COMPLIANCES IN REGARD TO SUBSIDIARIES BY LISTED HOLDING COMPANIES UNDER CLAUSE 49 OF THE LISTING AGREEMENT

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Section III of Clause 49 of the listing agreement with stock exchanges by listed companies which Clause would come into force with effect from the 1st January 2006 requires the following compliances in relation to subsidiaries of listed companies, viz.:

(a) At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non listed Indian subsidiary company.

(b) The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

(c) The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company.

(d) The management of the unlisted subsidiary should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

It should be noted that the compliances listed above would apply only in relation to material subsidiary and not to all subsidiaries of a listed company. Even though compliance (a) above specifically mentions that at least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of the subsidiary similar express provision is not there in relation to other compliances. But those compliances apply to material unlisted subsidiaries only could be inferred from explanation (2) given in Section III of Clause 49 while defining the term "significant transaction or arrangement' entered into by the unlisted subsidiary company. In the explanation for the purpose of determining as to which transaction of the unlisted subsidiary company is a significant transaction or arrangement for reporting to the Board of Directors of the listed holding company, the parameters mentioned is those obtaining in a material unlisted subsidiary. If the intention had been that the other compliances would apply to all subsidiaries irrespective of the fact whether they are material or not then the explanation need not have limited to the parameters obtaining in a material unlisted subsidiary. Here again there is a slip. The word 'Indian' has been omitted. This omission it could be inferred is unintentional. Instead of leaving the above for conjectures it would have been ideal if these have been properly and intelligibly set out in section III of Clause 49. For the purpose of determining what is a 'material non-listed Indian subsidiary', explanation 1 to the said section III of Clause 49 defines a "material non-listed Indian subsidiary" to mean an unlisted subsidiary, incorporated in India, whose turnover or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated turnover or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year. It is apparent from the definition, that subsidiary companies incorporated abroad need not have on its Board a director who is an independent director of its holding company. It is also apparent that the turnover and net worth that would enter the computation for determining whether a particular subsidiary is a material subsidiary or not the combined turn over and net worth of the holding company and all its subsidiaries (including those incorporated abroad) will have to be taken into account.

The requirement in the case of a material non-listed subsidiary company is that it should have an independent director of the holding company, on its Board. Therefore this does not intend to confer any

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power of nomination on the holding company to appoint one of its independent directors, as a director on the material non-listed subsidiary. It is for the subsidiary to make such an appointment. It is not known a subsidiary which is not amenable to the jurisdiction of stock exchanges could be compelled to appoint such a director and if such a director is not appointed by the subsidiary how the stock exchanges or the Securities and Exchange Board of India could initiate any penal action on such a subsidiary. If one is really interested in securing compliance with this requirement, he should cast an obligation on the holding company either to have such a director appointed in the subsidiary by using its voting power, and if necessary by introducing requisite resolutions in the general meeting for securing compliance with this requirement and if need by requisitioning a general meeting for this purpose or to secure the amendment of the Articles of Association of the subsidiary for introducing a provision therein for securing such an appointment. Unless this is done it would be impracticable for the holding listed company to secure compliance with this requirement. Further it is possible that a material non-listed subsidiary of a listed holding company may not have a director meeting with this requirement on the date this requirement comes into force and that the holding company has defaulted in any one of all the manners listed in section 274(1)(g) of the Companies Act, 1956 with the result all the directors of the listed holding company have become disqualified for appointment as a director and in that event how this requirement could me met? If it is met then it would result in the subsidiary committing a breach of the provisions of the Companies Act, 1956 and if not met, it would result in the holding listed company committing a breach of the provisions of the listing agreement leading to the attraction of the draconian penal consequences. One could not comprehend as to how this riddle could be solved? Possibly the Regulator should come out with suitable amendment or clarifications in regard to this predicament of defaulting listed companies. Pending such amendment or clarification this requirement could be met by the material unlisted subsidiary appointing a director and subsequently that director, if willing, could be appointed as an independent director of the listed holding company.

By another explanation given in the said section III the term "significant transaction or arrangement" has been defined to mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year. The implications of this explanation have been discussed earlier in this Article.

Explanation 3 of section III of Clause 49 states that where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned. The implication of this explanation is that compliances in respect of subsidiaries of a listed subsidiary have to be established by that listed subsidiary and not by the holing company of the listed subsidiary even though under section 4(1)(c) of the Companies Act, 1956 if a subsidiary of a holding company has a subsidiary the latter would be deemed to be the subsidiary of the said holding company.

It should be remembered that the subsidiary of a listed company in relation to which the compliances mentioned earlier has to be established to comply with the listing requirements itself is always registered as a company. On such registration under section 34 of the Companies Act, the subsidiary becomes incorporated and from the date of such incorporation the subscribers to the memorandum of association and other persons, as may from time to time become members of the subsidiary shall become a body corporate by the name mentioned in the memorandum of association and is capable of exercising all the functions of an incorporated company and having a perpetual succession and a common seal. The liability of the members of the company so incorporated to contribute to the assets of the company in the event of its winding up is as mentioned in the Companies Act, 1956. Further under section 36 of the Act the memorandum and articles shall bind the company and the members thereof to the same extent as if they respectively have been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the memorandum and of the articles. The Articles of association constitute a contract not merely between the shareholders and the company, but between each individual shareholder and every other. (cf. Wood v. Odessa Waterworks Co. (1889) 42 Ch.D.636. No member can demand more than what is provided in the articles from the company of which he is a member.

In the words of the Supreme Court, 'A shareholder has an undoubted interest in a company, an interest which is represented by his shareholding. The rights of a shareholder are: (i) to elect directors and thus to participate in the management through them; (ii) to vote on resolutions at meetings of a company; (iii) to enjoy the profits of the company in the shape of dividends; (iv) to apply to the court for relief in the case of oppression; (v) to apply to the court for relief in the case of mismanagement; (vi) to apply to the court for winding up of the company; and (vii) to share the surplus in winding up'. *Cf. Life Insurance Corporation of India* v. *Escorts Ltd. And others* [1986] 59 Comp. Cas. 548 (S.C.) Apart from the above rights the members cannot claim from the company of which they are members any further rights unless such rights are conferred on them through appropriate provisions in the Articles of Association of the company concerned. Therefore if any other right than those set out above not enshrined in the Articles is claimed by a member, the company can legitimately refuse to accede to the same and it cannot be hauled up on this account. In a subsidiary of a listed company whether that subsidiary is a material non-listed Indian subsidiary or not, the holding company is only a member and it cannot compel in law, the subsidiary to confer on it more rights than those set out above unless such rights are incorporated through appropriate provisions in the articles of association of the subsidiary. Once they are so incorporated then they are binding on the subsidiary and the holding company, a member in the subsidiary. The compliances required to be complied with in relation to a subsidiary by a listed holding company are in the nature of rights which are not ordinarily available to a member in a company. They can be made available to the listed company only through appropriate provisions in the Articles of Association of the subsidiary. Unless and until it is so done, it would be extremely difficult, if not impossible, for the listed company to establish compliances with the requirements set out above. In order to ensure full compliance with the requirements set out above it would be advisable for listed companies as are having subsidiaries to take steps for suitably amending the Articles of Association of the subsidiaries at the earliest.