

WHETHER AUDIT COMMITTEE'S "PRIOR" APPROVAL IS REQUIRED FOR TRANSACTIONS BETWEEN HOLDING COMPANY AND ITS WHOLLY-OWNED SUBSIDIARY ?

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Introduction : In the approval process for related party transactions, the audit committee's approval is a very crucial aspect under the corporate laws, i.e., under the Companies Act, 2013 ("the Companies Act") and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI Listing Regulations"). Under the Companies Act and SEBI Listing Regulations, the independent directors form majority in the audit committee. Such constitution brings in objectivity and impartiality in the approval process of the related party transactions. After the notification of the relevant provisions of the Companies (Amendment) Act, 2017, the moot question before the listed companies and unlisted public companies is whether the audit committee's approval is a "prior approval" for transactions between holding company and its wholly-owned subsidiary company. The article is an analysis of the relevant provisions under the Companies Act and the SEBI Listing Regulations.

Subsidiary and wholly-owned subsidiary company : Sub-section (87) of section 2 of the Act relates to "subsidiary" or "subsidiary company". A company is a subsidiary company of another company, i.e., holding company if : (i) The company controls the composition of the board of directors; or (ii) The company exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies. The Act, however, does not define "wholly-owned subsidiary companies". When a company holds the entire share capital of another company and at the same time complies with the provisions of minimum number of members (i.e., two members for private company or seven members for public company), then the investee company is a wholly-owned subsidiary company. In such cases, the companies are required to comply with the provisions of section 89 and section 187 of the Act. Subsidiary company and wholly-owned subsidiary company can be incorporated in India (i.e., company) or outside India (i.e., body corporate).

Provisions under the Act w.r.t. related party transactions : Sub-section (4) of section 177 of the Companies Act states that every audit committee shall act in accordance with the terms of reference specified in writing by

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the board of directors. One of the terms of reference is the approval or any subsequent modification of transactions of the company with its related party. Pursuant to the Companies (Amendment) Act, 2017¹ the approval of audit committee shall not apply to a transaction, other than a transaction referred to in section 188 of the Companies Act, between a holding company and its wholly-owned subsidiary company, i.e., audit committee is required to approve the transactions (as prescribed under section 188 of the Act) between a holding company and its wholly-owned subsidiary company. Such transactions include : (a) Sale, purchase or supply of any goods or materials, (b) Selling or otherwise disposing of, or buying, property of any kind, (c) Leasing of property of any kind, (d) Availing of or rendering of any services, (e) Appointment of any agent for purchase or sale of goods, materials, services or property, (f) Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company ; and (g) Underwriting the subscription of any securities or derivatives thereof, of the company.

The audit committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed (i.e., conditions prescribed under rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014). "Omnibus" means relating to or dealing with numerous objects or items at once, including many things or having various purpose (as per *Black's Law Dictionary*, eight edition, page 1121). In the context of audit committee's approval, "omnibus approval" refers to an approval of numerous related party transactions of similar nature.

Under the Companies Act, all related party transactions shall require approval of the audit committee. Such approval need not be prior approval. However, in the case of audit committee's omnibus approval, such approval is for related party transactions proposed to be entered into by the company subject to the prescribed conditions. As the omnibus approval is for related party transactions "proposed to be entered into" by the company, such omnibus approval, in my view, is "prior approval" of audit committee.

Provisions under the SEBI Listing Regulations w.r.t. related party transactions : Regulation 23 of the Listing Regulations relates to "related party transactions". All related party transactions shall require prior approval of the audit committee (i.e., sub-regulation (2) of regulation 23 of the SEBI Listing Regulations). The audit committee may grant omnibus approval for related party transactions "proposed to be entered into by the

1. Effective from May 7, 2018.

listed entity" subject to prescribed conditions (i.e., sub-regulation (3) of regulation 23 of the SEBI Listing Regulations). The provisions further state that all material related party transactions shall require approval of the shareholders through resolution and the related parties shall abstain from voting on such resolutions whether the entity is a related party to the particular transaction or not (i.e., sub-regulation (3) of regulation 23 of the SEBI Listing Regulations). Pursuant to sub-regulation (4) of regulation 23 of the SEBI Listing Regulations, the said approvals under the SEBI Listing Regulations, i.e., audit committee's prior approval, audit committee's omnibus approval and the shareholders' approval are not applicable in the following cases :

(a) Transactions entered into between two Government companies, and

(b) Transactions entered into between a holding company and its wholly-owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Interpretation issue : Under the Companies Act, the approval of audit committee shall apply to the transactions between a holding company and its wholly-owned subsidiary company. Such approval under the Companies Act is not a "prior approval". Under the SEBI Listing Regulations, audit committee's prior approval and omnibus approval is not applicable for the transactions entered into between holding company and its wholly-owned subsidiary company. Taking into consideration the conflicting provisions of the Companies Act and the SEBI Listing Regulations, the question is—Whether audit committee's "prior" approval is required for transactions between holding company and its wholly-owned subsidiary ?

View : The audit committee's approval (whether omnibus or not) is not required under the SEBI Listing Regulations for the transactions entered into between holding company and its wholly-owned subsidiary company. Therefore, the approval of the audit committee for the related party transactions is required under the Companies Act only. In case of omnibus approval, the audit committee shall give a prior omnibus approval for the related party transactions proposed to be entered into by the company subject to the prescribed conditions. In case of listed company or unlisted public company, where omnibus approval provisions are not applicable for a particular related party transaction, prior approval of the audit committee is not required.
