



# INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS

Open Access, Refereed Journal Multi Disciplinary  
Peer Reviewed Edition :

[www.ijlra.com](http://www.ijlra.com)

## **DISCLAIMER**

No part of this publication may be reproduced or copied in any form by any means without prior written permission of Managing Editor of IJLRA. The views expressed in this publication are purely personal opinions of the authors and do not reflect the views of the Editorial Team of IJLRA.

Though every effort has been made to ensure that the information in Volume 2 Issue 7 is accurate and appropriately cited/referenced, neither the Editorial Board nor IJLRA shall be held liable or responsible in any manner whatsoever for any consequences for any action taken by anyone on the basis of information in the Journal.

Copyright © International Journal for Legal Research & Analysis

IJLRA

## **EDITORIAL TEAM**

### **EDITORS**



### **Megha Middha**

*Megha Middha, Assistant Professor of Law in Mody University of Science and Technology, Lakshmangarh, Sikar*

*Megha Middha, is working as an Assistant Professor of Law in Mody University of Science and Technology, Lakshmangarh, Sikar (Rajasthan). She has an experience in the teaching of almost 3 years. She has completed her graduation in BBA LL.B (H) from Amity University, Rajasthan (Gold Medalist) and did her post-graduation (LL.M in Business Laws) from NLSIU, Bengaluru. Currently, she is enrolled in a Ph.D. course in the Department of Law at Mohanlal Sukhadia University, Udaipur (Rajasthan). She wishes to excel in academics and research and contribute as much as she can to society. Through her interactions with the students, she tries to inculcate a sense of deep thinking power in her students and enlighten and guide them to the fact how they can bring a change to the society*

### **Dr. Samrat Datta**

*Dr. Samrat Datta Seedling School of Law and Governance, Jaipur National University, Jaipur. Dr. Samrat Datta is currently associated with Seedling School of Law and Governance, Jaipur National University, Jaipur. Dr. Datta has completed his graduation i.e., B.A.LL.B. from Law College Dehradun, Hemvati Nandan Bahuguna Garhwal University, Srinagar, Uttarakhand. He is an alumnus of KIIT University, Bhubaneswar where he pursued his post-graduation (LL.M.) in Criminal Law and subsequently completed his Ph.D. in Police Law and Information Technology from the Pacific Academy of Higher Education and Research University, Udaipur in 2020. His area of interest and research is Criminal and Police Law. Dr. Datta has a teaching experience of 7 years in various law schools across North India and has held administrative positions like Academic Coordinator, Centre Superintendent for Examinations, Deputy Controller of Examinations, Member of the Proctorial Board*



## **Dr. Namita Jain**



*Head & Associate Professor*

*School of Law, JECRC University, Jaipur Ph.D. (Commercial Law) LL.M., UGC -NET Post Graduation Diploma in Taxation law and Practice, Bachelor of Commerce.*

*Teaching Experience: 12 years, AWARDS AND RECOGNITION of Dr. Namita Jain are - ICF Global Excellence Award 2020 in the category of educationalist by I Can Foundation, India. India Women Empowerment Award in the category of "Emerging Excellence in Academics by Prime Time & Utkrisht Bharat Foundation, New Delhi.(2020). Conferred in FL Book of Top 21 Record Holders in the category of education by Fashion Lifestyle Magazine, New Delhi. (2020). Certificate of Appreciation for organizing and managing the Professional Development Training Program on IPR in Collaboration with Trade Innovations Services, Jaipur on March 14th, 2019*

## **Mrs.S.Kalpana**

*Assistant professor of Law*

*Mrs.S.Kalpana, presently Assistant professor of Law, VelTech Rangarajan Dr. Sagunthala R & D Institute of Science and Technology, Avadi. Formerly Assistant professor of Law, Vels University in the year 2019 to 2020, Worked as Guest Faculty, Chennai Dr. Ambedkar Law College, Pudupakkam. Published one book. Published 8 Articles in various reputed Law Journals. Conducted 1 Moot court competition and participated in nearly 80 National and International seminars and webinars conducted on various subjects of Law. Did ML in Criminal Law and Criminal Justice Administration. 10 paper presentations in various National and International seminars. Attended more than 10 FDP programs. Ph.D. in Law pursuing.*



## **Avinash Kumar**



*Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC - NET examination and has been awarded ICSSR - Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and*

*learning.*

## **ABOUT US**

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS

ISSN

2582-6433 is an Online Journal is Monthly, Peer Review, Academic Journal, Published online, that seeks to provide an interactive platform for the publication of Short Articles, Long Articles, Book Review, Case Comments, Research Papers, Essay in the field of Law & Multidisciplinary issue. Our aim is to upgrade the level of interaction and discourse about contemporary issues of law. We are eager to become a highly cited academic publication, through quality contributions from students, academics, professionals from the industry, the bar and the bench. INTERNATIONAL JOURNAL FOR LEGAL RESEARCH & ANALYSIS ISSN 2582-6433 welcomes contributions from all legal branches, as long as the work is original, unpublished and is in consonance with the submission guidelines.

# **ABUSIVE RELATED PARTY TRANSACTIONS: SAFEGUARDING THE INTERESTS OF SHAREHOLDERS THROUGH STRENGTHENED CORPORATE GOVERNANCE**

AUTHORED BY - DIVYAM KANDHARI

The directors or the key managerial personnel have a fiduciary relationship towards their company and are supposed to take decisions that benefit the company rather than to pursue their own individual needs and interests. The directors must prioritize the company's interest by avoiding any conflict of interest that may arise in the due course of the functioning of the company and take all decisions in good faith, trust and with loyalty towards the company. The position of power of the top level should not be used by them to their personal advantage like entering into business with a company where the MD is their relative. Section 2(76) of the companies act defines related party as a director or any key managerial personnel or their relative or if they or their relatives hold position in any other company to be a related party.<sup>1</sup> Section 188 of the Companies Act 2013 defines related party transactions (hereinafter referred to as RPT) as; except with the permission of the board, a company cannot enter into business with a related party to sell, purchase, supply goods or services or to carry out any other business like lease or underwriting subscription or any sort of business directly or indirectly. Furthermore these members must not vote or be involved in any decision making if the board gives approval to get in business with a related party.<sup>2</sup> Related party transactions are those transactions wherein companies indulge in business with other companies where they have pre-existing professional and personal network. These transactions usually become quite detrimental to the interests of the company and the shareholders since they tend to cater to the individual interests of a person who enters into such transactions rather than catering to the interests of the company.<sup>3</sup> Abusive RPTs are a significant concern for many nations, including India. Such deals can be dangerous to both regulatory authorities and investors because they involve one party exerting influence or control over the other, whether through direct or indirect means. When these transactions occur, public

---

<sup>1</sup> Companies Act, 2013, Section 2

<sup>2</sup> Companies Act, 2013, Section 188

<sup>3</sup> What is related party transactions - understand related party regulation, GROWW (2022), <https://groww.in/blog/all-about-related-party-transactions> (last visited Apr 7, 2023).

confidence can erode, and the economic growth of companies involved in equity markets can suffer.<sup>4</sup> And so to prevent these transactions, several provisions in the Companies Act, AS 18, SEBI LODR and similar provisions have been adopted by the government. Despite the extensive rules and regulations laid down, the efforts to prevent abusive RPTs has failed and in this paper we are going to look at how RPTs are misused.

The misuse of RPTs creates a conflict of interest between the majority shareholders or promoter group and minority investors. If the company generates profits, the majority shareholders or promoters are required to share them with minority investors. However, if the promoter group can divert resources to themselves or another firm within the group where they have a larger stake, they can capture a greater portion of the company's profits. Self-dealing transactions are one of the most common methods used to divert resources, wherein value is shifted from one firm within the promoter group to another.<sup>5</sup> While it is compulsory to reveal the significant facts of the RPT, these transactions are usually clubbed under a vague and broad head like "Associates" or "Joint Ventures" and "Key Managerial Personnel's Controlled Entities". In 2020, PWC, the statutory auditor of Eveready Industries, resigned due to a "Basis of Disclaimer of Opinion." According to the auditor, the company had extended inter-corporate deposits totalling 230.8 crore INR, provided corporate guarantees amounting to an estimated 283.1 crore INR, and extended a credit of 62 crore INR to another company. However, the details of the deed were not disclosed, and no claims were made for the refund of the advanced amount. The audit committee did not receive enough evidence to account for these actions, which made it impossible to estimate the company's true financial standing and its future impact. Further investigation revealed that the "notes to accounts" of the audited reports showed that several loans had not been repaid, and the promoter directors had guaranteed the default. This is a clear case of the abuse of related party transactions.<sup>6</sup> Furthermore, the justifications to these dubious transactions are not provided and this undermines the faith and confidence of the minor shareholders. These investors are still in the dark about the company's investments since not enough information is revealed to them in the annual report. It is challenging to decide whether to authorise such RPTs because there aren't any

---

<sup>4</sup> Letishiya Chaturvedi & Poorna Dixit, RELATED PARTY TRANSACTIONS AND CORPORATE GOVERNANCE IN INDIA SCC BLOG (2021), <https://www.sconline.com/blog/post/2021/11/02/related-party-transactions/> (last visited Apr 7, 2023).

<sup>5</sup> Ami Galani & Nathan Rehn, *Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, 22 NATIONAL LAW SCHOOL OF INDIA REVIEW 29–57 (2010).

<sup>6</sup> Sharad Dubey, PWC RESIGNS AS STATUTORY AUDITOR FOR EVEREADY BQ PRIME (2019), <https://www.bqprime.com/business/pwc-resigns-as-statutory-auditor-for-eveready> (last visited Apr 9, 2023).

similar alternatives. This evasion of compliance is also facilitated by the Audit Committees. Mostly, the risks of RPTs are not communicated, primarily due to the ill-framed and vague statements deliberately made to avoid providing justifications of the dubious transactions, which then deceives the voting results. The reason for the same is that there is no prescribed format that has been provided for reporting of RPTs and thus no proper accountability mechanism is there to keep a check.<sup>7</sup>

Another way in which the RPTs are misused is when companies enter into RPTs through subsidiaries. According to section 184 of the Companies Act deals with the disclosure of interests by the directors. If any director has any interest in another company, he/she must disclose it to the board.<sup>8</sup> In order to circumvent this provision, directors use the subsidiaries to indirectly enter into RPTs. This way the director is not directly into business with the related party but still fulfils his interest. Many a times the directors go to an extent of forming a new sham company just for the purpose of entering into RPTs, wherein the company has no business and the directors/members are their own family members or people who are under their direct control. An example of this is; when investing over 24 crores in Mexia Resources Ltd., Assam Co. India Ltd. (ACIL) neglected to produce the necessary certificates and its correct accounts. Duncan Macneill Power India Ltd., an ACIL subsidiary was the only one to disclose investments which was done through compulsorily convertible preference shares. As a result, the company's financial standing was forged, which led to investors being misled.<sup>9</sup>

*The Satyam Computer Services scandal has been well-documented and illustrates some of the dangers associated with Related Party Transactions (RPTs). On December 16, 2008, Satyam's board of directors approved the purchase of Maytas Properties and Maytas Infrastructure for \$1.3 billion and \$300 million, respectively. These two entities were linked to B. Ramalinga Raju, Satyam's founder, chairman, and CEO. Due to concerns about the valuation of the companies, the timing and method of payment, as well as objections raised by independent directors, investors began to scrutinize Satyam more closely, resulting in the cancellation of the proposed*

---

<sup>7</sup> Letishiya Chaturvedi & Poorna Dixit, RELATED PARTY TRANSACTIONS AND CORPORATE GOVERNANCE IN INDIA SCC BLOG (2021), <https://www.sconline.com/blog/post/2021/11/02/related-party-transactions/> (last visited Apr 7, 2023).

<sup>8</sup> Companies Act, 2013, Section 184

<sup>9</sup> Letishiya Chaturvedi & Poorna Dixit, RELATED PARTY TRANSACTIONS AND CORPORATE GOVERNANCE IN INDIA SCC BLOG (2021), <https://www.sconline.com/blog/post/2021/11/02/related-party-transactions/> (last visited Apr 7, 2023).

*acquisition deals.* Following the revelation of a \$1 billion accounting fraud by Satyam's former chairman and CEO Raju on January 7, 2009, four independent directors resigned. Although abusive related party transactions were not necessarily the main cause of the fraud, the terms and conditions of these transactions brought Satyam into the spotlight and ultimately led to the discovery of the accounting fraud. The existence of an abusive RPT may not always be the direct cause of such fraud, but it can draw attention to the company's financial records, aiding regulators and investors in identifying other inappropriate activities.<sup>10</sup>

Now talking about some of the suggestions which must take place, the Board is accountable for recognizing and sanctioning RPTs, but there are situations where the Board hastily approves such transactions without conducting the necessary due diligence. Furthermore, "ordinary transactions" conducted at an "arm's length basis" do not require approval, making it challenging to differentiate between related and unrelated transactions. To ensure the interests of investors, all transactions should be reviewed and approved by the independent Audit Committee. To ascertain "unrelated transactions", it is essential to establish criteria that define the term "arm's length" and include specific parameters under Section 188 of the Act. One proposed solution is to expand the definition of 'RPT' in Regulation 2(1)(zc) to cover transactions at the subsidiary level, in order to ensure proper oversight. However, legitimate business transactions between holding, subsidiary, and associate companies within a large business conglomerate that are conducted at arm's length and in the normal course of business should still require approval from the audit committee. The definition of RPT under Regulation 2(1)(zc) should also include a more comprehensive list of legitimate business transactions that are part of the normal course of business activities of listed entities. This list should include transactions subject to other provisions of the Act and LODR, such as schemes of arrangements for mergers, demergers, and corporate restructuring that have specific regulatory requirements. *Thirdly, the previous threshold for determining the materiality of RPTs was too lenient, as it allowed most RPTs to go unnoticed by shareholders.* The imposition of an absolute monetary limit of INR 1000 crore for related party transactions lacks logical reasoning and could face constitutional challenges under Articles 14 and 19(1)(g) of the Indian Constitution. This is because it is being imposed on all listed companies, regardless of their size and business nature. A more feasible approach could be to use a materiality threshold under Regulation 23(1) that takes into account the company's annual

---

<sup>10</sup> Guide on Fighting Abusive Party Transactions in Asia, ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (2009), <https://www.oecd.org/daf/ca/corporategovernanceprinciples/43626507.pdf> (last visited Apr 7, 2023).

consolidated turnover or net assets. For instance, a lower threshold of 5% of annual consolidated turnover or 5% of net assets could be considered for investment companies. *Next*, there is a requirement for a standard reporting format for RPTs. To ensure transparency, all details of related party transactions must be disclosed, including reasons why certain high-value transactions could not be completed with unrelated entities. Prior to approval, an independent financial advisor should provide a fair opinion, which should also be included in the annual report. To protect the interests of minority investors, the establishment of proxy advisory firms to monitor transactions and keep shareholders informed is recommended. And lastly, SEBI has granted exemptions to certain corporate actions offered uniformly to all shareholders by the listed entity from the RPT definition. This exemption includes actions such as rights issue, buyback, and dividend. However, the use of the phrase "by the listed entity" has led to uncertainty regarding whether corporate actions undertaken by subsidiaries of the listed entity are also exempted. By listing only specific corporate actions that are exempted, there is confusion over other corporate actions that fall under strict regulation according to the Act. Such actions will now require prior approval from shareholders as per the LODR. This vagueness must be rectified and the definition of RPT must clearly specify these exemptions. The listed entity uncertainty must also be cleared so as to prevent misuse of RPTs by the subsidiaries.<sup>11</sup>

*India has made notable strides to safeguard shareholders; however, a significant gap persists between the legal framework and its implementation. It is crucial to take steps to enhance the state of corporate governance, particularly concerning abusive RPTs. These transactions, which are at the discretion of the Board and may involve entities related to top management, can lead to attempts to conceal information and evade disclosures. Thus, strict measures are necessary to balance needed RPTs and protect the interests of innocent shareholders. These measures should prioritize transparency and accountability in corporate actions, effective reporting and disclosure mechanisms, and bolstering the role of independent auditors and regulators. This will ensure that RPTs are conducted ethically and equitably, benefiting both the company and its shareholders.*

---

<sup>11</sup> Varun Kannan & Bharat Vasani, RPT REGULATIONS – SOME SUGGESTIONS FOR SEBI'S CONSIDERATION INDIA CORPORATE LAW (2022), <https://corporate.cyrilamarchandblogs.com/2022/07/rpt-regulations-some-suggestions-for-sebis-consideration/> (last visited Apr 8, 2023).