

Minority shareholders can block related-party deals

Corporate law experts welcome change in Companies Act rules, but warn against abuse of power to harass promoters even in genuine cases

RAJESH BHAYANI
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The new Companies Act rules have given a lot of powers to minority shareholders, but the one creating ripples in the corporate sector is that promoters, who are majority shareholders, cannot vote in special resolutions in cases of related-party transactions.

The new rules under Section 188 say any related-party transaction that is not done in the ordinary course of business and is not at an arm's length will need approval of minority shareholders by way of a special resolution. But, shareholders who are related or interested parties in the transaction will not be able to vote in resolutions relating to payment of brand fees or management fees to majority shareholders.

The section further says all related-party approvals will now be scrutinised by audit committees, comprising a majority of independent directors.

Related-party transactions include sale or purchase of goods, services and property, appointment in an office of profit in a company or group company, underwriting subscriptions, etc. The definition of 'related party' has also been widened to include holding companies, subsidiaries and several key managerial persons and



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What are related-party transactions?

- Sale, purchase or supply of goods, or materials
- dealing in properties
- Availing or rendering of any services
- Appointment of any agent for dealing in property, goods and services
- Appointment to any office of profit in the company, its subsidiary or associate company
- Underwriting the subscription of securities or derivatives of a company

How is 'related party' defined?

- A holding, subsidiary, sister or

associate company

- Directors, key management personnel (including relatives)
- Firms/companies where directors/relatives have interests
- Appointments of senior management-level and functional heads

What's the threshold to qualify as related-party transaction?

- If paid-up share capital of a company equals or exceeds ₹1 crore
- If related-party transactions exceed 5% of annual turnover, or 20% of net worth — whichever is higher

What is an office of profit in related-party deals?

- Remuneration exceeding ₹10 lakh

executives, besides relatives of directors. Also, thresholds have been prescribed to determine transactions that will be treated as related-party ones. The transactions are linked with turnover and net worth and appointments to salary levels.

Amit Tandon, managing director of Institutional Investor Advisory Services (IIAS), a proxy shareholder advisory firm, says the new provisions strengthen the hands of minority share-

holders and will improve corporate governance.

Earlier, in select cases, the Centre's approval was necessary for special resolutions relating to appointment of directors and key managerial personnel.

Yogesh Sharma, partner (Assurance), Grant Thornton India, says: "Under the previous Companies Act, minority shareholders' approval or consent was not necessary for entering into related-party transactions. As a

result, a majority of shareholders could go for transactions with themselves or related parties as they deemed appropriate." There will now be the much-needed checks and balances to protect minority shareholders, especially in companies where promoters continue to hold a majority of shares and even subsidiaries of multinational companies where the foreign parent holds a majority of shares.

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But there is a flip side, too. Many experts say the rules could open the doors to many minority shareholders "greenmailing" promoters for supporting or not supporting certain decisions. Tandon says "in many companies, smaller shareholders might greenmail promoters by asking for some favours or contracts against securing their votes in favour of the promoter when a special resolution comes up for voting."

Grant Thornton India's Sharma gives an example of other possible difficulties in implementing the rules. "In the case of

a wholly-owned subsidiary, the rules provide that a special resolution passed by the parent entity is enough for entering into transactions between the parent entity and the wholly-owned subsidiary. However, it is not clear by whom and how the transactions of such wholly-owned subsidiaries with say, a sister concern or an associate, will be approved."

Similarly, there might be cases of subsidiaries where a 99 per cent stake is owned by the single parent company. Even in such cases, the parent would not be able to approve the transactions and have to

depend on minority shareholders, who together own only one per cent shares.

Sai Venkateshwaran, partner & head (Accounting Advisory Services), KPMG India, says the changes in the Act are supportive of small shareholders but these could lead to abuse. "It could also lead to situations where majority shareholders find themselves unable to undertake genuine business transactions for want of minority shareholders' approval, even if the terms are reasonable. This could potentially cause hardship and disrupt business transactions."