Definitions of "holding company" and "subsidiary"

[This note is based on the Companies Bill 2012, as amended by Select Committee in November 2013]

Key points

- ***Only one definition of "subsidiary" proposed for both company law and accounting purposes.***
- ***Section 7 of the Companies Bill 2012 sets out a new definition of "subsidiary" (and by extension, of "holding company"), which combines the definition of "subsidiary" (and "holding company") in section 155 of the Companies Act 1963 and that of "subsidiary undertaking" (and "parent undertaking") in Regulation 4 of the European Communities (Companies: Group Accounts) Regulations 1992.***

Introduction

Section 7 of the Companies Bill 2012 (the "**Bill**") proposes a new definition of "subsidiary", merging the concepts of "subsidiary" as currently defined in section 155 of the Companies Act 1963 (the "**1963 Act**") and "subsidiary undertaking" as defined in regulation 4 of the European Communities (Companies: Group Accounts) Regulations 1992 (the "**1992 Regulations**").

Section 8(1) of the Bill provides that "*… a company is another company's holding company if, but only if, that other is its subsidiary*", so that section 7 by extension also defines the term "holding company". The holding company - subsidiary relationship can arise in the six circumstances below.

Section 7 also introduces the expressions "superior company" and "lower company", which are useful in assisting the understanding of the terms (but do not have any other significance).

(1) Holding a "golden share"

This circumstance, whereby a lower company will be a subsidiary of a superior company if the superior company is a shareholder or member of the lower company and controls the composition of the board of directors of the lower company (s 7(2)(a)(i) of the Bill) effectively restates regulation 4(1)(a)(ii) of the 1992 Regulations. Section 155(1)(a)(i) of the 1963 Act is worded similarly but only refers to "member" and not to "shareholder".

Section 7(3) of the Bill provides that a superior company shall be regarded as controlling the composition of the board of directors of a lower company if but only if the superior company can appoint or remove the holders of all or a majority of the directorships. This provision is unchanged from that in s 155(2) of the 1963 Act and regulation 4(2) of the 1992 Regulations.

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(2) Holding more than half of the equity share capital or voting rights

Section 7(2)(a)(ii) and (iii) restate the provisions of s 155(1)(a)(ii) and (iii) whereby a lower company will be a subsidiary of a superior company if the superior company holds more than 50% (in nominal value) of the equity share capital, or of the shares carrying voting rights, in the lower company. Section 7(10) restates the provision of s 155(5) whereby shares that do not have the right to participate in dividends or capital beyond a specified amount must not be counted in "equity share capital" for these purposes.

Section 7(2)(a)(iv) restates the provision of regulation 4(1)(a)(ii) of the 1992 Regulations whereby a lower company will be a subsidiary of a superior company if the superior company holds a majority of the shareholders' or members' voting rights in the lower company. This therefore extends the definition to include companies not having a share capital.

Section 7(3) sets out circumstances in which a superior company shall be treated, or not, as holding shares or exercising a power, while section 7(4) sets out circumstances in which voting rights shall be excluded from a computation; these provisions combine those of section 155(3) of the 1963 Act, and regulations 4(3) and (4) of the 1992 Regulations.

(3) Having the right to exercise a dominant influence

Section 7(2)(b) states that a lower company shall be a subsidiary of a superior company if the latter has the right to exercise a dominant influence over the lower company by virtue of provisions in the constitution of the lower company, or by virtue of a control contract. This restates the provision in regulation 4(2)(b) of the 1992 Regulations. Subsections (7) to (9) of section 7 similarly restate subsections (5) to (7) of regulation 4 of the 1992 Regulations.

(4) Having the power to exercise, or actually exercising, dominant influence or control

Section 7(2)(c) adds that a lower company shall be a subsidiary of a superior company if the superior company has the power to exercise, or actually exercises, dominant influence or control over the lower company. This is a restatement of regulation 4(2)(c) of the 1992 Regulations.

(5) Being managed on a unified basis

Section 7(2)(d) provides that a company shall be a subsidiary of a superior company where the two are managed by the superior company on a unified basis. This clarifies regulation 4(2)(ca) of the 1992 Regulations, in that the definition there – although establishing a parent undertaking - subsidiary undertaking relationship – did not make clear which company filled which role. The concept of being managed on a unified basis is a relatively novel one for company law purposes which, it is thought, will require to be scoped out by practitioners.

(6) Subsidiary of a subsidiary

Finally, section 7(2)(e) states that a lower company shall be a subsidiary of a superior company if the former is a subsidiary of a company which is itself a subsidiary of the superior company, restating regulation 4(1)(d) of the 1992 Regulations and section 155(4) of the 1963 Act. This will clearly also operate where there is a chain of holding company-subsidiary relationships.

Conclusion

The test for establishing a group relationship will be wider for general company law purposes, with more companies qualifying, than is currently the case.

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