Government asks Sebi to tweak rules on related party transactions to make it at par with Companies Act 2013

TOUGH TIMES Market participants to appeal to Sebi against relaxing its stand on protecting minority shareholders

The Securities and Exchange Board of India (Sebi) may find itself on a tricky terrain over the government's nudge to change rules on related party transactions in corporates.

In a move towards promoting ease of doing business, the ministry of corporate affairs (MCA) has asked the regulator to tweak rules to make them at par with those under the Companies Act 2013. This has raised concerns among market participants about a dilution in Sebi's stand on protection of minority shareholders. Experts and shareholder advisory firms, which believe Sebi should hold its ground on the issue, will soon take up the matter with the regulator.The MCA changed its stand on related party transactions in 2014, when it lowered the threshold for minority shareholder votes for listed companies from 75% to 50% for passing resolutions. It also allowed voting by `related parties' while barring only interested parties'.

“MCA's goal is to improve the ease of doing business while Sebi is for protecting investors. Therefore, while MCA can dilute its stance on related party transactions, Sebi will be better served in not doing so,“ said a report by IiAS, a proxy advisory firm. “Preventing interested parties, but allowing related parties to vote takes away all meaning. Most promoters hold stake through a series of entities (companies, trusts, and partnerships) that is spread across a catalogue of family members. Thus, with the amendment of the Companies Act 2013, the family and promoter entities not directly involved in the transaction can vote on it since they may not be interested parties. This cuts the power of minority shareholders at the knees. Promoters will likely manipulate their holding structure to get their way and minority shareholders may be unable to block unfair transactions,“ said IiAS.

Most of the times there is ambiguity regarding the kind of transactions that would be put to vote. The Companies Act 2013 states that transactions in the ordinary course of business that are done at an arm's length does not require any shareholder approval. But, how do companies define `ordinary course of businesses is a question that experts are now raising. The new Companies Act neither provides a definition nor does it give any framework for defining transaction that can be kept at an arm's length.

“Jurisprudence shows that Sebi can set higher standards for listed companies. Therefore, the regulator should not dilute its stand as it would be a loss for minority shareholders,“ said Sandeep Parekh, founder, Finsec Law Advisors. “A dichotomy does not seem to exist between related party and interested party . Any kind of related party is interest party in most transactions. Hence, there should be no debate on this.“ An IiAS study showed that only 9 out of the top 30 S&P BSE Sensex companies had attempted to define ordinary course of business with regard to related party transactions. Sebi's method for defining related party transactions that may come for vote is much clear: all transactions that account for more than 10% of company's turnover need to be put to vote.

Few companies have designed long flow charts to help their internal teams and board members decide if a transaction needs board or shareholder approval. Such complexity is unnecessary and an alignment of regulations is imperative -in the interest of minority shareholders. “In the interest of minority shareholders, the Companies Act 2013 needs to align itself to SEBI's Clause 49 requirements for listed companies,“ said the IiAS report.

According to Tejesh Chitlangi, Partner at IC Legal, “There are precedents wherein Sebi has aligned its provisions with the new Companies Act -for instance, permitting the pre-emptive rights in shareholders agreements in line with the new companies' law provisions. Since any conflicting provisions cause uncertainty and practical difficulties, the same need to be harmonised. Sebi laws are likely to be more weighed towards investors, but the same may not continue to be conflicting with any company law provisions and hence should be appropriately modified to the extent warranted.“

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