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## Related party transactions | SEBI casts a wide net

In an [ex-parte interim order](#) recently issued against Linde India Limited (“**Linde India**”), SEBI has (yet again) shown its leanings towards taking a purposive approach to interpretation of its regulations. Rejecting Linde India’s contentions focussed on the literal words used in the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2015 (“**SEBI Listing Regulations**”), SEBI has cast a wide net for material related party transactions that require prior approval of public shareholders.

### Brief facts

- Linde India, an Indian listed entity and Praxair India Private Limited (“**Praxair India**”), are both subsidiaries of a common offshore parent entity, Linde Plc., listed on NASDAQ. Praxair India qualifies as a related party of Linde India, in accordance with the definition of ‘related party’ under the SEBI Listing Regulations.
- The business interests of Linde India and Praxair India overlap to the extent that both are engaged in manufacturing and supply of various gases and related products.
- Various related party transactions (“**RPTs**”) were executed between Linde India and Praxair India, including relating to purchase of goods, purchase of fixed assets/capital spares, sale of goods/spares, recovery of personnel cost and sale of fixed assets (“**Transactions**”), without a master contract governing such independent transactions.
- Also, Linde India and Praxair India executed a Joint Venture and Shareholders Agreement (“**JV&SHA**”) setting out, amongst others, certain product and geographical allocations between Linde India and Praxair India (“**Business Allocation**”), such that two companies do not compete with each other in the Indian market.

SEBI was alerted through shareholder complaints that the Business Allocation was detrimental to the interests of public shareholders and such arrangement, as well as the Transactions with Praxair India, required shareholder approvals under Regulation 23 of the SEBI Listing Regulations, which were not obtained by Linde India.

### Issues covered under SEBI’s order

1. Should the value of all the Transactions executed with Praxair India in a particular year be aggregated to test for materiality and the need to obtain shareholders’ approval?
2. Was the Business Allocation, which essentially involved relinquishment of future business opportunities by Linde India to Praxair India, a material RPT requiring shareholders’ approval?

### Linde India’s contentions v. SEBI’s ruling and rationale

#### Issue 1

Linde India contended that while under Regulation 23 of the SEBI Listing Regulations, shareholder approval is required for material<sup>1</sup> RPTs, in terms of the definition of ‘related party transaction’ under Regulation 2(1)(zc), “...a “*transaction*” with a related party shall be construed to include a single transaction or a group of transactions in a contract”. Given use of the words “*in a contract*”, to test materiality, transactions with a particular related party were required to be aggregated only if such transactions were in pursuance of a common objective and were ancillary to a mother contract. If there was no nexus between transactions pertaining to unrelated items, the value of such transactions did not have to be consolidated when testing materiality.

SEBI did not agree with Linde India’s interpretation and opined that there is no ambiguity in the proviso to Regulation 23 which clearly provides that “...*transaction in question has to be taken together with previous transactions during a financial year with the same related party while considering whether it has crossed the materiality threshold*”. The scope of Regulation 23 cannot be restricted by reading in the requirement of “*in a contract*” from the definition clause – rather, the definition clause should be read within the context of the provision. Noting that the consolidated value of RPTs between Linde India and Praxair India during each of the years in question exceeded the materiality threshold, SEBI held that the Transactions required shareholders’ approval under Regulation 23 of the SEBI Listing Regulations.

<sup>1</sup> While the SEBI Listing Regulations permit listed entities to formulate a policy to determine the materiality threshold, it also deems RPTs to be material, if the RPT to be entered into, individually or taken together with previous transactions during a financial year, exceeds ₹ 1,000 crores or 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.



# SAM Securities Law Update

## Issue 2

Linde India contended that, since the Business Allocation agreed with Praxair India did not contemplate or constitute the transfer of any resources, services or obligations to/from Praxair India, it did not qualify as a 'related party transaction' under the SEBI Listing Regulations<sup>2</sup>. The intent and effect of the Business Allocation was to only to demarcate geographies and products to ensure that the two related entities were not competing in the same areas – this did not result in any *inter-se* transfer of resources/obligations.

This contention was rejected by SEBI, relying on the objective and intent behind the legal requirement for shareholder consent for material RPTs. In SEBI's view, the Business Allocation effectively led to redistribution of business opportunities, potentially hampering Linde India's growth prospects, which would not be in the best interests of public shareholders. In SEBI's view, the effect of relinquishment of its rights to undertake certain business in the future (along with the consequent growth, cash flows and revenues) was similar to that of a direct transfer of resources/ business to a related party; accordingly, the Business Allocation would qualify as a RPT. SEBI also directed that a valuer be appointed by the National Stock Exchange to issue a report to Linde India's board of directors on the valuation of the forgone and received business pursuant to the Business Allocation.

<sup>2</sup> Regulation 2(1)(zc), defines 'related party transaction' to mean a transaction involving a transfer of resources, services or obligations between: (i) a listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or (ii) a listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023; regardless of whether a price is charged and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract.

## Takeaways

This order against Linde India is in line with the consistent trend SEBI has been following of eschewing a literal interpretation of the 'letter of the law' for a purposive interpretation that meets what SEBI believes to be the 'spirit of the law'.

Careful scrutiny of transactions with related parties continues to be a key cornerstone of good governance, aimed at safeguarding the interests of public shareholders. Any arrangements with related parties that are designed to undermine, or have the effect of undermining, the fundamental principles of fairness and transparency in a listed entity are likely to be viewed by SEBI as contrary to its regulations.

Even while recognising that the Business Allocation was aimed at achieving operational synergies for the Linde group in India, SEBI underscored the primacy of protecting public shareholder interests. This regulatory outlook necessitates that listed entities carefully consider any proposed material arrangements with related parties through the lens of whether such arrangement has the potential to be construed as prejudicial to the public shareholders. When in doubt, co-opting public shareholders by seeking their consent may be prudent, particularly in the face of increased activism from shareholders and proxy advisory firms.

Please feel free to address any further questions or request for advice to:



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