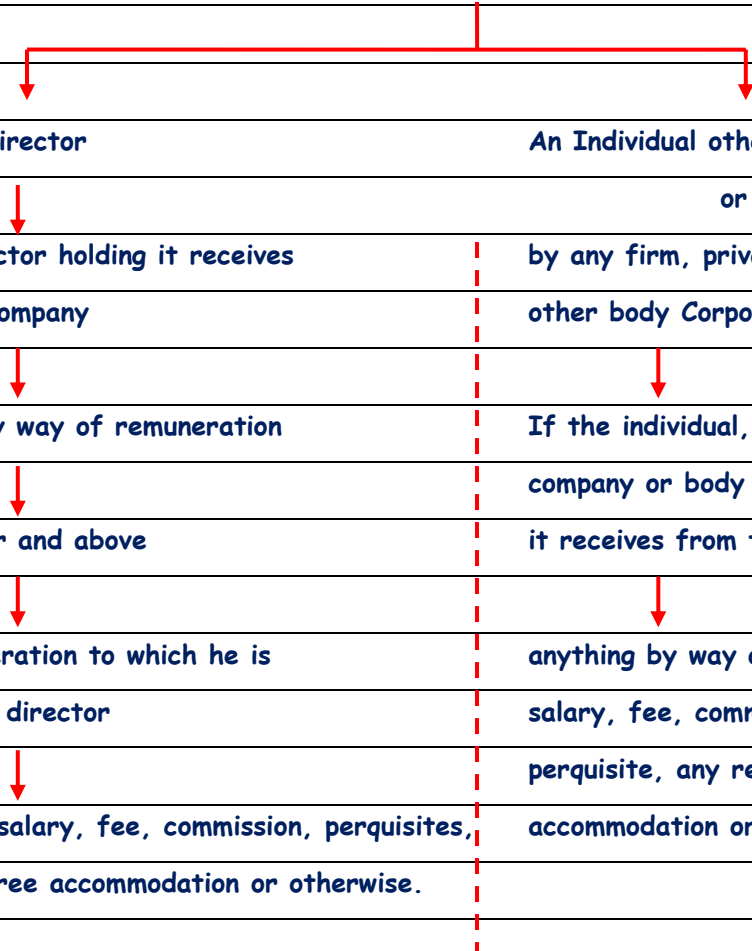


**Lecture -  
12**

# Chapter - 2 "Meetings of the Board and its Powers"

XV	<u>Related Party transactions: Sec. 188</u>			
	Sec. 188(1) + Rule 15	First proviso to	Special Cases	Other provisions
	(Requirement of Board	Sec. 188(1) + Rule 15	2 <sup>nd</sup> , 3 <sup>rd</sup> , 4 <sup>th</sup>	Sec. 188(2)
	Resolution and Nature	(Requirement of OR	and 5 <sup>th</sup> Proviso	Sec. 188(3)
	of RP transactions)	and specific limits)		Sec. 188(4)
				Sec. 188(5)
	<u>Sec. 188(1): Requirement of Board Resolution and Nature of RP transactions</u>			
	Except with the consent of BOD given by a resolution at a meeting of Board			
	and			
	subject to such conditions as may be prescribed (Rule 15)			
	↓ No			
	company shall enter into any contract or arrangement with related party w.r.t.			
	(a) Sale, Purchase or Supply of any goods or materials	(b) Selling or otherwise disposing of, or buying property of any kind	(f) appointment to any office or place of Profit in the - Company - Subsidiary - Associate	(g) underwriting of any securities or derivative
	(d) availing or rendering of any services	(c) Leasing of property any kind		
	(e) appointment of any agent for purchase or sale of goods, materials, services or property			

<b><u>Meaning of office or place of profit:</u></b>	
Any office or place where such office or place is held by	
	
<b>A director</b>	<b>An Individual other than director</b>
↓	or
if the director holding it receives	by any firm, private company or
from the company	other body Corporate
↓	↓
anything by way of remuneration	If the individual, firm, private
↓	company or body corporate holding
over and above	it receives from the company
↓	↓
the remuneration to which he is	anything by way of remuneration,
entitled as director	salary, fee, commission,
↓	perquisite, any rent-free
by way of salary, fee, commission, perquisites,	accommodation or otherwise.
any rent-free accommodation or otherwise.	

<b><u>Conditions prescribed by Rule 15:</u></b>	
A company shall enter into any contract or arrangement with a related party subject to following conditions:	
(i)	Agenda of Board meeting at which the resolution is proposed to be moved shall disclose below mentioned particulars:
	(a) Name of related Party and Nature of relationship
	(b) Nature, duration and particulars of the contract or arrangement.
	(c) Material terms of the contract or arrangement including the value, if any.
	(d) Manner of determining the pricing and other commercial terms.
	(e) Consideration of all factors relevant to the contract.
	(f) Any other information relevant or important for the Board.

	(ii) Where any director is interested in any contract or arrangement with a RP, such director shall not be present at the meeting during discussions on the subject matter of the resolution to such contract or arrangement.
	<b><u>First proviso to Sec. 188(1) and Rule 15:</u></b>
	Prior approval of company by a resolution shall be required to enter into a transaction:
	(a) as contract or arrangements w.r.t. clauses (a) to (e) of Sec. 188 (1), with criteria as mentioned below:
	(i) sale, purchase or supply of any goods or materials, directly or through appointment of agent amounting to $\geq 10\%$ of Turnover*
	(ii) Selling or otherwise disposing of or buying property of any kind directly or through appointment of agent amounting to $\geq 10\%$ of Net Worth*
	(iii) Leasing of property of any kind amounting to $\geq 10\%$ of Turnover*
	(iv) availing or rendering of any service, directly or through appointment of agent, amounting to $\geq 10\%$ of Turnover*
	(b) for appointment to any office or place of profit in company, its subsidiary or associate at a monthly remuneration $> 2.50$ Lac p.m.
	(c) for remuneration for underwriting of securities of the company $> 1\%$ of Net Worth*
	<b>*On basis of audited F.S. of preceding financial year</b>

Examples:

S. No.	Contracting party	Nature of transaction	BR u/s 188(1)	OR Under 1 <sup>st</sup> proviso	Remarks
(i)	Relative of director	Sale of Goods: ₹5 lac (T/O of company - ₹1 Cr.)	Required	Not Required	Refer limits (Rule 15)
(ii)	Subsidiary Company	Sale of Goods - ₹5 Cr. (T/o of Holding) - ₹60 Cr. (T/o of Subsidiary)-₹40 Cr.	Required (H) Required (S)	Not Required (H) Required (S)	Refer limits (Rule 15)
(iii)	Relative of director	Sale of Goods - ₹15 Cr. Further Sale - ₹5 Cr. (T/o of Co. - ₹170 Cr.)	Required Required	Not Required Required	Aggregate amount exceeds limit.
(iv)	Relative (A)	Sale of goods - ₹15 Cr. Further sale - ₹1.5 Cr. Further sale - ₹2 Cr. (T/o of Co. - ₹170 Cr.)	Required Required Required	Not Required Not Required Required	Refer limits (Rule 15)
	Relative (B)	Sale of Property - ₹8 Cr. 2 <sup>nd</sup> sale of Property - ₹3 Cr (NW of Co. - Rs. 100 Cr.)	Required Required	Not Required Required	Refer limits (Rule 15)
(v)	Subsidiary Co.	Sale of Goods - ₹101 Cr.	Required	Depends upon T/O	
(vi)	Relative of director	Appointment as sales manager - Remuneration ₹1.5 lac/p.m. - Remuneration ₹2.60 lac/p.m.	Required Required	Not Required Required	Office or place of Profit Refer limits
(vii)	Director	Appointment as CS Rem. - Nil Rem. - 1.75 lac p.m. Rem. - 3.00 lac p.m.	Not Required Required Required	Not Required Not Required Required	Not an office of profit

<b>Special Cases - 2<sup>nd</sup>, 3<sup>rd</sup>, 4<sup>th</sup>, and 5<sup>th</sup>, proviso: of Sec. 188(1)</b>	
<b>2<sup>nd</sup> proviso:</b>	No member of company shall vote on such resolution
	↓
	to approve any contract or arrangement which may be entered into by the company
	↓
	if such member is a related party.
	Note: 2 <sup>nd</sup> proviso not applicable to a private company.
<b>3<sup>rd</sup> proviso:</b>	Restriction under 2 <sup>nd</sup> proviso shall not apply to a company
	↓
	in which $\geq$ 90% members (in numbers) are
	↓
	relative of promoters or are related parties.
<b>Example:</b>	A private limited company enters into a contract with one of its directors for sale or purchase of goods, transaction value exceeds 10% of turnover of the company. Whether the director (also a member) can vote on such resolution to approve the contract?
	<b>Answer:</b> YES, being a case of private company.
<b>Example:</b>	ABC Ltd, a closely held company with 10 members, relatives of each other, is entering into a contract with one of the directors (also a member). Whether the members (relatives of contracting party) can approve the transaction in general meeting
	<b>Answer:</b> Yes, refer proviso (2 <sup>nd</sup> and 3 <sup>rd</sup> ) of Sec. 188(1).
<b>4<sup>th</sup> proviso:</b>	Nothing contained in Sec. 188(1) shall apply to any transaction entered into by the company
	↓
	in its ordinary course of business, other than transactions which are not on an arm's length basis.

<b><u>5<sup>th</sup> Proviso:</u></b>	Requirement of passing the resolution under first proviso shall not be applicable for transactions entered into between a holding Company and its wholly owned subsidiary company
	↓
	whose accounts are consolidated with such holding company and placed before shareholders at the general meeting for approval.
<b><u>Sec. 188(2):</u></b>	Every contract or arrangement entered u/s 188(1) shall be referred to in the Board's report along with the justification for entering into such contract.
<b><u>Sec. 188(3):</u></b>	Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting u/s 188(1)
	and
	if it is <u>not ratified</u> by the Board or, as the case may be, by the shareholders at a meeting within <u>3 months</u> from the date on which such contract or arrangement was entered into,
	↓
	such contract or arrangement shall be <u>voidable</u> at the option of the Board or as the case may be, of shareholders
	and
	if the contract or arrangement is with a related party to any director, or is authorised by any other director, the <u>directors concerned shall indemnify the company</u> against any loss incurred by it.
<b><u>Sec. 188(4):</u></b>	Without prejudice to anything contained in Sec. 188(3), it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.

**Sec. 188(5): Penalty for Contravention:**

Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall-

**In case of listed company:** be liable to a penalty of ₹ 25 Lacs.

**In case of any other company:** be liable to a penalty of ₹ 5 Lacs.

**DO Practice - Questions on Sec. 188**