SES Proxy Advisory Guidelines Update: #1/2023-24

1. Requirement of Valuation Report for determining the value of shares of the Company in case of new issue of shares

A. Requirement pursuant to articles of association of the Company

The articles of the company may contain a clause pursuant to which companies are required to obtain valuation report for determining the value of their shares at the time of making new issue of shares through a particular mode or all.

Fresh issue of Equity shares can have two stages of approval, viz.,

pure enabling approvals wherein the terms of issue are not finalized yet and the Company seeks approval beforehand to ensure that they have the shareholders' support for future projects and that shares cannot be issued unless further approval is obtained;

second being final stage of approval which is proposed with specific details regarding the type, size, allottees and other details of issue or a resolution where second stage of approval may not be required and can include a hybrid enabling resolution which contains a mode of issuance where secondary stage approval may not be required.

If the articles of the Company have a provision for requirement of valuation report in case of new issue of shares, then:

a) In case of enabling resolution where secondary approval is required, since material terms of the issue might still be pending to be determined, hence, an assurance that the Company will comply with its articles in case the articles require the valuation report to be obtained prior to making the issue of shares would suffice.

However, in case the explanatory statement fails to make a disclosure regarding the assurance, SES will highlight the same in its report and advocate such inclusion citing good governance measure. Yet SES will not vote against it.

b) SES shall be recommending 'Against' in case valuation reports are not disclosed in case of approvals which do not require secondary approval or hybrid enabling resolutions for instance Preferential Issue of shares, in which no further approval will be obtained from shareholders.

c) However, in cases where valuation report may not be required yet SES is of the opinion that valuation needs to be done by an independent person, SES may raise governance issue and vote Against, on case by case basis.

B. Requirement pursuant to SEBI (ICDR) Regulations, 2021

As per SEBI ICDR regulations, valuation reports are mandatory in cases whether the preferential allotment will lead to change in control or where allotment of more than 5% of the total diluted paid-up capital is proposed to be made to an allottee or in aggregate to allottees acting in concert. According, in case the said requirement is not met, SES will raise Compliance Concern.

However, there might be instances when allotment to multiple subscribers will turn out to be more than 5%, however, the allottees might not be acting in concert. In such cases, SES is of the view that the number of allottees or whether they are acting in concert or not would not materially affect the shareholders, as the

end result remains the same that existing shareholders are diluted at a price which may not reflect true or fair value. What will matter to them is the dilution caused as a result of the new issue.

Hence, even in cases where shares are being issued to a group of persons who might not be acting in concert, SES will raise governance concern in case the dilution exceeds the limit of 5% and would want the valuation report in line with the spirit of regulation. And recommend vote AGAINST

Further, upholding good governance standards, SES will also expect the enabling resolutions to be supported with the assurance that valuation report will be obtained as and when the issue is undertaken in cases of dilution exceeding the 5% limit.

Although, on enabling resolutions, no immediate action will be taken in absence of assurance. However, SES will highlight the issue in its report and take a suitable policy decision in the near future.

2. **Disclosure of Basis of Arm's Length Pricing in Proposals of Related Party Transactions ('RPT')**

SES has observed that Companies merely state in the explanatory statement to their RPT proposals that the RPTs are at arm's length basis, however, provide no disclosure regarding the basis of arriving at the same. SES is of the view that just as Audit Committee must be having a rationale and a basis for considering the RPT to be at Arm's Length, similarly, such rationale should also be disclosed for shareholders' information and decision making.

While analyzing RPT proposals, the primary element SES analyses is the fairness of the proposals. Basis of Arm's Length Pricing is a key parameter for analyzing the fairness of the resolution.

Although, no immediate action will be taken in absence of such disclosure (unless such non-disclosure raises material concerns on the resolution), however, SES will highlight the issue in its report and take a suitable policy decision in the near future.

3. **Board Remuneration Skewness and role of interested Nomination and Remuneration Committee ('NRC') Member**

Presently, SES raises concern against the appointment of NRC Chairperson in case the Board remuneration is skewed in favour of a Director without adequate justification.

In case the Board remuneration is skewed in favour of a Director without adequate justification and concerned director is a member of NRC or is related to the member of NRC, then SES will raise concern against the appointment of such NRC member as remuneration skewness raises question over the role played by the NRC member in managing the conflict of interest situation and approving the terms of remuneration of the said director.

4. **Director Appointment Proposals on Non-Retiring basis**

SES, as a policy, used to raise concern in cases when the appointment of Directors was proposed on a non-retiring basis without a specified term as such approvals would render the appointment to continue for a perpetual term as the Company was not bound to propose retirement of such non-retiring directors at regular intervals. However, with the recent SEBI LODR Regulation amendment mandating the non-retiring directors to be proposed for shareholders' approval at least once in every five years, hence, legally the non-retiring terms cannot continue for perpetuity.

Although, SES will continue to advocate that all the non-retiring Director appointments should be proposed with a specific term, however, SES will not raise concern in this regard.

Further, the amendment excludes the applicability to financial institution nominees. Hence, the length of the tenure of such directors appointed on non-retiring basis cannot be ascertained.

Although, it can be argued that such nominee positions are ex-officio positions in most cases and that they will continue so far as the nominating entity holds investment in the Company, however, SES, is of the view, that a Director once appointed on the Board, irrespective of the mode of appointment, i.e., proposed by shareholders or the NRC, has fiduciary duties towards the Company and the shareholders. Hence, such appointments too should be proposed before shareholders for approval at intervals. Hence, governance concern will be raised in case financial institution nominees are proposed on non-retiring basis.

5. **Discretionary Powers of alterations of approved terms of a Resolution**

SES has observed that resolutions are supported with ancillary resolutions that seeks discretionary powers to alter the terms of resolution being approved without seeking further approval of shareholders. Such ancillary approvals are most observed in cases of Director Remuneration and Employee Stock Option Scheme approvals. In Director Remuneration proposals, the discretion is at times linked to the legally permissible limits or as per mutually agreed terms between the Board and the concerned Director. In ESOPs, the alterations are left upto the absolute discretion of the Nomination and Remuneration Committees.

SES is of the view that such open-ended approval defeats the purpose of obtaining shareholders' approval even when the Director Remuneration resolutions are proposed with absolute caps or ESOP proposals with detailed disclosures. Although there might be Companies who intend to undertake only procedural alterations through such ancillary approvals, however, the possibility of exercise of unfettered powers through such approvals cannot be ruled out.

SES is of the view that such ancillary approvals should be drafted with care explaining as to what are the nature of alterations that can be undertaken pursuant to such approvals and further explicitly stating that material terms will not be altered without seeking shareholders' approval.

SES, as a policy, will be highlighting the issue for Company's notice and will be taking a suitable policy stance in the near future.

6. **Two Managing Director Positions in Companies with substantial stake**

SES, so far, has been raising concerns against two positions of Managing Directors unless they were held in the Companies sharing Holding Subsidiary relationship and were engaged in related businesses.

SES is of the view that when the Companies are engaged in the similar nature of businesses, the time commitments of a director need not be considered excessive since the second position as Managing Director can be seen as an extension to the primary role already served by the Managing Director, in the Company.

Hence, SES henceforth, will not raise concern if a Director holds two positions as Managing Director in another Company which is engaged in similar business as of the Main Company and wherein one of the Company holds substantial stake in another Company.

It must be noted that the above stance will not apply for two full time positions one as a Managing Director and another as Whole Time Director as the same will lead to non-compliance with the provisions of the Companies Act, 2013.

7. **Drafting of Nature of Transactions in Related Party Transactions**

SES has observed that in many cases drafting of resolutions falls short of expectations, so much so that it is difficult to understand the nature of transaction. Consequently, disclosure of nature of transactions in the RPT proposals appear to be vague.

For instance, SES notices that when a Related Party 'A' might be buying goods from a Related Party 'B' who could be seller, the transactions are loosely described as 'sale/purchase of goods (Say X) ', which can be interpreted as sale of goods or purchase of goods, or both sale and purchase of goods, thus, it becomes impossible to determine as to approval is sought for which leg of the transaction. While it is a prerequisite of any transaction that there are at least two parties with contra actions, the RPT disclosures made by the Companies provide no clarity as to which party deals with which side of the transaction.

Generally, an agreement is titled as a sale purchase agreement as it is between two parties, where each other's roles are defined clearly. However, when a company is approaching its shareholders, it is seeking approval only for one leg of the transaction.

Further, a transaction which is in the ordinary course of business for one party might not be the same for the other party. In the above example, sale of X could be in the ordinary course of business for Related Party 'A', however, the same might not be in the ordinary course of business for Related Party 'B'. However, if Related Party 'B' will seek shareholders' approval stating that 'sale/purchase of X' is in the ordinary course of business, then the same will create confusion as sale of X is not in the ordinary course of business for Related Party 'B'.

Hence, SES is of the view that nature of transactions should be separately described for the respective related parties involved with clear explanation as to which party will deal with which leg of the transaction.

It must be noted that the above observation is not a company specific issue rather it is a common problem of disclosure all across. SES will highlight the above observation in its Proxy Advisory Reports with an objective to improve the disclosure practices across the Companies.

8. **Incorporation of SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023**

   With the above regulations having come into force from 13th June, 2023, SES will incorporate the amendments introduced into its proxy advisory analysis accordingly.

9. **Material Concerns identified in an area where a Director on the Board holds expertise**

   SES is of the opinion that a director is on the Board because of his/ her particular area of expertise which sets them apart from any other person. If any director is not able to discharge his/ her duty on the Board in that particular field for the interest of the Company at large, SES would raise a concern on the re-appointment of that person on the board.

Effective Date:

With immediate effect (i.e. July 31, 2023)

Circulation:

All Listed Companies in SES coverage and all SES clients