactions at least on quarterly basis and the omnibus approval shall be valid for period not exceeding one year and thereafter fresh approvals is necessary.

Shareholders and Board approval to RPTs

7. All 'material' RPTs shall require approval of the shareholders through special resolution and the related parties shall abstain from voting on such resolutions. With respect to the approval of Board of directors for the RPTs, there is no mention in the revised clause 49 (in SEBI Circular April and September, 2014). Therefore, such Board approval shall be in accordance with the provisions of the Act.

Exception to RPTs approval

8. Listed companies are not under obligation to obtain prior approval of audit committee and shareholders' approval by special resolution (in case of material RPTs) for the following transactions :

- Transactions entered into between two Government companies
- Transactions entered into between holding company and its wholly-owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Disclosures of RPT

9. Details of all material RPTs shall be disclosed quarterly along with the compliance report on corporate governance. The company shall disclose the policy on dealing with RPTs on its website and a web link thereto shall be provided in the annual report.

Conclusion

10. The SEBI Circular of September 2014 has provided a breather to the listed companies, in simplifying the definitions of 'related parties', 'material transaction' and introducing audit committee's omnibus approval, etc. However, there are some pain-points and practical difficulties in applying the provisions of the related party transactions prescribed under clause 49 of the Listing Agreement. The confusion is further compounded as the listed companies are also required to comply with the Act. Such compliance/non-compliance of these provisions will have repercussions on Board approval, audit committee approval, shareholders approval, statutory audit, secretarial audit, quarterly corporate governance reporting, disclosures in Boards' report, etc.

FOOTNOTES

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