COMPANY LAW

[2016] 134 CLA (Mag.) 33

'Private company subsidiary of public company' – Impact and analysis of provisions of the Companies Act, 2013

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This article is an analysis of the applicability of the various provisions of the Companies Act, 2013 to private company which is a subsidiary of public company.

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Introduction

1. "Types of companies" under the company law is one of the very crucial issues. The question – whether "private company which is a subsidiary of public company" is third type of company was a debatable topic under the Companies Act, 1956. This debate has been put to rest by the proviso to the clause (71) of section 2 of the Companies Act, 2013 ('the Act'). Such class of companies either exists in group company structure or relevant provisions are considered when a public company proposes to takeover (by acquiring majority share capital) in private company.

Analysis of the definition of 'private company'

2. Clause (*71*) of section 2 defines 'public company'. It means a company which is not a private company, and has a minimum paid-up share capital as may be prescribed. Private company has been defined in clause (*68*) of section 2, which means a company having prescribed minimum paid-up share capital and has following provisions in its articles of association :

- Restricts the right to transfer its shares
- Except in case of one person company, limits the number of its members to 200,
- Prohibits any invitation to the public to subscribe for any securities of the company.

It is mandatory for a private company to have the aforesaid conditions in its articles of association. Such company is also required to comply with all the said conditions during its lifetime and if such company fails to comply with

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any of the conditions, then it loses its status of "private company". Such conditions can be eliminated from the articles of association of private company when it proposes to convert into public company. Also, whenever, a public company converts into private company, then it is mandatory to alter the articles of association and include the aforesaid three conditions. Therefore, it can be said that the inclusion or non-inclusion of the said conditions and its compliance defines the status of the company, *i.e.*, a private company or public company.

Analysis of the definition of 'public company'

3. The definition of "public company" is not elaborate. It defines as a company which is not a private company. Therefore, a public company should not have the above-mentioned 3 conditions in its articles of association. Therefore, a public company can have provisions in the articles of association which would include no restriction on transfer of shares, no limit on the number of members and no prohibition on public invitation to subscribe for any securities of the company. *Vide* the Companies (Amendment) Act, 2015, the criteria of minimum paid-up share capital for private company and public company has been removed.

Definition of 'subsidiary company'

4. Clause (*87*) of section 2 defines "subsidiary company". It is, in relation to any other company (that is to say the holding company), a company in which the holding company –

(*i*) controls the composition of the Board of directors ; or

(*ii*) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

Private company which is subsidiary of public company under the 1956 Act

5. Under the 1956 Act there was no explicit provision relating to the status and compliance of private company, which is a subsidiary of public company. However, Company Law Board in *Hillcrest Realty Sdn. Bhd* v. *Hotel Queen Road (P.) Ltd.* [2006] 72 CLA 245 (CLB) observed as follows :

> "Basic characteristics of a private company in terms of section 3(3) of Companies Act, 1956 do not get altered just because it is a subsidiary of a public company in view of the fiction in terms of section 3(3)(*iv*)(*c*) of the Companies Act, 1956 that it is a public company. May be it is a public company in relation to other provisions of the Act but not with reference to its basic characteristics. In terms of that section, a company is a private company when its articles restrict the right of transfer of shares, restrict its membership to 50

(other than employee shareholders) and prohibits invitation to public to subscribe to its shares. Therefore, all the provisions in the articles to maintain the basic characteristics of a private company in terms of section 3(1)(*iii*) of the Companies Act, 1956 will continue to govern the affairs of the company even though it is a subsidiary of a public company. One of the basic characteristics of a private company in terms of that section is restriction on the right to transfer and the same will apply even if a private company is a subsidiary of a public company."

Private company which is subsidiary of public company under the 2013 Act

6. "Private company, which is subsidiary of public company" is not 3rd type of company. However, it is a class of company due to its shareholding pattern or Board composition. Proviso to clause (*71*) of section 2 states as follows :

"Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles."

It can be interpreted that a private company which is a subsidiary of public company shall be deemed to be public company for the purposes of the 2013 Act. Such private company continues to be a private company in its articles of association, *i.e.,* such private company is not required to alter its articles of association and eliminate the basic 3 conditions that defines the private company (*i.e.* restriction on transfer of shares, limit on number of members and prohibition on public invitation to subscribe for any securities of the company). It can also be said that the principle laid down by the Company Law Board in *Hillcrest Realty Sdn. Bhd.* (*supra*) has been meticulously included in the definition section of Companies Act, 2013.

Impact of the proviso to clause (*71*) of section 2

7. On the applicability and non-applicability of certain provisions and its compliance, the proviso to clause (*71*) of section 2 will have the following impacts :

• *Minimum number of members* – The provisions relating to minimum number of members required to incorporate a private or public company is provided in section 3 of the Act, *i.e.,* minimum 7 or more persons for a public company and minimum 2 or more persons for a private company.

• *Maximum number of members* – The provision relating to maximum number of members (*i.e.,* 200) is provided in clause (*71*) of section 2. Therefore, a private company which is a subsidiary of public company will be required to have maximum 200 members.

• *Minimum number of directors* – Section 149 of the Act relates to "company to have Board of directors". It states that every company shall have a Board of directors consisting of individuals and shall have minimum 3 directors in case of public company and minimum 2 directors in case of private company. Section 149 does not define the basic parameters of private company, therefore, a private company which is a subsidiary of public company will be required to have minimum 3 directors.

• *Maximum number of directors* – In accordance with the provisions of section 149, the maximum number of directors shall be 15 for private company and public company. Therefore, the limit of maximum number of directors also applies to a private company which is a subsidiary of public company.

• *Transferability of shares* – Restriction on the transfer of its shares is one of the essential conditions that ought to be included in the articles of association of the private company. Taking into consideration the proviso to clause (*71*) of section 2, the restriction on transferability of shares applies to the private company which is a subsidiary of public company.

• *Quorum in general meeting* – Section 103 of the Act relates to "quorum for meetings", states that unless the articles of association provide for a larger number, the quorum for a public company shall be as follows :

- 5 members personally present if the number of members as on the date of meeting is not more than 1,000
- 15 members personally present if the number of members as on the date of meeting is more than 1,000 but up to 5,000
- 30 members personally present if the number of members as on the date of the meeting exceeds 5,000

According to the provisions of section 103, the quorum for a meeting of private company shall be 2 members personally present. Considering the above discussion and analysis of the provisions relating to private company which is a subsidiary of public company, the quorum for such company will be either 5 or 15 or 30 members personally present (depending on the number of members of the company).

• *Applicability of exemptions to private companies* – *Vide* Notification dated 5th June, 2015, MCA has exempted private companies from the compliances of certain provisions of the Act. Some of the exemptions include certain parties are not "related party" [as defined in section 2(*76*)], non-applicability of sections 43, 47, 101-107, 117(3)(*g*), 160, 162 and 180 and limited applicability of sections 67, 73(2) and 185. Private company which is a subsidiary of a public company cannot avail exemptions as prescribed in the MCA Notification. This is due to the phrase in the definition [in proviso to clause (*71*) of section 2 of Companies Act, 2013] which states that "*subsidiary of a*

company, not being a private company, shall be deemed to be public company for the purposes of this Act".

• *Applicability of other critical provisions of the Act* – A private company which is a subsidiary of public company is required to comply, on breaching the thresholds prescribed under the particular section, with the provisions that are exclusively applicable to public companies. Such provisions include appointment of independent directors, constitution of audit committee, nomination and remuneration committee, appointment of key managerial personnel, managerial remuneration, etc.

Conclusion

8. Once the status of a company is identified as "private company subsidiary of public company", the company secretary of that company (or group company) or practising company secretary is required to determine the necessary compliances under the Act. Accordingly, the checklist for the compliances will change, taking into consideration the applicable and not applicable provisions of the Act. All such critical issues are usually addressed either at the time of acquiring another company or restructuring a corporate group. ❖❖❖