

15 June 2023

Ms. Yogita Shrikant Jadhav,
Corporation Finance
Department Division of Policy and Development
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4- A, "G" Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051
India

Dear Mrs. Jadhav,

Re: Clarification on Monetary Threshold and Royalty Payments

It was a pleasure meeting you last month, and my thanks to your team and you for answering my questions. I am writing to follow up on our meeting regarding SEBI's amendment to Regulation 23, whereby the materiality threshold for shareholder approval was amended, but which has become a point of contention for institutional investors and companies.

Amendment of Materiality Threshold

In January 2020, the Working Group on Related Party Transactions published its report, noting that following a review of transactions involving shareholder resolutions of the top 500 listed entities over the past five years, that "some high value transactions in absolute terms may not get covered under the existing materiality threshold". SEBI accepted its recommendation to include an absolute threshold of Rs.10 billion, which became effective in April 2022.

Issue with royalty payments sub-clause

On January 19, 2023, Hindustan Unilever's (HUL) board approved a proposal to sign a new five-year agreement with Unilever PLC for technology, trademark licenses and central services on February 1, 2023, wherein its payments would be increased in phases over three years from 2.65% to 3.45%. Its old 10-year agreement ended at the end of January 2023. The increase is divided into two parts: brand and technology payments to 1.95% and central services to 1.5%. The company told its institutional investors that it would put the central services increase to a shareholder vote at the next AGM in July as it is a material related-party transaction and would likely cross the monetary threshold of Rs10 billion. However, it would not seek shareholder approval for the brand and technology portion even though it would also most likely cross the Rs10 billion materiality threshold. The company contends that because these payments are specifically for royalty and brand usage, shareholder approval is only required if such payments exceed "five percent of the annual consolidated turnover of the listed entity", as stated in Regulation 23 (1A).

HUL contends that because the regulation for royalty payments is a carve-out of material related party transactions, the five percent threshold needs to be applied individually and cannot be combined with other related party transactions. To clarify, the central services segment and royalty payments portion together would likely exceed Rs.20 billion.

Clarification and resolution

There seems to be a lack of clarity on this issue. The institutional investor who brought this issue to our attention, APG Asset Management (APG), an asset manager for Dutch pension funds, believes that the monetary threshold must be extended to royalty payments and shareholder approval should be required when the quantum crosses the Rs.10 billion mark, as would be the case with HUL. The current interpretation, which HUL is employing, indicates a more relaxed framework for royalty payouts that runs contrary to SEBI's intent of ensuring higher monitoring for royalty payouts which had prompted the carve-out in 2019; a perspective that Mr. Debanik Basu, Senior Manager Global Responsible Investment & Governance Asia Pacific at APG, shared with Ms. Surabhi Gupta from SEBI's CFD (Compliance monitoring & Reg-Tech) team earlier this month.

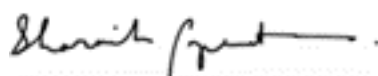
On June 2, however, HUL wrote to ACGA and APG to further clarify its position: it had also relied on an FAQ issued by the National Stock Exchange on April 25, 2022 (NSE/CML/2022/18) stating that "transaction involving brand usage or royalty shall only be tested with the materiality threshold provided in regulation 23 (1A) and be disclosed only if the threshold therein is exceeded".

When we had spoken in May, you explained that a monetary threshold had not been specifically given for the royalty payment clause because it would involve getting approval from other regulators, including the tax department.

While we understand that a number of regulators need to be consulted in order for a change in regulation to occur, we would urge SEBI to ensure that Regulation 23 (1A) also has a monetary threshold and provide the clarity needed on this issue. At the very least, we recommend that SEBI ensure royalty and brand fees are linked with other material related party transactions when testing the threshold. Otherwise companies will continue to choose to not be fully aligned with the regulatory intent of tighter shareholder scrutiny and control over royalty payouts.

We would be pleased to answer any questions regarding this issue.

Yours truly,

A handwritten signature in black ink, appearing to read 'Sharmila Gopinath', with a horizontal line underneath.

Sharmila Gopinath
Specialist Advisor, India