RELATED PARTY TRANSACTIONS: TRANSPARENCY OR TROUBLE?

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INTRODUCTION [1]:

It started as a routine board meeting in a family-owned company. The agenda looked ordinary approval of a new office lease, vendor payments, and quarterly financials. But one proposal caught the attention of an independent director: the company planned to lease a property owned by the CEO's brother at a price significantly higher than the market rate. What seemed like a harmless internal arrangement soon sparked tough questions from auditors and shareholders alike. Was the deal truly in the company's best interest, or was it benefiting someone behind the scenes?

This is the reality of 'Related Party Transactions (RPTs)' business dealings that often occur quietly within connected entities, family businesses, or corporate groups. While many such transactions are perfectly legitimate and even necessary for smooth operations, they can easily blur the line between strategic business decisions and conflicts of interest. In an era where corporate transparency and accountability are under constant scrutiny, understanding the risks, regulations, and governance surrounding RPTs has become more important than ever. This article examines the legal definition and regulatory framework of RPTs under Indian law primarily the Companies Act, 2013.

[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.

DEFINITION AND SCOPE OF RELATED PARTY TRANSACTIONS

1. Relevant definitions under the Companies Act, 2013[2]

Companies Act recognises that transactions between connected persons or entities carry an inherent risk of conflict of interest and therefore require enhanced scrutiny, disclosure and procedural safeguards. The concept of a "related party" has been broadly defined to capture relationships capable of influencing corporate decision-making or enabling diversion of corporate resources.

A)Definition of Related Party

Section 2(76) of the Companies Act, 2013 defines a "related party" with reference to a company and includes a wide range of individuals and entities connected directly or indirectly with the management or control of the company. The provision covers:

- a director or his/her relative;
- key managerial personnel (KMP) or his/her relative;
- a firm in which a director, manager, or their relative is a partner;
- a private company in which a director, manager, or their relative is a member or director;
- a public company in which a director or manager is a director and, together with relatives, holds more than 2% of its paid-up share capital;
- any body corporate whose Board of Directors, managing director, or manager is accustomed to act in accordance with the advice, directions, or instructions of a director or manager of the company;
- any person on whose advice, directions, or instructions a director or manager is accustomed to act, excluding advice given in a professional capacity;

[2] https://www.indiacode.nic.in/bitstream/123456789/2114/5/A2013-18.pdf

- any body corporate that is, a holding, subsidiary, or associate company of the company; a subsidiary of a common holding company (fellow subsidiary); or an investing company or venturer of the company; and
- such other persons as may be prescribed under the law.

The definition reflects the legislature's intention to adopt a substance-over-form approach. Rather than limiting scrutiny to transactions involving direct ownership, the Act extends its reach to relationships involving influence, control, familial proximity, and managerial dominance.

Consequently, even where no formal ownership link exists, a transaction may still qualify as an RPT if the surrounding circumstances demonstrate the possibility of undue influence or conflict of interest. The inclusion of "relatives" within the statutory framework is particularly significant in the Indian corporate context, where many enterprises are family controlled.

B) Definition of Relative

Under Section 2(77) read with Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014, the term "relative" includes members of a Hindu Undivided Family, spouses, parents, children, siblings, and certain other lineal relations. By extending the definition to close family relationships, the law seeks to prevent promoters and directors from circumventing corporate governance norms through indirect dealings routed via family members or controlled entities.

2.RELEVANT PROVISIONS:

Under Section 177, every related party transaction must first receive the approval of the Audit Committee, which is required to consist primarily of independent directors. The Audit Committee acts as the first level of scrutiny and examines whether the proposed transaction is fair, commercially justified, and in the best interests of the company. The Audit Committee may also grant omnibus approval for repetitive transactions subject to prescribed conditions under the Companies (Meetings of Board and its Powers) Rules, 2014. Such approval is generally permitted only where the transactions are routine in nature and adequate details regarding pricing, value, and duration are available.

Section 188 governs related party transactions and applies to the following categories of transactions:

- sale, purchase, or supply of goods or materials;
- selling or otherwise disposing of or buying, property of any kind;
- leasing of property of any kind;
- availing or rendering of services;
- appointment of agents for purchase or sale of goods, materials, services, or property;
- appointment of a related party to any office or place of profit in the company, its subsidiary, or associate company; and
- underwriting the subscription of securities or derivatives of the company.

The provision further provides that:
a)transactions conducted in the "ordinary course of business" and those undertaken on an "arm's length basis." Transactions satisfying both conditions are exempt from shareholder approval requirements;

a)prior approval of the Board of Directors for such transactions. The interested director is prohibited from participating in the discussion or voting process, thereby reinforcing the principle that fiduciaries must avoid situations involving personal interest and corporate duty.

c)where a related party transaction is entered into by a director or employee without obtaining the consent of the Board or approval of shareholders and such transaction is not subsequently ratified by the Board or shareholders within three months, the contract or arrangement becomes voidable at the option of the company. This means that the company retains the legal authority to rescind or avoid the transaction if it is found to be prejudicial to its interests.

In certain prescribed cases particularly where the transaction exceeds thresholds specified under Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 shareholder approval through an ordinary resolution is also required.

3.ARMS LENGTH TRANSACTION

The concept of an arm's length transaction refers to a transaction conducted as though the parties were unrelated, ensuring that commercial terms are fair, reasonable and comparable to prevailing market conditions. This principle seeks to ensure that related parties do not derive undue advantage merely because of their relationship with the company.

However, determining whether a transaction genuinely satisfies the arm's length standard is often complex in practice. This has made judicial interpretation and regulatory oversight crucial in assessing the legitimacy of RPTs.

- Section 134, the Board's Report must disclose particulars of contracts or arrangements with related parties in the prescribed form.
- Section 189 requires companies to maintain a register of contracts and arrangements in which directors are interested. These disclosure mechanisms are intended to facilitate informed decision-making by shareholders, auditors, and regulators while discouraging concealment of conflicted transactions.

Furthermore, where the transaction involves a related party connected to a director, or is otherwise authorised by a director, the concerned director may be required to indemnify the company against any loss incurred as a result of such transaction.

The provision thus reinforces the fiduciary duties of directors by imposing personal accountability for unauthorised or conflicted dealings.

4.Additional Provisions for Listed Companies

For listed companies, the regulatory framework is further strengthened through the Securities and Exchange Board of India (SEBI) and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Thus, the statutory framework governing RPTs under Indian law seeks to balance commercial flexibility with corporate accountability. While the law acknowledges that transactions between related entities are often commercially unavoidable, it simultaneously recognises their potential misuse as instruments of self-dealing, tunnelling, and oppression of minority shareholders.

5.ILLUSTRATION

A. Company A Ltd. sells a product in the market for Rs. 400 per unit and it also sells the same to its associate company B Ltd. for Rs. 400 per unit and on the same terms of contract as with other parties. Here, the price charged from the associate company and others is the same and the transaction between A Ltd. and B Ltd. is governed by market forces and, therefore, is on arm's length basis.

B. Company A purchases raw materials worth Rs. 50 Lakh from Company B, which is owned by the spouse of a director of Company A. Since there is a family relationship between the director and the owner of Company B, both entities qualify as related parties under the Companies Act, 2013, and the transaction constitutes a Related Party Transaction (RPT). Accordingly, under Section 177 read with Section 188 of the Companies Act, 2013, such a transaction requires appropriate corporate approvals and must be conducted on an arm's length basis to ensure that it is not influenced by conflicts of interest.

6. ENFORCEMENT CHALLENGES AND REGULATORY GAPS

A. Omnibus Approvals and Their Misuse

The mechanism of omnibus approval was introduced to reduce transactional friction in recurring related party transactions (RPTs). However, in practice, it has often evolved into a form of blanket approval for broad categories of transactions without adequate specificity or scrutiny. Audit Committees, under Section 177(4)(iv) of the Companies Act, 2013, are required to approve and monitor related party transactions to ensure proper oversight. Despite this mandate, omnibus approvals are frequently granted in a manner that covers virtually all inter-group transactions, thereby diluting the intended transaction-wise review and defeating the purpose of individuated examination envisaged under the law.

B. Minority Shareholder Remedies

While Sections 241 and 242 of the Companies Act, 2013 provide minority shareholders with the right to petition the National Company Law Tribunal (NCLT) for relief against oppression and mismanagement, including oppressive RPTs the cost and complexity of tribunal proceedings has limited their practical utility. The threshold requirement of holding at least ten percent of the issued share capital (for companies having share capital) further restricts access to relief.

7.CONCLUSION

Related Party Transactions represent one of the most consequential and contested domains of corporate law. The tension between commercial utility and the risk of abuse has driven successive rounds of legislative reform in India and internationally, with each cycle seeking to address governance failures exposed through corporate scandals and regulatory gaps. India's regulatory framework is designed to ensure transparency and reduce the scope for conflicted decision-making in corporate transactions.

However, the effectiveness of this framework ultimately depends on consistent enforcement and meaningful institutional vigilance. While gaps in implementation and oversight persist, continued regulatory refinement and stronger compliance culture remain central to strengthening corporate governance in this area.

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