Dematerialisation of Securities of Unlisted Companies under the Companies Act, 2013 – Comprehensive Analysis

A private company which is a subsidiary of a public company, would be considered as a public company for all purposes of the Act and is required to comply with all the requirements under that Act applicable to a public company including the requirements under Rule 9A of the Rules; such private company would not fall within the ambit of rule 9B of the Rules. If the private company which is a subsidiary of a public company, is neither a nidhi company, government company, or a wholly owned subsidiary company of the public company, then no exemption is available to it under sub-rule (11) of rule 9A of the Rules.

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INTRODUCTION

Earlier, only 'listed companies' were required to facilitate dematerialisation of its existing securities and issue new securities in dematerialised form. The Ministry of Corporate Affairs, with effect from 2 October 2018, has made it mandatory for all 'unlisted public companies' to facilitate dematerialisation of its existing securities and to issue new securities only in dematerialised form. More recently, 'private companies' also which on the last day of the financial year ending on or after 31 March 2023 are not small companies as per audited financial statements for such financial year, are given eighteen months' time to facilitate dematerialisation of its existing securities and issue new securities only in dematerialised form.

STATUTORY PROVISIONS

Section 29 of the Companies Act, 2013 (the Act), reads as follows:

29. Public offer of securities to be in dematerialised form.

(1) Notwithstanding anything contained in any other provisions of this Act,—

(a) every company making public offer; and

(b) such other class or classes of [***][1] companies as may be prescribed,

shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.

[2][(1A) In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.]

(2) Any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.

Relevant rules of the Companies (Prospectus and Allotment of Securities) Rules, 2014 ('the Rules') read as follows:

[3][9A. Issue of securities in dematerialised form by unlisted public companies.

(1) Every unlisted public company shall –

(a) issue the securities only in dematerialised form; and

(b) facilitate dematerialisation of all its existing securities

in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

1. *Omit., w.e.f. 15-08-2019, the word "public" in s 29(1)(b), by the Companies (Amendment) Act, 2019 (22 of 2019), s. 7(i), vide Notification SO 2947(E), dt. 14-08-2019.*
2. *Ins. w.e.f. 15-08-2019, sub-s (1A), by the Companies (Amendment) Act, 2019 (22 of 2019), s. 7(ii), vide Notification SO 2947(E), dt. 14-08-2019.*
3. *Inserted w.e.f. 2-10-2018 by the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018, vide GSR 853(E), dated 10-09-2018.*

(2) Every unlisted public company making any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer shall ensure that before making such offer, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

(3) Every holder of securities of an unlisted public company,-

(a) who intends to transfer such securities on or after 2nd October, 2018, shall get such securities dematerialised before the transfer; or

(b) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after 2nd October, 2018 shall ensure that all his existing securities are held in dematerialized form before such subscription.

(4) Every unlisted public company shall facilitate dematerialisation of all its existing securities by making necessary application to a depository as defined in clause (e) of sub-section (1) of Section 2 of the Depositories Act, 1996 and shall secure International Security Identification Number (ISIN) for each type of security and shall inform all its existing security holders about such facility.

....

[4][(8) Every unlisted public company governed by this rule shall submit Form PAS-6 to the Registrar with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within sixty days from the conclusion of each half year duly certified by a Company Secretary in practice or Chartered Accountant in practice. .....]

....

[5][(11) This rule shall not apply to an unlisted public company which is:—

(a) a Nidhi;

(b) a Government company or

(c) a wholly owned subsidiary.]

[6][9B. Issue of securities in dematerialised form by private companies:-

(1) Every private company, other than a small company, shall within the period referred to in sub-rule (2) -

(a) issue the securities only in dematerialised form; and

(b) facilitate dematerialisation of all its securities, in accordance with provisions of the Depositories Act, 1996 (22 of 1996) and regulations made thereunder.

(2) A private company, which as on last day of a financial year, ending on or after 31st March, 2023, is not a small company as per audited financial statements for such financial year, shall, within eighteen months of closure of such financial year, comply with the provisions of this rule.

(3) Every private company referred to in sub-rule (2) making any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer, after the date when it is required to comply with this rule, shall ensure that before making such offer, entire holding of securities of its promoters, Directors, Key Managerial Personnel has been dematerialised in accordance with the provisions of the Depositories Act, 1996 (22 of 1996) and regulations made thereunder.

(4) Every holder of securities of the private company referred to in sub-rule (2),-

(a) who intends to transfer such securities on or after the date when the company is required to comply with this rule, shall get such securities dematerialised before the transfer; or

(b) who subscribes to any securities of the concerned private company whether by way of private placement or bonus shares or rights offer on or after the date when the company is required to comply with this rule shall ensure that all his securities are held in dematerialised form before such subscription.

(5) The provisions of sub-rules (4) to (10) of rule 9A shall, mutatis mutandis, apply to the dematerialization of securities under this rule.

(6) The provisions of this rule shall not apply in case of a Government company.

WHETHER ALL THE EXISTING SECURITIES OF UNLISTED PUBLIC COMPANY AND PRIVATE COMPANY WHICH IS NOT A SMALL COMPANY WHICH ARE IN PHYSICAL FORM MUST BE CONVERTED INTO DEMATERIALSED FORM?

Section 29(1)(b) of the Act provides that such class or classes of companies as may be prescribed other than a company making public offer, shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder. Section 29(1A) of the Act provides that in case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner

4. *Subs. w.e.f. 30-09-2019, for sub-r (8), by the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2019, vide GSR 376(E), dt. 22-05-2019. Formerly sub-r (8) read:*

"(8) The audit report provided under regulation 55A of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 shall be submitted by the unlisted public company on a half-yearly basis to the Registrar under whose jurisdiction the registered office of the company is situated."

5. *Ins. w.e.f. 22-01-2019, r 11, by the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2019, vide GSR 43(E), dt. 22-01-2019.*

6. *Inserted by the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 dated 27-10-2023 w.e.f. 27-10-2023*

laid down in the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder. Rule 9A of the Rules provides in respect of dematerialisation of securities of unlisted public companies and rule 9B provides in respect of dematerialisation of securities of private companies which are not small companies.

From rules 9A and 9B it becomes clear that fresh issue of securities in dematerialised form and facilitation of dematerialisation of existing securities, is mandatory and not recommendatory (or optional). The use of the word 'shall' in Section 29 and Rule 9A indicate that the provisions are mandatory in nature. The standard rule of interpretation is that the provision containing 'shall' is mandatory and the provision containing 'may' is either permissive or discretionary. In other words, 'shall' conveys mandatory nature of the provision, while 'may' conveys permissive or discretionary nature.

In view of rule 9A(4), facilitation of dematerialisation of existing securities must be made by:

- Making necessary application to a depository as defined in clause (e) of sub-section (1) of Section 2 of the Depositories Act, 1996;
- Securing International Security Identification Number (ISIN) for each type of security; and
- Informing all its existing security holders about such facility.

Under rule 9A, though it is mandatory for unlisted public companies to facilitate dematerialisation of all existing securities and to issue fresh securities in dematerialised form, a date or deadline has not been prescribed within which all the existing securities must be dematerialised. Under rule 9B also, a period of eighteen months from closure of financial year has been specified within which facilitation of dematerialisation of all its securities must be done by a private company which is not a small company on the last day of the financial year; a period within which the existing securities which are in physical form must be dematerialised has not been specified.

Point which is required to be noted here is that both under rules 9A and 9B, what is mandatory is the facilitation of dematerialisation of existing securities and the issue of fresh securities in dematerialised form, and not dematerialisation of existing securities. The relevant rules have nowhere provided that the existing securities must be dematerialised within a specified period.

However, an existing shareholder, in view of relevant provisions of rules 9A and 9B will be compelled to convert his physical shares into dematerialised form before happening of any of the following events ('the three events'):

- If the existing shareholder is either a promoter, Director or Key Managerial Person, then any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer, cannot be made by the company, unless before making such offer, entire holding of securities of the promoter, Director and Key Managerial Person has been dematerialised in accordance with provisions of the Depositories Act 1996 and regulations made thereunder;
- If the existing shareholder intends to transfer his securities, he cannot transfer the same unless he gets such securities dematerialised before the transfer; or
- If the existing shareholder intends to subscribe to any securities of the company (whether by way of private placement or bonus shares or rights offer), he cannot do so unless he ensures that all his existing securities are held in dematerialised form before such subscription.

Hence, except in the above three cases, existing securities of companies falling under rules 9A and 9B are not required to be mandatorily dematerialised.

TIME LIMIT WITHIN WHICH THE PROVISIONS WITH RESPECT TO DEMATERIALISATION MUST BE COMPLIED WITH

Unlisted public company

Though under rule 9A it is mandatory for facilitating dematerialisation of all existing securities of an unlisted public company, a period or deadline has not been specified within/before which the facilitation for dematerialisation of all existing securities must be done. However, an unlisted public company must, after promulgation of rule 9A i.e. from 2 October 2018, before happening of any of the three events mentioned earlier above, is required to facilitate dematerialisation of all its existing securities. Also, since the company is required to specify the details with respect to dematerialisation of securities and the reasons for holding the securities in physical form in Form No. PAS-6 every half year, the facilitation must be done by unlisted public company as soon as possible.

Every fresh issue of securities by an unlisted public company on or after 2 October 2018 must be made only in dematerialised from. The notification promulgating rule 9A, specifies 2 October 2018 as the date on which the provisions of the rule shall come into force.

Private company which is not a small company

Rule 9B which was promulgated on 27 October 2023, clearly specifies the period within which the requirements specified under the rule must be complied with by a private company which is not a small company. The requirements under rule 9B are:

- Issue of securities only in dematerialised form; and
- Facilitate dematerialisation of all securities, in accordance with provisions of the Depositories Act, 1996 (22 of 1996) and regulations made thereunder.

According to rule 9B(2) a private company, which as on last day of a financial year, ending on or after 31 March

2023, is not a small company as per audited financial statements for such financial year, shall, within eighteen months of closure of such financial year, comply with the provisions of this rule. 31 March 2023 is the first financial year ending as on which it must be determined whether a private company is not a small company within the meaning of Section 2(85) of the Act or not. If a private is not a small company as on the last day of the financial year ending 31 March 2023, then it must comply with the requirements under rule 9B within eighteen months from 31 March 2023.

Interpretation of 'within eighteen months of closure of such financial year'

When a statutory provision or a document states a certain thing to be done within a particular number of days or months from/of/after the happening of a stated event, the period limit stated in the relevant provision is the maximum or the outer limit and, therefore, the thing must be done before that outer limit is crossed but at any time before that outer limit is crossed. The meaning of the word 'within' as given in various dictionaries is: occupying inside (a particular period of time); inside or not further than a period of time; before a particular period of time has passed; during a particular period of time; within a particular length of time means before that length of time has passed.

It was observed by Stone J. in *Commissioner of Income Tax v Ekbal & Co.* [1945] 13 ITR 154 (Bom); AIR 1945 Bom 316,

> "In my judgment expressions "within 30 days" and "not less than 30 days" are two quite different things. "Within 30 days" is within two points of time, one at which the period begins and the other at which it expires. On the other hand, "not less than 30 days" is outside these two points of time. There must be an interval of not less than 30 days and that means 30 days clear: see (1885) 29 Ch. D. 204. The period must continue beyond the expiration of the stated time. Whereas "within" the stated period must mean what it says, something less than the moment of expiration. In my opinion, therefore, the notice is invalid and the question referred to must be answered in the negative."

The above decision was followed by the Bombay High Court in *Kishore Ramalu Telang v Municipal Commissioner, Nagpur* 2015 (5) ABR 671. In this case, the High Court observed:

> ".... both the said expressions are different. While "within thirty days" is a shorter period, expression "not less than thirty days" connotes larger period of time. .... by using the expression "within thirty days" the noticee did not get thirty clear days period as was contemplated by the expression "not less than thirty days".

Thus, 'within eighteen months of closure of such financial year' means before the completion of the term of eighteen months. The available period to comply is eighteen months from closure of such financial year 31 March 2023 which is ending on 30 September 2024 within which the company must comply with the requirements under rule 9B.

In view of the above rule which is plain and unambiguous, a private company which is not a small company as on 31 March 2023 as per audited financial statements for such financial year can continue to issue and transfer securities in physical manner up to 30 September 2024 i.e. up to eighteen months of closure of the financial year ended on 31 March 2023. This also means that though not mandatorily required, the company may within

Statutory provisions

Section 29 of the Companies Act, 2013 (the Act), reads as follows:

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(1) Notwithstanding anything contained in any other provisions of this Act,—

(a) every company making public offer; and

(b) such other class or classes of [***] companies as may be prescribed,

shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.

[(1A) In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.]

(2) Any company, other than a company mentioned in sub-section (1), may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 (22 of 1996) and the regulations made thereunder.

the eighteen months period, voluntarily facilitate for dematerialisation of its securities and start issuing new securities in dematerialised form.

In other words, up to 30 September 2024, a private company which is not a small company has the option of not complying with the any of the requirements specified under rule 9B. In view of this, up to eighteen months of closure of the financial year ended on 31 March 2023, the requirements under rule 9B are voluntary but not mandatory. However, after 30 September 2024, all the requirements under rule 9B must be mandatorily complied, failing which would amount to violation of the provisions of the Act.

Reading rule 9B in a manner which implies that the requirements under that rule shall mandatorily apply from the date of the MCA notification (i.e. 27 October 2023) through which rule 9B was introduced, would amount to adding of words into the statute which is not allowed. Sub-rule (2) in no way implies that the securities cannot be issued or transferred in physical manner (i.e. other than dematerialised mode) within the grace period of eighteen months from closure of the financial year ended on 31 March 2023 as specified therein.

The language of sub-rule (2) of rule 9B is clear and unambiguous with respect to the period from which the provisions under rule 9B would mandatorily apply to a private company. No words can be added in, or deducted from, a statute. It is a corollary to the general rule of literal construction that nothing is to be added to or taken out from a statute unless there are adequate grounds to justify the inference the legislature intended something which it omitted to express.[7]

WHICH PARTIES ARE REQUIRED TO CONVERT THE SECURITIES HELD BY THEM INTO DEMATERIALSED FORM?

Though it's not mandatory for the existing security holders of unlisted public company and private company which is not a small company to dematerialise their securities, in view of the relevant provisions of rules 9A and 9B of the Rules they will have to convert their physical securities into dematerialised form before happening of any of the following events ('the three events'):

- If the existing shareholder is either a promoter, Director or Key Managerial Person, then any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer, cannot be made by the company, unless before making such offer, entire holding of securities of the promoter, Director and Key Managerial Person has been dematerialised in accordance with provisions of the Depositories Act 1996 and regulations made thereunder;
- If the existing shareholder intends to transfer his securities, he cannot transfer the same unless he gets such securities dematerialised before the transfer; or
- If the existing shareholder intends to subscribe to any securities of the company (whether by way of private placement or bonus shares or rights offer), he cannot do so unless he ensures that all his existing securities are held in dematerialised form before such subscription.

WHETHER A HOLDER OF SECURITIES CAN CHOOSE NOT TO CONVERT ANY OF HIS SECURITIES INTO DEMATERIALISED FORM?

As discussed earlier above, what is mandatory under rules 9A and 9B is the facilitation of dematerialisation of existing securities and the issue of fresh securities in dematerialised form, and not dematerialisation of existing securities. The relevant rules have nowhere provided that the existing securities must be dematerialised within a specified period; reading the relevant provisions otherwise would amount to adding of words into the statute. It is against the principle of statutory interpretation to insert any words in a statute. No words can be added in, or deducted from, a statute. It is a corollary to the general rule of literal construction that nothing is to be added to or taken out from a statute unless there are adequate grounds to justify the inference the legislature intended something which it omitted to express.[8] The intention of the legislature is required to be gathered from the language used and, therefore, a construction, which requires for its support with additional substitution of words or which results in rejection of words as meaningless has to be avoided.[9]

Unless the holder of existing securities wants to undertake any of the three events mentioned earlier above, he can choose not to convert his physical securities in the dematerialised form.

WHETHER EXISTING PREFERENCE SHARES WHICH ARE TO BE REDEEMED ARE FIRST REQUIRED TO BE DEMATERIALISED?

Some people have doubt as to whether preference shares issued by a company before promulgation of rules 9A and 9B, will have to be first dematerialised before redeeming the same. The relevant provisions of the rules have specified only three instances where the existing holders of physical securities (i.e. the securities which were issued before promulgation of the rules) will have to dematerialise the securities before happening of certain events; these are the three events mentioned earlier above.

Since redemption of preference shares is not one of those events specified in the relevant rules, the preference shares issued by the company are not mandatorily required to be dematerialised before their redemption. This interpretation is consonant with the Latin maxim *expressio unius est exclusion alterius.*

7. *Maxwell on the Interpretation of Statutes, 12th edn, page 33*

8. *Maxwell on the Interpretation of Statutes, 12th edn, page 33*

9. *State of Maharashtra v. Nanded Parbhani Z.L.B.M.V. Operator Sangh 2000 AIR SCW 261.*

The Supreme Court has held that when the new Act contains a repealing section mentioning the Acts which it expressly repeals, the presumption against implied repeal of other laws is strenghtened on the principle *expressio unius persone vel rei est exclusio alterius* (The express intention of one person or thing is the exclusion of another).[10] This is explained as follows in Maxwell on the Interpretation of statutes (12th Edn, p. 293):"By, the rule usually know in the form of this Latin Maxim, mention of one or more things of a particular class may be regarded as silently excluding all other in members of the class.[11] *In Cross Interpretation of Statutes,* 4th edition, the principle is explained thus: "The effect of the Latin maxim *expressio unius est exclusio alterius,* sometimes stated in the form *expressum facit cessare taciturn* (that which is expressed puts an end to that which is unspoken) is that mention of one or more things of a particular class may be regarded as by implication excluding all other members of the class.

It is a canon of construction holding that to express or include one thing implies the exclusion of the other or of the alternative. For example, the rule that "each citizen is entitled to vote" implies that noncitizens are not entitled to vote.[12]

Hence, when certain events have been expressly specified in the relevant provisions of the rules where a holder of securities is required to dematerialise his existing securities, and when conversion of existing preference shares before their redemption is not one of those events, then the existing preference shares are not required to be dematerialised before their redemption.

WHEN A PRIVATE COMPANY WHICH WAS NOT A SMALL COMPANY ON THE LAST DATE OF THE FINANCIAL YEAR ENDING ON 31 MARCH 2023 BECOMES A SMALL COMPANY AS ON 31 MARCH 2024

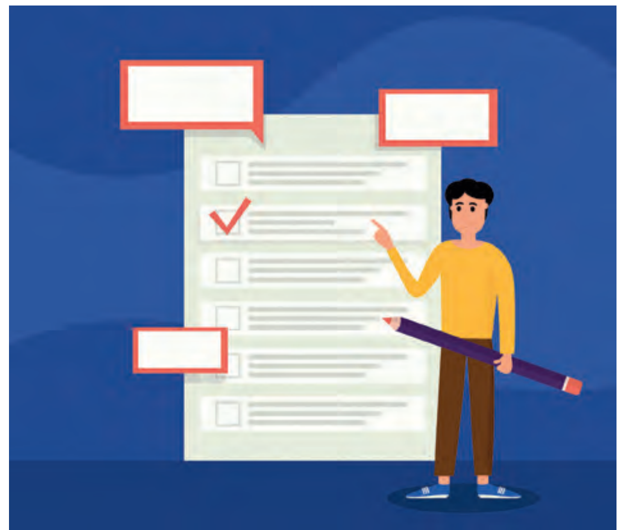
There is no clarity in rule 9B as to whether a private company which was not a small company on the last date of the financial year ending on 31 March 2023 becomes a small company as on 31 March 2024, will still have to comply with the requirements under rule 9B within 30 September 2024 or not.

A private company which was not a small company on the last date of the financial year ending on 31 March 2023 is given eighteen months' time from 31 March 2023 to comply with the requirements under rule 9B. The grace period of eighteen months travels beyond 31 March 2024, and hence the relevant provision gives impression that a company to which rule 9B became applicable would again need not ascertain as on the last date of the financial year ended 31 March 2024 whether it still continues to remain a company which is not a small company in order to ascertain its liability to comply with the relevant requirements.

10. *Kishorebhai Khamanchand Goyal v. State of Gujarat AIR 2004 SC 1006; State of M.P. v. Kedia Leather and Liquor Ltd AIR 2003 SC 3236.*

11. *Khemka and Co. (Agencies) Pvt. Ltd. etc. v. State of Maharashtra (1975) 2 SCC 22; AIR 1975 SC 1549.*

12. *Black's Law Dictionary, 8th edition.*



However, a legal provision which is applicable to a company on satisfying a statutory criterion, cannot apply to it perpetually and should not continue to apply once the company is not satisfying the criterion anymore, unless the provision has been clearly made applicable perpetually. The criterion here is that a private company should not be a small company on the last day of a financial year. When a private company after satisfying the criterion in one financial year, no more satisfies the criterion in the subsequent financial year, it would be unfair to make the company comply with the requirements under rule 9B when it is no more satisfying the criterion specified in that rule.

There is no provision in rule 9B which infers that applicability of the requirements under that rule is perpetual. Reading the relevant provisions differently would amount to adding of words into the statute which is not allowed. The Ministry of Corporate Affairs needs to provide clarity in this regard either by amending the rule or by issuing a circular.

APPLICABILITY OF RULE 9B WHEN FINANCIAL YEAR ENDS ON 31 DECEMBER INSTEAD OF 31 MARCH

The words of rule 9B(2) are clear and unambiguous. According to the rule a private company, which as on last day of a financial year, ending on *"or after"* 31st March, 2023, is not a small company as per audited financial statements for such financial year, shall, within eighteen months of closure of such financial year, comply with the provisions of this rule.

In view of first proviso to Section 2(41) of the Act, a company, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, it is allowed to have any period as its financial year whether or not that period is a year on an application made by that company to the Central Government.

According to rule 9B(2), a company is required to comply with the requirements under rule 9B if it is not a small company on the last date of financial year:

- If the financial year is ending on 31 March 2023; or
- If the financial year is ending on "*any date*" after 31 March 2023.

In view of the above requirement, 31 March 2023 is the first financial year ending on the last date of which it is required to be ascertained whether a private company is a small company or not. Thereafter, as on the last date of any financial year which ends on any date after 31 March 2023 (whether 30 April 2023, 30 September 2023, or 31 December 2023), it is required to be ascertained whether a private company is a small company or not as on such last date. Hence, where any company's financial year has ended on 31 December 2023, and as on that date such company was not a small company, then the available period to comply is eighteen months from closure of such financial year which is ending on 30 June 2025 (and not 30 September 2024) within which the company must comply with the requirements under rule 9B.

EXEMPTION FROM COMPLYING WITH THE REQUIREMENT OF DEMATERIALISATION OF SECURITIES

As per sub-rule (11) of rule 9A of the rules, an unlisted public company is not required to comply with the requirements under rule 9A if the unlisted public company is either a nidhi company (as defined under Section 406(1) of the Act), a government company (as defined under Section 2(45) of the Act), or a wholly owned subsidiary company (as defined under Section 2(87)) of the Act.

As per sub-rule (11) of rule 9B of the rules, a private company which is a government company (as defined under Section 2(45) of the Act) is not required to comply with the requirements under rule 9B. Point which is required to be noted here is that unlike an unlisted public company, a private company which is not a small company would be required to comply with the dematerialisation requirements even if it is wholly owned subsidiary of another company.

APPLICABILITY OF DEMATERIALISATION PROVISIONS TO A PRIVATE COMPANY WHICH IS SUBSIDIARY OF A PUBLIC COMPANY

Some people are uncertain whether a private company which is subsidiary of a public company would fall under rule 9A (which applies to unlisted public companies) or rule 9B (which applies to private companies) of the Rules.

The expressions "private company" and "public company" are defined in Sections 2(68) and 2(71) of the Act respectively, as follows:

(68) "private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

....

(iii) prohibits any invitation to the public to subscribe for any securities of the company.

(71) "public company" means a company which—

(a) is not a private company; and

(b) has a minimum paid-up share capital as may be prescribed:

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.

The proviso appended to Section 2(71) substantially corresponds to clause (c) of the definition of 'public company' in section 3(1)(iv) of the Companies Act, 1956 which read as follows:

"public company" means a company which—

....

(c) is a private company which is a subsidiary of a company which is not a private company.

Simply stated, this meant that a private company which is a subsidiary of a public company is a public company. The words 'shall be deemed to be' were absent in this provision. According to the proviso appended to Section 2(71) of the Act, in simple words, a private company which is a subsidiary of a public company shall be deemed to be a public company, for the purposes of the Act, even where such subsidiary company continues to be a private company in its articles.

A provision in a statute which contains the word 'deemed' is called a deeming provision or legal fiction. To deem means to regard or consider (something) in a specified way; to treat something as if it were something else; assuming a fact which does not really exist. It is well settled that a deeming provision is an admission of the non-existence of the fact deemed. The Legislature is quite competent to enact a deeming provision for the purpose of assuming the existence of a fact which does not really exist.[13] When a person

13. *J. K. Cotton Spinning and Weaving Mills Ltd v. Union of India AIR 1988 SC 191.*

> is deemed to be something the only meaning possible is that whereas he is not in reality that something, the law requires him to be treated as if he were (that something).[14] The legal fiction must be given its due play. There should be no half way play.[15] But a fiction created by law cannot operate beyond the purpose for which it has been created.[16]

Although not happily worded and being ambiguous and grammatically incorrect (since a company is not a private company "*in its articles*" but due to inclusion in its articles the conditions specified in the definition), the effect of the words "even where such subsidiary company continues to be a private company in its articles" is that a private company which becomes a subsidiary of a public company can continue to have included in its articles the conditions required to be included in the articles of every private company as per the definition in Section 2(68) of the Act quoted above. As will be noticed from that definition, to constitute the company a private company, the articles of the company must contain the conditions stated in clauses (i), (ii) and (iii) of that definition.

The effect of the proviso to Section 2(71) is that a private company which becomes a subsidiary of a public company is considered a public company for all intents and purposes under the Act, but the articles of the company can continue to contain the conditions stated in clauses (i), (ii) and (iii) of the definition of 'private company' in Section 2(68). In other words, a private company which becomes a subsidiary of a public company is to be treated as a public company and must comply with all the provisions of the Act as if it is a public company, except that it can continue to have the conditions specified in the definition of 'private company'.

It is important to note that the private company which is a subsidiary of a public company is a private company by birth; it was incorporated as a private company; its basic structure is that of a private company, but it is treated as a public company by the legal fiction in the definition of "public company". The words "is a private company" in the proviso to the definition of 'public company' makes it clear that the company (which is a subsidiary of a public company) is a basically private company. The use of these words clearly indicates legislative intent that the private company which is a subsidiary of a public company is a private company and remains so even after it becomes a subsidiary of a public company but it must comply with the provisions of the Act as if it was a public company. Therefore, the basic structure of the private company which is a subsidiary of a public company is that of a private company and may continue to remain so after it becomes a subsidiary of a public company. However, for all other purposes under the Act, it will be treated as a public company.

In Needle Industries India Ltd v Needle Industries Newey (India) Holding Ltd,[17] the Supreme Court stated that under Companies Act there are two kinds of companies, namely, private companies and public companies. Besides, the Supreme Court held that the definitions of 'public company' and 'private company' are mutually exclusive and collectively exhaustive of all categories of companies, that is to say, that there is no third kind of company recognised by the 1956 Act. The definition of 'private company' and the manner in which a 'public company' is defined ("public company means a company which is not a private company") bear out the argument that these two categories of companies are mutually exclusive. If it is this, it cannot be that and if it is that it cannot be this. The Supreme Court observed in the context of Section 43A of the 1956 Act (which was omitted in 2000) as follows:

"In the first place, a Section 43A company may include in its articles, as part of its structure, provisions relating to restrictions on transfer of shares, limiting the number of its members to 50, and prohibiting an invitation to the public to subscribe for shares, which are the typical characteristics of a private company. A public company cannot possibly do so because, by the very definition, it is that which is not a private company, that is to say, which is not a company which by its articles contains the restrictions mentioned in Section 3(1)(iii). Therefore, the expression "public company" in Section 3(1)(iv) cannot be equated with a "private company which has become a public company be virtue of Section 43A".

These observations are relevant in the case of a private company which becomes a public company by being a subsidiary of a public company although retains its basic character as a private company. Thus, except for the basic structural framework, a private company which is a subsidiary of a public company is, for all intents and purposes, to be treated as a public company and is required to comply with the requirements under the Act applicable to public companies.

Hence, a private company which is a subsidiary of a public company, would be considered as a public company for all purposes of the Act and is required to comply with all the requirements under that Act applicable to a public company including the requirements under Rule 9A of the Rules; such private company would not fall within the ambit of rule 9B of the Rules. If the private company which is a subsidiary of a public company, is neither a nidhi company, government company, or a wholly owned subsidiary company of the public company, then no exemption is available to it under sub-rule (11) of rule 9A of the Rules.

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14. *Commissioner of Income-tax v Bombay Trust Corporation Ltd AIR 1930 PC 54.*
15. *Union of India v Jalyan Udyog AIR 1994 SC 88: 1994 (1) SC 318: 1993 (3) Scale 758: 1993 (5) JT 266.*
16. *H.S. Atwal v Union of India AIR 1994 SC 2531: 1994 (5) SCC 341: 1994 (3) Scale 555: 1994 (5) JT 346. See also Braithwaite & Co. (India) Ltd. v Employees State Insurance Corporation AIR 1968 SC 413: 1968 (1) SCWR 379: 1968 (1) SCR 771.*
17. *(1981) 51 Comp Cas 743 (SC).*