COMPANY LAW

MEANING AND NATURE OF COMPANY

In India the law relating to company is govern by the COMPANIES ACT 1956

The word company is derived from the latin word which means come together for bread or for meals.

But Company in its ordinary sense, means an association or group of person , associated together with a common objective , may be for profit making by doing business or for attainment of any social or economic objective , or for any other charitable purpose.

Company has its own separate legal identity independent from the identity of member associated together with it , it can sue and can be sued just like an ordinary person but being created by law it has no body and soul ,it works through its member.

In other words we can say that the company is an group of common minded people grouped together for a common goal, for promoting business, research, religion, trade, commerce or any other charitable purpose.

DEFINATION OF COMPANY

According to Section 3(1) of the Companies Act 1956

"Company means a company formed and registered under the companies Act or an existing company"

According to Lindley L.J.

" A company is an association of many persons who contribute money or money's worth to a common stock, and employ it in some common trade or business (i.e., for a common purpose) , and who share the profit or loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to with each member is entitled is share. Share are always transferable although the right to transfer them is often more or less restricted "

DEFINATION OF COMPANY

Under Halsbury's Laws of England

the term Company has been defined as a "Collection of many individuals united into one body under a special domination, having perpetual succession under an artificial form , and vested by the policy of law with the capacity of acting in several respects as an individual , particularly of taking and granting property, of contracting obligation and of suing and being sued, of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive , according to the designs of its institution , or the powers upon it, either at the time of its creation or at any subsequent period of its existence".

COMPANY AS DEFINED IN CASES

In case of Solomon Vs Solomon & Co. (1897 A.C.22)

Company has been defined as a legal person or legal entity separate from and capable of surviving beyond the lives of its members.

In Case of Electronics Corp. Vs. Secretary (A.I.R. 1999 S.C. 1734)

It was held that the company registered under the act is distinct legal entity other than legal entity of entities that holds it shares.

In India even before the decision of Salomon Vs. Salomon & Co. Ltd , Calcutta High Court in **Re Kandoli Tea Co. Ltd (1886 I.L.R. 13 Cal. 43)** observed that " The company was a separate person, a separate body altogether from the shareholder and the transfer was as much a conveyance , a transfer of property , as if the shareholders had been totally different persons"

This case seems to be the first case on the subject , In this case , a tea estate was transferred by certain persons to a company who become the shareholders of the company. They claimed exemption from advalorem duty on the ground that transfer was from them to themselves under another name. Court while deciding the case rejected the plea and has given the above definition.

NATURE / CHARACTERISTICS OF COMPANY

- Separate legal entity
- Limited liability
- Perpetual Succession
- Separate Property
- Transferability of shares
- Common Seal
- Capacity to sue and be sued
- Limitation of Action

Separate legal entity.

Separate Legal entity means a company is vested with a corporate personality which is distinct from its members. Being a separate legal entity it has its own name, own property, own business and It can enter into contract in the same manner as any other individual can enter into contracts, it is true that company perform all its action through its members but member of the company or share holder of the company cannot be held responsible for the act of the company even if it holds entire share capital of the company. The share holder of the company are the agent of the company and so they cannot be held responsible for the act of company.

In case of Salomon Vs. Salomon & Co. Ltd. (1897 AC 22) it has been laid down that the once a company has been validly constituted under the Companies Act, it become legal per son distinct from its member

Separate legal entity..

In this case Salmon who carried on a prosperous business as a leather merchant and boot manufacturer . He formed a limited company consisting of himself, his wife, his daughter and his four sons as the share holders, all of whom subscribed for 1 share each so that the actual cash paid as capital was $ 7 . Salomon sold his business (which was perfectly solvent at that time) to the company for the sum of $ 38,782 . The company's nominal capital was $ 40,000 in $ 1 shares . In part payment of the purchase money for the business sold to the company , debentures of the amount of $ 10,000 secured by a floating charge on the company's assets were issued to Salomon , who also applied for and received an allotment of 20,000 $ 1 fully paid share . The remaining amount of $ 8782 was paid to salmon in cash . Salomon was the managing director and two of his sons were other directors.

Separate legal entity…

The company soon ran into difficulties and the debenture holders appointed a receiver and the company went into liquidation. The total assets of the company amounted to $ 6050, its liabilities were $10,000 secured by debentures, $ 8000 owning to unsecured trade creditors , who claimed the whole of the company's assets Viz $6050 , on the ground that , as the company was mere 'alias

or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf. The trial judge and the Appellate court agreed with these contentions and decreed against Salomon. The House of Lords disagreeing with the lower courts, repudiated these contentions and accepted the appeal and reversed the order of the Appellate court .

Separate legal entity….

The House of Lords held that on registration , the company comes into existence and the attains maturity on its birth. There is no period of minority, no interval of incapacity. Its has its own existence or personality separate and distinct from its members and , as a result , a shareholder cannot be held liable for its acts even though he holds virtually the entire share capital. Thus the case also established the legality of what is known as “one man company” The case also recognised that the subscribers do not have to be independent or strangers to one another. The case also recognised the principle of limited liability . It also established that a person can be at the same time a member, a creditor and an employee of the company as well as director.

Separate legal entity…..

Their Lordships of the House of Lords observed :

When the memorandum is duly signed and registered, though there be only seven shares taken, subscribers are a body corporate capable forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statute can lose its individuality by issuing the bulk of its capital to one person. The company is at law a different person altogether from the subscribers of the memorandum and though it may be that after incorporation the business is precisely the same as before the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trustee. The statute enacts nothings as to the extent or degree o interest which may be held by each of the seven or as the proportion of interest , or influence possessed by the one or majority of the shareholder over other . There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take substantial interest in the undertakings, or that they should have a mind or will of their own, or that there should be any thing like a balance o power in the constitution of Company.

Limited Liability.

Limited liability is one of the greatest advantage for doing business under the corporate form i.e. by forming a company with limited liability. The company being a legal person and having a distinct identity the members or shareholders of the company are not personally liable for the debts of the company. They can be held liable at the most for their contribution in share capital of the company which is not paid by the .

For example if in a company face value of one share is Rs 100 and one of shareholder has paid only Rs 70 the at the most he can be called upon to pay only Rs 30 being value unpaid by the shareholder at the time of allotment of the share, in the life time of the company. This is the case where the company is limited by shares

But is case of company limited by guarantee , the liability of members is limited up the amount which for which they had agreed to give guarantee to contribute to the assets of the company in the event if company is wound up.

Perpetual succession

A company once created as per the provision of law never dies by its own. Even a case where all the shareholders or members of company dies then too the company remains in existence . Not only this company always remains unaffected with the coming and going of its members or shareholders Therefore it is very rightly said that the member may come and member may go but company go on for ever. Death , insolvency , insanity , in capacity of its member do not have any affect on the company . During war if all member of the company were killed by a atom bomb or by a hydrogen bomb , company will survive , company will never die. Only way is winding up or dissolution or amalgamation or by any other process of law .

Seperate Property

A company being a legal person can enjoy sale , purchase of properties as an ordinary person can enjoy. A company can purchase and own the movable and immovable properties in his own name . No share holder has any right or title in any property of the company even if he has maximum number of shares of that company. The property of company is not the property of the shareholders, it is the property of the company.

But in case of Partnership firm the partners are the joint owner of the firms property

Transferability of Shares

The capital of company is divided into share . Shares are nothing but the small small parts of capital for which the shareholders contributes . These shares are the movable assets of the share holders and with certain condition these shares can be easily and freely transferable, which makes the relationship of shareholder and company temporary i.e. till the share holder is holding the share of the company

A member can sell his share in open marked and can get his money so invested in the company this feature provides the liquidity to the member of the company and ensures stability to the company but this is possible only in case of public limited company , limited by share and who are listed in the stock exchange .

The member or the share holder is not required to take any consent or permission from other member or the company as soon as the shares are transferred to another person the transferee acquires all right what the transferor has in that company with respect to that shares .

Common Seal

A company as soon as incorporated/Registered it acquires the legal entity , perpetual succession and a common seal . A company being an legal person do not have any physical existence . Company do not have any body or soul to work , it always work through its agents and agents while representing the company uses the name of company under a common seal of the company . This common seal of the company is very important as every work done by the agent under the common seal is treated as work done by the company and company is bound by that act of the agent and If any document doesnot bear common seal of the company do not have any binding effect. The seal must be such that the name of company must be engraved on it . A rubber stamp does not serve the purpose .

Capacity to Sue and Be Sued

A company being an juristic/legal person distinct identity from its members , can sue and be sued in its own name , There may be any number of members of the company but the company if wants to file a suit he can file its suit in his own name there is no need to make any individual or the person looking after the transaction of the company to be made as a party. Not only this company can recover all dues under its own name and can brought any action against any person in its own name

But in case of any other unincorporated association all the member of the association are necessary party and suit has to be brought in the name of all members either individually or collectively

Limitation of Action

A company being an juristic/legal person distinct identity from its members , working through its agent it is controlled by the Memorandum of Association.

Memorandum of Association of a company regulates the power and fixes the objects of the company . A company cannot work beyond powers granted to him under the Memorandum of Association. It cannot go beyond the power granted under Memorandum of Association unless the Memorandum of Association is itself altered prior to doing so.

COMPANY IS NOT A CITZEN

A company although regarded as a legal person it cannot become citizen of a country . A company may have nationality or residence like Indian company or American company but it cannot be citizen and cannot have right of vote. Under Constitution of India Company cannot enjoy Fundamental right which are expressly available to a citizen only.

But a Company can enjoy all the right provided by the constitution to an non citizen like right of equality etc.

DIFFERENCE BETWEEN COMPANY AND PARTNERSHIP

- Company is govern and regulated by the Companies Act 1956 But A partnership is regulated by the Indian Partnership Act 1932

- Company comes into existence after registration of company under Companies Act 1956 . In Case of Partnership Registration is not mandatory it depends on the will of partner who are entering into partnership.

- Company has its own legal identity distinct from its members and members are not personally liable for the act of the company But in case of a partnership firm , firm is not a legal person in the eyes of law and the members of partnership firm i.e. partners are personally liable for the act of the firm.

DIFFERENCE BETWEEN COMPANY AND PARTNERSHIP.

- Member or Share holder of the company are not the owner of the property of a Company even if they hold entire capital of the company But in case of partnership all partners are jointly and collectively owner of the firm's property .

- The liability of members of Limited company towards the debts and liabilities of a company , is limited, Whereas the partners are liable for all the debts and liabilities of firm without any limit , that means they and their personal assets are also liable for the debts of the firm, Creditors obtaining decree against firm can proceed against and attach the property of the partners..

DIFFERENCE BETWEEN COMPANY AND PARTNERSHIP..

- In case of company all the affairs of a company are managed by its directors, managing directors appointed as per law . Every Member is not permitted to take part in management. Where as in the case of Partnership Firm every partner has right to take part in management unless the partnership agreement debarred them.
- Share of company are freely transferable, unless otherwise provided in Article of Association But in case of partnership firm a partner cannot transfer his share without the consent of other partners
- Every partner is an agent of the firm and makes contracts on behalf of the firm in the ordinary course of business of the firm. But in case of company shareholders of company are not the agent of the company and they do not have such power

DIFFERENCE BETWEEN COMPANY AND PARTNERSHIP..

- In case of Partnership firm , Firm can do any business or activity for which partners agrees but in case of company , Company cannot work beyond the object clause of the its Memorandum of Association
- Insolvency of a firm means insolvency of every partner but winding up of insolvent company does not make all its member insolvent
- Minimum number of partners in a firm is 2 whereas in case of public limited company it is 7 and in case of private limited company is 2.
- Maximum number of partners for a banking business can be 10 and in any other business is 20 . In case of Private limited company maximum number of share holder is 50 and in case of Public limited there is maximum limit.

DIFFERENCE BETWEEN COMPANY AND PARTNERSHIP...

- A Partnership firm may dissolved at any time by the partner and if partnership is for fixed time period it dissolves automatically after expiry of such time or a firm can be dissolved on death of partners. But in case of Company, Company enjoys perpetual succession and personal circumstances like death , insolvency, unsoundness of member do not effect existence of company . It comes to end only when it is wound up by due process of law.
- A company is legally required to have its accounts audited by chartered accountant annually but in case of partnership it depends on the discretion of the partners.

Lifting of corporate veil

A company from juristic point is a legal person having its distinct identity from its members , This principal is referred as the veil of incorporation. It means that there is a fictional veil (and not a wall) between the company and its members .

But some times the members of company uses this principal of veil of corporate personality for fraud or for some illegal or for some improper conduct . In such situation court has left with no option but to lift the corporate veil and to look into the matter beyond the corporate veil at the persons who are behind the company and who are real beneficiaries of the company or who had taken benefit of corporate veil.

Circumstances for Lifting of corporate veil

General Circumstances

- Protection of Revenue
- Prevention of Fraud
- To Know the Character of the company
- Where the company is mere a Cloak or Shame
- Where company is avoiding its legal Obligation
- Where company is acting as a trustee of the Share holder
- Where there is a conflict with Public Policy

General Circumstances for Lifting of corporate veil

Protection of revenue

Where the corporate veil has been used for evasion of Tax then court is empowered to lift the corporate veil and looked at the realities of the situation. It doesn't mean that a person or a company cannot do tax planning, tax planning is permitted but it must be within the four corners of law.

Fox example : If a assessee was receiving huge dividends from private companies formed by him, only for saving of tax and to manage the income of the assessee and those companies were doing nothing except the managing the income and assets of the assessee i.e they do no other business but created simply for receiving dividends and interest and handed them over to assessee as a loan or by any other means then in such circumstances , court can lift the corporate veil.

General Circumstances for Lifting of corporate veil

Prevention of Fraud

Where the corporate veil has been used for commission of fraud or improper conduct , courts have lifted the veil and looked at the realities of the situation.

In case of Jones V/s Lipman (1962) I W.L.R 832 . A agreed to sell certain land to B. Pending completion of formalities of sale , A sold and transfer land to a company which he had incorporated with a nominal capital of 100 and with a share holder and director , This was done with and intention to escape from decree for specific performance of contract in a suit brought by B. The court held that the company was a creature of A and a mask to avoid recognition and it was directed that A must complete the contract as he has full control on the property of the company and he is in position to complete contract.

General Circumstances for Lifting of corporate veil

To Know the Character of the company

Where the corporate veil has been used by a company whose all or maximum share capital is owned by such person who are the citizen of enemy country or if a company is created only for the purpose to deal with enemy company or to avoid debt or liability to be recovered from enemy company then in such circumstances Court can lift the corporate veil and look into the real character of the company

In case of Daimler Co. Ltd Vs Continental Tyre & Rubber. Co (1916) 2 A.C. 307 . A company was incorporated in England in which all the directors were German and all shareholders are German except one . During First World War This company Commenced an action for recovery of huge trade debts. It was held that since the company is an alien company and the payment of debt to it would be amount to trading with the enemy company , therefore the company was not allowed to proceed with the action of recovery of debts.

General Circumstances for Lifting of corporate veil

Where the company is mere a Cloak or Shame

In case of Gilford Motor Co. Vs Home (1933) 1 ch 935. A former employee of company entered into a covenant not to solicit with the customers of company. He formed a company and under the garb of corporate veil he started solicitation with customer then court held that such company is nothing but created only to defeat the covenant entered into by the employee. And he is restrained from soliciting with the customer of the company with which he had entered into a covenant.

General Circumstances for Lifting of corporate veil

Where company is avoiding its legal Obligation

Where it was found that the sole purpose for which the company was formed was to evade taxes the court will ignore the concept of separate entity and make the individuals liable to pay the taxes which they would have paid but for the formation of the company

In Case of Sir Dinshaw Manakjee Petit, A.I.R. 1927 Bombay 371 . The assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability . It was held by the court that the company was formed only for avoiding the super-tax and company was nothing more than assessee himself , company had not done any business. The court disregard the corporate entity of that company as it was being used for tax evasion.

General Circumstances for Lifting of corporate veil

For Protection of Public Policy

Where it was found that the transaction of company is against the public policy then to prevent such transaction , court can lift the corporate veil . Thus where there is a conflict with public policy , the court can ignore the separate legal entity of company by lifting the corporate veil and looked into realities of the matter.

Circumstances for Lifting of corporate veil

Statutory Circumstances

- Reduction in Number of Members of Company
- Failure to refund application money
- Misdescription of Company's name
- Fraudulent trading in case of winding of company
- Common Holding and subsidiary company relationship

Statutory Circumstances for Lifting of corporate veil

Reduction in Number of Members of Company

Where it was found that the company is carrying its business with less then 7 members in case of public limited company and 2 in case of private limited company for more than 6 month then the member who are carrying on such business are personally liable for the debts of the company.

Statutory Circumstances for Lifting of corporate veil

Failure to refund application money

Where it was found that the company fails to refund the application money to the person who had applied for share but shares were not allotted to them within 130 days from the date of issue of prospectus then the director of the company were personally liable for the debts and the interest on such amount.

Statutory Circumstances for Lifting of corporate veil

Misdescription of Company's name

Where it found that any officer of the company or any agent of the company enters into contract without mentioning the company's name and address of the registered office or In case of Hundi, Bills of exchange , or promissory note does not bear the name and the registered address of the company with the designation of the person who is entering a contract then such person or agent or officer of the company would be personally liable to the holder of such instruments.

Statutory Circumstances for Lifting of corporate veil

Fraudulent trading in case of winding of company

Where it found that any officer of the company or any agent of the company enters into contract or does any transaction to defraud the creditors of the company then court on the application of the official liquidator, or by any creditor can lift the corporate veil and held that such person is personally liable.

Statutory Circumstances for Lifting of corporate veil

Common Holding and subsidiary company relationship

In the eyes of law the Holding company and subsidiary company is having separate legal entity but in the case where at the end of financial year the profit and loss of the holding company is shown with the profit and loss of the subsidiary company collectively, then subsidiary company loses its separate legal entity Or where the subsidiary company is nothing but only working like a branch or department of the a big holding company then too if it is proved , subsidiary company can lose its separate legal entity .

COMPANY LAW

CHAPTER 2

KINDS OF COMPANIES

Classification of companies

- Classification on the basis of Incorporation
- Classification on the basis of Liability
- Classification on the basis of Number of Members
- Classification on the basis of control
- Classification on the basis of ownership

KINDS OF COMPANIES

CLASSIFICATION ON THE BASIS OF INCORPORATION

- Statutory Companies

  Statutory companies those are created by a special act or legislature . The provision of Companies Act 1956 apply to them if the provision of such special act are inconsistent. Normally such type of companies are formed for public utility services.

Example : State Bank of India, Life Incorporation , Industrial Finance Corporation, Railways, Tramways , Electricity company

- Registered Companies

Registered companies means companies formed and registered under the provision of companies act 1956 or were registered under any of the earlier companies Act.

KINDS OF COMPANIES

CLASSIFICATION ON THE BASIS OF LIABILITY

- Companies with Limited liability
- Companies with unlimited liability

Classification on the basis of Liability

1. Companies with limited liability

Companies limited by share :

Where the liability of the members of a company is limited to the amount unpaid on the shares.

Companies limited by guarantee :

Where the liability of the members of a company is limited to a fixed amount which the members undertake to contribute to the assets of the company in the event of its being wound up the company is called company limited by guarantee.

Classification on the basis of Liability

2. Companies with unlimited liability

Sec 12 specifically provides that any 7 or more persons(2 or more in case of of a private company) may form an incorporated company , with or with out limited liability. A company without limited liability is know as an unlimited company . In case of such company ,every member is liable for the debts of the company.

An unlimited company may or may not have a share capital. If it has a share capital it may be a public company .

KINDS OF COMPANIES

CLASSIFICATION ON THE BASIS OF NUMBER OF MEMBERS

- Private Company
- Public Company

Classification on the basis of Number of Members

1. Private company :

According to Sec 3 (1),a private company means a company which has minimum paid up capital of Rs 1,00,000 or such higher paid-up capital as may be prescribed ,

and by its Article

Restrict the right to transfer its share if any .This restriction is meant to preserve the private character of the company

Limits the number of its member to 50 not including its employee members

Prohibits any invitation to the public to subscribe for any shares in or debentures of the company

Prohibits any invitation or acceptance of deposits from persons other than its members directors or relatives

A private company must have its own Article of Association

Public Company

A public company means a company which has

- minimum paid up capital of Rs 5,00,000
- Minimum number of members for a public company is 7
- Public company must have at least 3 directors
- Share and debentures are transferable in case of public limited company
- The Managers remuneration in public company cannot exceed 11% of net profit (Sec 198)

Difference between private company and public company

- Minimum Paid-up Capital :

  A company to be Incorporated as a Private Company must have a minimum paid-up capital of Rs. 1,00,000, whereas a Public Company must have a minimum paid-up capital of Rs. 5,00,000

- Minimum number of members :

  Minimum number of members required to form a private company is 2, whereas a Public Company requires at least 7 members

- Maximum number of members :

  Maximum number of members in a Private Company is restricted to 50, there is no restriction of maximum number of members in a Public Company.

- Transferability of shares :

  There is complete restriction on the transferability of the shares of a Private Company through its Articles of Association , whereas there is no restriction on the transferability of the shares of a Public company

Difference between private company and public company

Issue of Prospectus :

A Private Company is prohibited from inviting the public for subscription of its shares, i.e. a Private Company cannot issue Prospectus, whereas a Public Company is free to invite public for subscription i.e., a Public Company can issue a Prospectus.

Number of Directors :

A Private Company must have at least 2 directors to manage the affairs of the company, whereas a Public Company must have at least 3 directors

Consent of the directors :

consent of the directors is not necessary to file with the registrar of company in case of Private Company, whereas the Directors of a Public Company must have file with the Registrar a consent to act as Director of the company

Qualification shares :

The Directors of a Private Company need not sign an undertaking to acquire the qualification shares, whereas the Directors of a Public Company are required to sign an undertaking to acquire the qualification shares of the public Company

Difference between private company and public company

Commencement of Business :

A Private Company can commence its business immediately after its incorporation, whereas a Public Company cannot start its business until a Certificate to commencement of business is issued

Shares Warrants :

A Private Company cannot issue Share Warrants against its fully paid shares, Whereas a Public Company can issue Share Warrants against its fully paid up shares.

Further issue of shares :

A Private Company need not offer the further issue of shares to its existing share – holders, whereas a Public Company has to offer the further issue of shares to its existing share – holders as right shares. Further issue of shares can only be offer to the general public with the approval of the existing share – holders in the general meeting of the share – holders only

Statutory meeting :

A Private Company has no obligation to call the Statutory Meeting of the member, whereas of Public Company must call its statutory Meeting and file Statutory Report with the Register of Companies

Difference between private company and public company

Quorum :

The quorum in the case of a Private Company is TWO members present personally, whereas in the case of a Public Company FIVE members must be present personally to constitute quorum. However, the Articles of Association may provide and number of members more than the required under the Act

Managerial remuneration :

Total managerial remuneration in the case of a Public Company cannot exceed 11% of the net profits, and in case of inadequate profits a maximum of Rs. 87,500 can be paid. Whereas these restrictions do not apply on a Private Company.

Special privileges :

A Private Company enjoys some special privileges, which are not available to a Public Company

These are , Allotment before minimum subscription, issue of new share, kinds of shares , commencement of business , no need to keep index of members, managerial remuneration etc.

KINDS OF COMPANIES

CLASSIFICATION ON THE BASIS OF CONTROL

- Holding Companies
- Subsidiary Companies

Classification on the basis of control

- Holding Company :

  {Sec 4(4)} A company is known as the holding company if it has control over the other company .

- Subsidary company :

  {Sec4(1)} A company is know as a subsidary company when control is exercised by the holding company

KINDS OF COMPANIES

CLASSIFICATION ON THE BASIS OF OWNERSHIP

- Government Companies
- Non Government Companies
- Foreign Companies
- One man Companies

Classification on the basis of ownership

- Government Company:

A government company means any company in which not less than 51% of the paid up share capital is held by

a) The central Government
b) State Government
c) Partly by Central government and partly by State government

for example :-

State Trading Corporation of India Ltd Minerals and Metals Trading Corporation of India Ltd.

Rules applicable to Government companies

1) Appointment of auditor and audit reports (Sec. 619).

The auditor of a Government company shall be appointed or re-appointed by the Central Government on the advice of the Comptroller and Auditor-General of India. The Comptroller and Auditor-General shall have power to direct the manner in which the company's accounts shall be audited by the auditor. He shall also have the power to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorize in this behalf.

The provisions of Sec. 619 shall apply notwithstanding anything contained in Sees. 224 to 233 which deal with audit.

Audit reports to be submitted to Comptroller and Auditor-General of India. The auditor of a Government company shall submit a copy of his audit report to the Comptroller and Auditor-General of India who shall have the right to comment upon, or supplement, the audit report. Any such comments upon, or supplement to, the audit report shall be placed before the annual general meeting of the company.

- 2. Annual report to be placed before Parliament (Sec. 619-A).

Where the Central Government is a member of a Government company. it shall cause an annual report on the working and affairs of the company to be prepared within 3 months of its annual general meeting before which the audit report is placed. The report shall be laid before both Houses of Parliament together with a copy of the audit report, and any comments upon, or supplement to, the audit, made by the Comptroller and Auditor General of India.

Where in addition to the Central Government, any State Government is also a member of a Government company. the State Government shall cause a copy of the above documents to be laid before the House or both Houses of the State Legislature. Where the Central Government is not a member of a Government company, the State Government or every State Government which is a member, shall cause the above documents to be prepared within the specified time and laid before the House or both Houses of the State Legislature.

The provisions of Sec. 619-A shall, so far as may be, apply to a Government company in liquidation as they apply to any other company.

- **3. Provisions 0 Sec. 619 to apply to certain companies (Sec. 619-B).**
- The provisions of Sec. 619 shall apply to a company in which not than 51 per cent of the paid-up share capital is held by one or more of
- the following or any combination thereof, as if it were a Government company, namely,
- (a) the Central Government and one or more Government companies;
- (b) any State Government or Governments and one or more Government companies;
- (c) the Central Government, one or more State Governments and one or more Government companies;
- (d) the Central Government and one or more corporations owned or controlled by the Central Government;
- (e) the Central Government or one or more State Governments and one or more corporations owned or controlled by the Central Government;
- (j) one or more corporations owned or controlled by the Central Government or the State Governments ; and
- (g) more than one Government company.
- Sec. 619-B is intended to strengthen the financial discipline in case of companies in which more than 51 per cent shares are held jointly by Government, Government companies and public financial corporations.

4. Certain provisions of the Companies Act not to apply (Sec. 620).

The Central Government may by notification in the Official Gazette, direct that any of the provisions of the Companies Act (other than Sees. 618, 619 and 619-A), specified in the notification-

(a) shall not apply to any Government company; or

(b) shall apply to any Government company, with such exceptions. modifications, and adaptations, as may be specified in the notification.

A copy of every notification proposed to be issued shall be laid in draft before each House of Parliament while it is in session for a total period of 30 days which may be comprised in 1 or 2 or more successive sessions. If both the Houses agree in disapproving the issue of the notification. the notification shall not be issued. If they agree in making any modification in the notification, the notification shall be issued in the modified form.

Foreign Company

It means any company incorporated outside India which has an established place of business in India [Sec. 591 (I)). Where for example, representatives of a foreign company frequently come and stay in a hotel in India for purchasing raw material, machinery. cotton etc., the foreign company has a place of business in India.

- Where a minimum of 50 per cent of the paid-up share capital (whether equity or preference or partly equity and partly preference) of a foreign company is held by one or more citizens of India or/and by one or more bodies corporate incorporated in India, whether singly or jointly,

- such company shall comply with such provisions as may be prescribed as if it were an Indian company [Sec. 591 (2)).

Rules applicable to foreign companies

- Sec. 592 to 602 apply to foreign companies. The provisions contained in these Sections are as follows:

- 1. Documents (Sec. 592).

  Every foreign company shall, within 30 days of the establishment of a place of business in India, file with the Registrar the following documents.

- (1) A certified copy of the charter, Statutes, Memorandum and Article of the company and, if the instrument is not in the English language, a certified translation thereof.

- (2) The full address of the registered or principal office of the company.

- (3) A list of the directors and secretary of the company.

- (4) The names and addresses of any person or persons resident in India, authorized to accept on behalf of the company service of process and any notices required to be served on the company.

- (5) The full address of the principal place of business in India.

- Return of alteration (Sec. 593). If any alteration is made or occurs in any of the documents aforesaid, the company shall file with the Registrar a return of such alteration within the prescribed time.

- Office where documents to be delivered (Sec. 597). The documents which a foreign company has to file with the Registrar, shall be delivered both to the Registrar of the State where the principal place of business of the company is situate and also with the Registrar at New Delhi.

2. Accounts (Sec. 594). The provisions of Sec. 209 regarding books of

- Accounts to be kept a company shall apply also to a foreign company so far as it concerns its business in India.

3. Obligations (Sec. 595).

(a) Country of incorporation:- Every foreign company shall state in every prospectus inviting subscriptions in India, for its shares or debentures, the country in which the company is incorporated.

- (b) Exhibition of name. The company shall conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company together with the name of the country where it is incorporated in English characters and in one of the local languages. All business letters, bill-heads, letter papers, and all notices and other official publications of the company shall also show the name.

(c) Whether liability limited.

If the liability of the members of the company is limited, it shall cause notice of that fact

- (i) to be stated in every prospectus and in all business letters, bill heads, letter papers, notices, advertisements and other official publications of the company in legible English characters; and

- (ii) to be conspicuously exhibited on the outside of every office or place where it carries on business in India in legible English characters and one of the local languages.

4. Service of documents on foreign company (Sec. 596).

Any process, notice or other document required to be served on a foreign company shall be deemed to be sufficiently served, if it is addressed to any person whose name has been delivered to the Registrar and left at, or sent by post to, the address which has been so delivered.

5. Office where documents to be delivered (Sec. 597).

Any documents which any foreign con$ffi1y is required to deliver to the Registrar shall be delivered to the Registrar at New Delhi. These documents shall also be delivered to the Registrar of the State in which the principal place of business of the company is situated. If any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact, to the Registrar.

6. Penalty (Sec. 598).

If any foreign company fails to comply with the provision applicable to it, the company and every officer or agent of the company who is in default shall be punishable with fine up to Rs. 10,000 and in the case of a continuing offence, with an additional fine up to Rs. 1,000 for every day during which the default continues.

7) Registration of Charges (Sec. 600).

The provisions of Sec. 124 to 145 relating to registration of charges, appointment of receivers, and the keeping of registers, documents and books of accounts, shall apply mutatis mutandis (with necessary changes) to foreign companies also.

8) Requirements as to prospectus (Sec. 603)

Sec. 603 specifies the particulars to be stated in the prospectus inviting subscriptions for shares or debentures issued by a foreign company. These particulars are as follows:

- (a) Name of the company in English;
- (b) Name of the country in which it is incorporated; (c) Whether the liability of the members is limited;
- (d) Particulars regarding its constitution, date and country of incorporation, and the law under which it was incorporated abroad;
- (e) The address of its registered office and the address of its principal place of business ; and
- f) Matters required to be included in a prospectus issued by a company incorporated under the Companies Act, 1956.
- Before a prospectus is issued, circulated or distributed by a foreign company in India, a copy of it shall be registered with the Registrar of Companies. The prospectus shall be dated.

Winding up of foreign companies (Sec. 584).

Where a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Part X of the Companies Act, 1956. A foreign company's business in India can be wound up even in cases where the company has been dissolved or otherwise ceased to exist under the laws of the country under which it was incorporated.

ASSOCIATIONS NOT FOR PROFIT (Sec. 25)

- According to Sec. 13, the name of a limited company must end with the word "Limited" in the case of a public company, and with the words Phrase Private Limited" in the case of a private company. Sec. 25 of the Act, however, permits the registration, under a licence granted by the Central government, of an association not for profit with limited liability without using the word "Limited" or the words "Private Limited" to its name.

- Conditions for grant of licence.

  The Central government may grant such a licence to an association where it is proved to the satisfaction of the Central Government that it-

- (a) is about to be formed as a limited company for promoting commerce, science, religion. charity or any other useful object; and

- (b) intends to apply its profits. if any, or other income in promoting its objects and to prohibit the payment of any dividend to its members.

- The Central Government may, by licence. direct that the association may be registered as a company with limited liability, without the adding to its name of the word "Limited" or the words "Private Limited". The association may thereupon be registered accordingly. On registration it enjoys all the privileges, and is subject to all the obligations of limited companies. Unless its Articles otherwise provide, it is exempt from such of the provisions of the Companies Act as may be specified by the Central Government in a general or special order.

- A licence may be granted by the Central Government on such conditions and subject to such regulations as it thinks fit. The conditions and regulations are binding on the body to which the licence is granted. These conditions shall be inserted in the Memorandum, or in the Articles, or partly in the one and partly in the other, if the Central Government so directs.

- A firm may be a member of any association or company licensed under Sec. 25.

- Revocation of licence. The licence may at any time be revoked by the Central Government. Upon revocation the Registrar shall enter the word "Limited" or the words "Private Limited" at the end of the name upon the register of the body to which it was granted and the body shall cease to enjoy this exemption. But before a licence is so revoked, the Central Government shall give notice in writing of its intention to the body and afford it an opportunity of being heard in opposition to the revocation.

- A body in respect of which licence is granted under Sec. 25 can alter the provisions of its Memorandum with respect to its objects only with the previous approval of the Central Government. If an alteration is made without the approval of the Central Government, the Central Government may revoke the licence. If a body whose licence has been revoked contains the words Chamber of Commerce", it shall, Within a period of 3 months from the date of revocation or such longer period as the Central Government may allow, change its name to a name which does not contain these words. If the body makes default in complying with these requirements, it shall be punishable with fine which may extend to Rs. 5000 for every day during which the default continues.

• ONE-MAN COMPANY

- This is a company (usually private) in which one man holds practically the whole of the share capital of the company, and in order to meet the statutory requirement of minimum number of members, some dummy members who are mostly his relations or friends, hold just 1 or 2 shares each. The dummy members are usually nominees of the principal shareholder who is the virtual owner of the business and who carries it on with limited liability.

- Example. A private company is registered with a share capital of Rs. 5,00,000 divided into 5,000 shares of Rs. 100 each. Of these shares 4,999 are held by A and one share is held by A's wife, B. This is a one-man company.

- A one-man company, like any other company, is a legal entity distinct from its members. On the facts of a case, it may appear that a company is not the real owner of a business but it is merely carrying it on as an agent of the person who holds the shares in the company just as an individual may carry on a business as agent of another. But if a business is in fact and in law the property of a seperate legal entity, a limited company, it cannot be held that the business is the property of the person who owns all the shares in the company and that the company is an agent for that other person [E.B.M. & Co. Ltd. v. Dominion Bank, (1937) All E.R. 555).

- PROHIBITION OF LARGE PARNERSHIPS (Sec. 11)

- Illegal association. A company, association or partnership consisting of more than 10 persons for the purpose of carrying on banking business and of more than 20 persons for the purpose of carrying on any other business with the object of earning profits can be legally formed only when it is registered under the Companies Act, 1956, or is formed in pursuance of some other Indian law or is a Joint Hindu Family carrying on business as such. If the number of members in an association or partnership exceeds this statutory limit and it is not registered under the Companies Act, it is an illegal association and has no legal existence.

- An association of more than 20 persons which exists not for acquisition of gain but for some other purpose such as the promotion of art, charity. religion, science, etc., does not require registration.

- Consequences of illegal association. The consequences of an illegal association are as follows :

- 1. Personal liability. Every member of an illegal association is personally liable for all liabilities incurred in the business and is punishable with fine which may extend to Rs. 10,000.

- 2. Contracts. (a) An illegal association cannot enter into any contract nor can it sue any member or outsider, not even if the company is subsequently registered.

- (b) It cannot sue or be sued for debts due to it or from it in carrying on its business for it cannot contract debts. or enter into any contract.

- (e) No member of the association can sue any other member in. respect of any matter connected with the association.

- (d) The members cannot either individually or collectively bring an action to enforce any contract which they may have purported to make on behalf of the association. or to recover any debt given to the association.

- 3. Winding up. An illegal association cannot be wound up under the Companies Act either at the instance of a creditor, or a member or the association itself. The Tribunal will do nothing in relation to it that will amount to its recognition. In fact, the Tribunal does not even entertain a petition for its winding up. for if it did. it would be indirectly according recognition to the illegal association.

- Penalty for improper use of words "Limited" and "Private Limited" (Sec. 631)

- If any person or persons trade or carry on business under any name or title of which the word, "Limited" or the words "Private Limited" is or are the last word or words. that person or each of these persons· shall. unless duly incorporated as public or private company. as the case may be, be punishable with fme which may extend to Rs. 500 for every day upon which that name has been used.

COMPANY LAW

CHAPTER 3

FORMATION OF COMPANIES

Incorporation Of Company

- **Mode of forming incorporated company**

Any 7 or more persons(2 or more in case of private company) associated for any law full purpose may form an incorporated company ,with or without limited liability. they shall subscribe their names to a Memorandum of association and also comply with other formalities in respect of registration. A company so formed may be :

A company limited by shares, or

A company limited by guarantee ,or

An unlimited company.

Documents to be filed with Registrar

Before a company is registered, it is desirable to ascertain from the Registrar of Companies if proposed name of the company is approved. Then the following document duly stamped together with the necessary fees are to be filed with the registrar :-

- The Memorandum of Association duly signed by the subscribers.
- The Article of Association , if any signed by the subscribers to the Memorandum of association. A public company limited by shares need not have its own Article of Association.
- The agreement, if any, which the company proposes to enter in to with any individual for appointment as its managing or whole-time director or manager [Sec.33(1)] .

Documents to be filed with Registrar

- A list of directors who have agreed to become the first directors of the company (this implies to a public company limited by shares) and their written consent to act as directors and take up qualification shares [Sec.266].
- A declaration stating that all the requirement of companies Act and other formalities relating to registration have been complied with. Such declaration shall be signed by any of the following persons:

(a) an advocate of the Supreme Court or of a High Court or

(b) a secretary or a chartered accountant in whole-time practiced in India

(c) a person named in the article as a director ,manager , or secretary of the company.

Certification of incorporation

- When the requisite documents are filed with the registrar , the Registrar shall satisfy himself that the statutory requirements regarding registration have been duly compiled with. In exercising this duty , the registrar is not required to carry out any investigation . If the registrar is satisfied as to the compliance of statutory requirements , he retains and registers the memorandum , the Articles and other documents filed with him and issues a Certificate of incorporation ,i.e, of the formation of the company [sec 33(3)]
- By issuing certificate of incorporation the registrar certifies under his hand that the company is incorporated and in the case of a limited company , that the company is limited.

Effect of Registration

- When a company is registered and a certificate of incorporation is issued by registrar , three important consequence follow:

1. a company becomes a distinct legal entity .Its life commence from the date mentioned in the certificate of incorporation .

2.the company requires a perpetual succession. The members may come and go, but it goes on for ever, unless it is wound up.

3. The company's property is not the property of the shareholders. The shareholders have a right to share in the profit of the company when realized and divided. Likewise any liability of the company is not the liability of the individual shareholders.

Promoter

- The first persons who control a company's affairs are its promoters. It is they who conceive the idea of forming the company, with reference to a given object and then to set it going.
- It is they who take the necessary steps to incorporate the company, provided with share and loan capital and acquire the business or property which it is to manage.

Functions of a Promoter

- The promoter of a company decides its name and ascertains that it will be accepted by the registrar of companies.
- He settle the detail of the company's Memorandum and Article, the nomination of directors, solicitor, bankers, auditors and secretary and the registered office of the company.
- He arranges for the printing of the memorandum and Article, the registration of the company, the issue of prospectus ,where a public issue is necessary. He is, in fact, responsible for bringing the company into existence for the object which he has in view.

Legal Status of a Promoter

While the accurate description of a promoter may be difficult, his legal position is quite clear. A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company and therefore requires full disclosure of the relevant facts, including any profit made as held by Lord Cairns in Erlanger v. New Sombrero Phosphate Co. (39 LT 269

Lindley L.J. describes :

" Although not an agent for the company, nor a trustee for it before its formation, the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is well settled that a promoter of a company is accountable to it for all moneys secretly obtained by him from it just as the relationship of the principal and agent or the trustee and cestui que trust had really existed between him and the company when the money was obtained".

Fiduciary position of a Promoter

- The fiduciary position of a promoter may be summed up as follows:

1. Not to make any profit at the expense of the company. The promoter must not take, either directly or indirectly, any profit at the expense of the company which is being promoted. if any secret profit is made in violation of this rule, the company may ,on discovering it, compel him to account for and surrender such profit.
2. To give benefit of negotiation to the company.
3. To make full disclosure of interest or profit.
4. Not to make unfair use of position.

Duty of promoter as regards Prospectus.

The promoter must see in connection with the prospectus, if any is issued , that the prospectus

- Contains the necessary particulars,
- Does not contain any untrue or misleading statements or dose not omit any material fact.

Remuneration of Promoters

A promoter takes remuneration for his services in one of the following ways:-

- He may sell his own property at a profit to the company for cash or fully-paid shares provided he makes a discloser to this effect.
- He may be given an option to buy a certain number of shares in the company at par.
- He may take a commission on the shares sold.
- He may be paid a lump sum by the company.

Pre- Incorporation or Preliminary Contracts

The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated. Such contracts are called pre-incorporation or preliminary contracts. The promoters generally enter into such contracts as agents for the company about to be formed . The legal position is that “two consenting parties are necessary to a contract whereas the company ,before incorporation, is a non entity.” The promoter can’t ,therefore act as agent for a company which has not yet come into existence . As such the company is not liable for the acts of the promoters done before its incorporation.

Position of promoters as regards pre-incorporation contracts

- Company not bound by pre-incorporation contract. A company, when it come into existence, is not bound by a pre-incorporation contract even where it takes the benefit of the contract entered into on its behalf.
- Company cannot enforce pre-incorporation contract. A company cannot, after incorporation, enforce the contract made before its incorporation. The leading case on the point is:
- Natal Land and Colonisation Co. Ltd vs Pauline Colliery and Development Syndicate Ltd. (1904) A.C. 120. THE n Company agreed with an agent of the P Syndicate Ltd. Before its formation to grant a mining lease to the Syndicate. The Company refused to grant the lease. Held, there was no binding contract between the Company and the Syndicate.

Cont.

- Promoters personally liable. The promoters remain personally liable on a contract made on behalf of a company not yet in existence. Such a contract is deemed to have been entered into personally by the promoters.
- Kelner vs Baxter, (1866) L.R. 2 C.P. 174. A hotel company was about to be formed and persons responsible for the new company stock on behalf of the proposed company, payment to be made on 28th January, 1866. the company was incorporated on 20th February 1866. the goods were consumed in the business and the company went into liquidation before the debt was paid. The persons signing the agreement were sued on the contract. Held, the persons sinning were promoters and personally liable on their signatures.

Ratification of a pre-incorporation

- A company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at at the time of the contract by the agent.
- Where a contract is made on behalf of a company known to both the parties to be non-existence. The contract is deemed to have been entered into personally by the promoters. The company can if it desires, enter into a new contact, after its incorporation with the other party and
  - If the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end : and
  - If the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Specific performance of pre-incorporation contract

Secs. 15 and 16 of the Specific Relief Act, 1963 deal with this point. When the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation, specific performance may be obtained by, or enforced against, the company : provided that the company has accepted the contract and has communicated such acceptance to the other party to the contract

Provisional contracts

- Provisional contracts refer to contracts entered into by a public company after its incorporation but before it is issued the certificate to commence business.
- According to Sec. 149 (4), any contract made by a company before the date at which it is entitled to commence business shall be provisional only, and shall not be binding on the company until that date, and on that date it shall become binding. If the company is unable to obtain the certificate to commence business , the provisional contract automatically lapses ; if it gets the certificate, the provisional contract ratification of the contract by the company ; the contact becomes binding automatically.

COMPANY LAW

CHAPTER 4

MEMORANDUM OF ASSOCIATION

- The Memorandum of Association is a document which sets out the constitution of the company and as such is the foundation on which the structure of the company stands. It defines the scope of the company's activities and its relations with the outside world. Its purpose, as observed by Lord Macmillan is "to enable the shareholders, creditors and those who deal with the company to know what is the permitted range of enterprise".
- The first step in the formation of a company is to prepare a document called the memorandum of association. It is a vital document. In fact memorandum is one of the most essential pre-requisites for incorporating a registered company under the Act.
- Act specifies in clear terms the contents of this important document which is a charter of the company.
- The memorandum of association of a company contains the fundamental provisions of the company's constitution. It contains the essential conditions upon which the company can be incorporated. In this respect, it is company's charter of its existence and operations and is of supreme importance in determining its powers. It defines as well as confines the powers of the company. It not only shows the objects of formation but also determines the utmost possible scope of its operations beyond which its actions cannot go. "THE MEMORANDUM OF ASSOCIATION", observed Palmer, "is a document of great importance in relation to the proposed company".

- PURPOSE OF MEMORANDUM

- The purpose of the object clause in the memorandum is two fold. First, the intending shareholder before making investment in the company should know the field in, or the purpose for which it is going to be used and what risk he is taking in making the investment. The second purpose is that anyone dealing with the company will know without doubt what is the permitted range of enterprise of the company [Cotman v. Brougham (1918) A.C. 514].
- Sections 12 to 23 of the Act prescribe the particulars to be mentioned in a memorandum of association and other requirements. It is the constitution of the company in its relation to the outside world. The company cannot depart from the provisions of the memorandum however great the necessity be. If it enters into contract or engages in any trade or business which is beyond the powers conferred on it by the memorandum, such a contract or the act will be ultra vires the company and hence void.

- FORM OF MEMORANDUM OF ASSOCIATION
- Section 14 of the Companies Act provides that the memorandum of association should be in any one of the Forms specified in Tables B, C, D and E of Schedule I to the Companies Act, 1956,

- Form in Table B is applicable in the case of companies limited by shares;
- Form in Table C is applicable to companies limited by guarantee and not having a share capital
- Form in Table D is applicable to the companies limited by guarantee and having a share capital;
- Form in Table E is applicable to unlimited companies.
- A company may either adopt any of the model Forms of the memorandum of association mentioned above, as may be applicable to it, or it may prepare it in any other Form, but the same should be as near thereto as the circumstances may admit.

- CONTENTS OF MEMORANDUM
- As per Section 13, the memorandum of a limited company must state the following:
- (a) the name of company with “Limited” as its last word in the case of a public company; and “Private Limited” as its last word in the case of a private company;
- the state in which the registered office of the company is to be situated;
- in the case of a company in existence immediately before the commencement of the Companies (Amendment) Act, 1965, the objects of the company;
- in the case of a company formed after such commencement:
- the main objects of the company to be pursued by the company on its incorporation; and objects incidental or ancillary to the attainment of the main objects;
- other objects of the company not included in sub-clause (i); and
- in the case of companies (other than trading corporations) with objects not confined to one State, the States to whose territories the objects extend;
- The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited.
- The memorandum of a company limited by guarantee shall also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company, or of such debts and liabilities of the company as may have been contracted before he ceases to be a member, as the case may be, and of the costs, charges and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required not exceeding a specified amount.
- In the case of a company having a share capital—
- unless the company is an unlimited company, the memorandum shall also state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount;
- no subscriber of the memorandum shall take less than one share; and
- each subscriber of the memorandum shall write opposite to his name the number of shares he takes.
- The above clauses are compulsory and are designated as “conditions” prescribed by the Act, on the basis of which a company is incorporated.
- It is to be noted that the Companies Act, 1956 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act (Section 9).

- NAME CLAUSE
- A company being a legal entity must have a name of its own to establish its separate identity. The name of the company is a symbol of its independent corporate existence. The first clause in the memorandum of association of the company states the name by which a company is known. The company may adopt any suitable name provided it is not undesirable.
- Section 20 provides that no company shall be registered by name which, in the opinion of the Central Government, is undesirable. A name which is identical with or too nearly resembles, the name by which a company in existence has been previously registered, will be deemed to be undesirable.
- The object is to prevent the use of name likely to mislead the public. For example, a company will not be allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950, or suggestive of any connection with Government or of State patronage where there is none.
- In case, despite these rules, a company is registered by a name so similar to that of another company that the public are likely to be misled or deceived the Court may grant an injunction restraining it from using that name.
- Publication of Name
- The name of the company and the address of its registered office must be painted or affixed outside every office or place at which its business is carried on, in a conspicuous position and in letters easily legible in English and in the language in general use in the locality. The name must also be engraved on the company's common seal. Further, the name of the company and the address of the registered office must be mentioned in legible characters in all business letters, in all its bill heads and in all its notices and other official publications, as well as in all negotiable instruments (Section 147).
- When "Limited" Dropped
- The Central Government may by licence permit the registration of a company with limited liability, without using the word "limited" as part of its name, if it is formed for the promotion of commerce, art, science, religion, charity or any other useful object, and prohibits distribution of its income as dividend to its members (Section 25).

- **SITUATION OR REGISTERED OFFICE CLAUSE**

- The name of the State in which the registered office of the company is to be situated must be given in the memorandum. But the exact address of the registered office is not required to be stated therein. This can be filed with the Registrar of Companies separately in e-Form No. 18 within 30 days of incorporation of the company.
- Registered Office
- Within 30 days of incorporation or on the day when it commences business, whichever is earlier, the company must have a registered office to which all communications and notices may be sent. The company must also give notice of the situation of the registered office to the Registrar.

- **OBJECTS CLAUSE**

- **The third compulsory clause in the memorandum sets out the objects for which the company has been formed. All companies registered after the coming into force of the Companies (Amendment) Act, 1965, must divide their objects clause into two sub-clauses, namely:**
- **Main objects: This sub-clause contains the main objects of the company to be pursued on its incorporation and objects incidental or ancillary to the attainment of the main objects.**
- **Other objects: This sub-clause must state other objects which are not included in the "Main objects" and which may be pursued by the company at anytime in the future.**
- **The objects clause is of great importance because it determines the purpose and the capacity of the company. It indicates the purpose for which the company has been set up and its actual capability, besides its sphere of activities. It states affirmatively the ambit and extent of powers of the company and its states negatively that nothing should be done beyond that ambit and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified. The purpose of the objects clause is to enable the persons dealing with the company to know its permitted range of activities. The acts beyond this ambit are ultra vires and hence void. Even the entire body of shareholders cannot ratify such acts.**
- **Although express powers are necessary, a company may do anything which is incidental to and consequential upon the powers specified, and the act will not be ultra vires [Attorney General v. G.E. Rly. Co., (1880) 5 A.C. 473]. Thus, a trading company has an implied power to borrow money, draw and accept bills of exchange in the ordinary form, but a railway company cannot issue bills although it may borrow money.**
- **The subscribers to the memorandum of association enjoy almost unrestricted freedom to choose the objects. The only restriction is that objects should not be illegal and against the provisions of the Companies Act, 1956.**

- LIABILITY CLAUSE
- The fourth compulsory clause must state that liability of the members is limited, if it is so intended that the company be limited by shares or by guarantee. The effect of this clause is that, in a company limited by shares, no member can be called upon to pay more than what remains unpaid. If his shares are fully paid up, his liability is nil. Where a shareholder holding a Rs. 100 share has paid Rs. 75 on it, he can be called upon to pay the balance of Rs. 25. In case, he has paid the full value of Rs. 100, he cannot be required to pay anything more even if the company owes huge debts to its creditors.
- In a company limited by guarantee, the liability clause will state the amount which each member should undertake to contribute to the assets of the company in the event of liquidation of the company. He cannot be called upon to pay anything before the company goes into liquidation.
- The liability of each subscriber is equal to the total amount due on the shares subscribed for by him. The liability will neither be discharged by his taking a transfer of the shares allotted to any other persons nor by the allotment to him of any shares credited as fully paid up to which some other person is entitled [Migotti's case, Re South Blackpool Hotel Co., (1867) LR 4 EL 238].

- CAPITAL CLAUSE
- This is the fifth compulsory clause which must state the amount of the capital with which the company is registered, unless the company is an unlimited company. The shares into which the capital is divided must be of fixed value, which is commonly known as the nominal value of the share. The capital is variously described as “nominal”, “authorised” or “registered”.
- The amount of nominal capital is determined having regard to the present as well as future requirements of the company with reference to its objects. The usual way to state the capital in the memorandum is: “The capital of the company is Rs. 10,00,000 divided into 1,00,000 equity shares of Rs. 10 each”. This amount lays down the utmost limit beyond which the company cannot issue shares without altering the memorandum as provided by Section 94 of the Companies Act, 1956.
- If there are both equity and preference shares, then the division of the capital is to be shown under these two heads. A company is not authorised to issue capital beyond its authorised/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorised capital, the amount received on excess number of shares should be returned.
- Out of the issued capital, the total amount actually subscribed or agreed to be subscribed is known as subscribed capital, and this subscribed capital again may be wholly paid or partly paid in which latter case the balance would be payable on future calls when made. The amount actually paid by the shareholders is called the paid-up capital.

The liability clause

The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited This means that the members can only be called upon to pay to the company at any time the uncalled or unpaid amount on the shares held by them, or up to the maximum of the amount which they have guaranteed.

- ASSOCIATION CLAUSE AND SUBSCRIPTION

- The memorandum concludes with the subscription clause in which there is a declaration of association. The subscribers to the memorandum declare: “We, the several persons whose names and addresses subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names”. Then follow the names, address, occupations of the subscribers, and the number of shares each subscriber has taken and his signatures attested by a witness.
- The statutory requirements regarding subscription of memorandum are that:
- the memorandum must be signed by each subscriber in the presence of at least one witness who must attest the signatures;
- each subscriber must take at least one share;
- each subscriber must write opposite his name the number of shares which he agrees to take (Section 13).

ALTERATION OF MEMORANDUM OF ASSOCIATION

- The memorandum of association of a company may be altered in the following respects:
- By changing its name (Sections 21 to 24).
- By altering it in regard to the State in which the registered office is to be situated or its objects (Section 17).
- By altering its share capital (Section 94).
- By reorganising its share capital (Sections 391 to 396).
- By reducing its capital (Section 100).
- By making the liability of the directors unlimited (Section 322).

- CHANGE IN NAME

- The name of the company can be changed by a special resolution and with the approval of the Central Government. Approval of the Central Government is not necessary if the change relates to the addition/deletion of the word 'private' to the name.
- For this purpose an application is required to be made to the Registrar in e-Form No. 1A with a fee of Rs. 500/- to ascertain availability of name. The period of validity is sixty days. The change must be communicated to the Registrar by filing e-Form No. 23 prescribed under the Companies (Central Government's) General Rules and Forms, 1956 (as amended) alongwith a printed or typewritten copy of the special resolution and explanatory statement within 30 days of the passing thereof.
- where a company is registered by a name identical with the name of the company registered earlier, the petition for change of name should be made within 12 months. A petition made after 12 months shall be rejected pursuant to limitation under Section 22 of the Companies Act, 1956.
- The Registrar will enter the new name in his register and issue a fresh certificate of incorporation and the change of name will be effective only thereafter. The changed name should be noted in each copy of the memorandum and articles of association.

- ALTERATION OF REGISTERED OFFICE CLAUSE
- Change within the local limits of same town
- Section 146 of the Act provides that a company can change its registered office from one place to another within the local limits of the city, town or village, where it is situated, by a Board resolution. A notice of the change is required to be given to the Registrar in e-Form No. 18 within 30 days of such change. This does not involve alteration of memorandum.
- Change from one city to another within the same State
- If the registered office is to be shifted from one city, town or village to another city, town or village within the same State, a special resolution has to be passed in the general meeting of the company and a printed or type-written copy of the special resolution along with the explanatory statement has to be filed with e-Form No. 23 within 30 days. Also within 30 days of the change of the registered office a notice to the Registrar should be given of the new location of the office in e-Form No. 18. This change of the registered office also does not involve alteration of memorandum.
- Change within the same State from the jurisdiction of one Registrar of **Companies to the jurisdiction of another Registrar of Companies**
- Section 17A provides that confirmation by the Regional Director will be necessary for changing registered office of a company from one place to another if the change of registered office is from the jurisdiction of one Registrar to the jurisdiction of another within the same State. For this purpose, the company is required to make an application in e-Form No. 1AD.The Regional Director, after hearing the parties shall pass necessary orders within 4 weeks from the date of the receipt of the application. Thereafter, the company concerned shall file a copy of the said orders to Registrar of Companies (ROC) within 2 months from the date of the confirmation order by Regional Director. The said ROC shall record the ordered changes in its records, while the ROC of the state where the registered office of the company was previously situated, shall transfer all the documents and papers to the present ROC.

- Change of Registered office from one State to another
- The change of registered office from one State to another State involves alteration of memorandum, and the change can be effected by a special resolution of the company which must be confirmed by the Company Law Board1/Central Government2 (Section 17).
- The copy of petition to Company Law Board1/Central Government2 is also required to be submitted to the Chief Secretary of the State Government in which the present registered office is situated.
- According to Section 17(1), a company may, by special resolution alter the provisions of its memorandum so as to change the place of its registered office from one State to another or alter the objects of the company so far as may be required to enable it:
- to carry on its business more economically and more efficiently;
- to attain its main objects by new or improved means;
- to enlarge or change the local area of its operations;
- to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company.
- to restrict or abandon any of the objects specified in the memorandum;
- to sell or dispose of the whole, or any part of the undertaking, or of the undertakings, of the company; where a company feels it has grown so big or that management has become difficult and uneconomical, it may alter its objects to sell or dispose of any of its undertakings.
- amalgamate with any other company or body of persons - Section 17(1) and (2).
- The alteration of the provisions of memorandum relating to the change of the place of its registered office from one State to another shall not take effect unless it is confirmed by the Company Law Board1/Central Government2 on petition [Section 17(2)].**Before confirming** the alteration, the Company Law Board1/Central Government2 must be satisfied:that sufficient notice has been given to every debenture holder of the company, and to every other person or class of persons whose interest will, in the opinion of the Company Law Board1/Central Government2, be affected by the alteration. (The Company Law Board1/Central Government2 may in the case of any persons or class of persons, for special reasons, dispense with the notice); and

- that, with respect to every creditor who, in the opinion of the Company Law Board1/Central Government2, is entitled to object to the alteration, and who signifies his objection in the manner directed by the Company Law Board1/Central Government2, either his consent to the alteration has been obtained or his debt or his claim has been discharged or has been determined, or has been secured to the satisfaction of the Company Law Board1/Central Government2 [Section 17(3)].
- The Company Law Board1/Central Government2 shall cause notice of the petition for confirmation of the alteration to be served on the Registrar who shall also be given a reasonable opportunity to appear before the Company Law Board1/Central Government2 and state his objections and suggestions, if any, with respect to the confirmation of the alteration [Section 17(4)].
- The Company Law Board1/Central Government2 may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit, and may make such order as to costs as it thinks proper [Section 17(5)].
- The Company Law Board1/Central Government2 shall, in exercising its powers under the section have regard to the rights and interests of the members of the company and of every class of them, as well as to the rights and interests of the creditors of the company and of every class of them [Section 17(6)].
- The Company Law Board1/Central Government2 may, if it thinks fit, adjourn the proceedings in order that an arrangement may be made to its satisfaction for the purchase of the interests of dissentient members; and may give such directions and make such orders as it thinks fit for facilitating or carrying into effect, any such arrangement provided that no part of the capital of the company, may be expended in any such purchase [Section 17(7)].
- Regulation 36 of Company Law Board Regulations, 1991 lays down the provision regulating petition to Company Law Board under Section 17 of the Companies Act.
- While confirming the resolution altering the situation clause of the memorandum of association, the Company Law Board cannot substitute its own wisdom or judgement for the corrective wisdom or judgement of the company expressed in special resolution [Zuari Agro Chemical Limited v. E.S. Wadia and others, (1974) 44 Comp. Cas. 465).
- According to Section 17(3), the Company Law Board1/Central Government2 must be satisfied, before confirming the alteration in the memorandum that sufficient notice has been given to every person whose interest, in the opinion of the Company Law Board1/Central Government2, will be affected by the alteration. No notice of the petition is required to be served on the State, but in view of the wider language of Section 17,

- **ALTERATION OF OBJECTS CLAUSE OF THE COMPANY**
- a company can change its object clause by passing a special resolution and confirmation of Company Law Board/Central Government for the same is not required. However the requirement of confining the alteration to the seven points formula of sub-section (1) remains applicable:
- To carry on its business more efficiently and economically [Section 17(1)(a)]
- When a company is not in fact carrying on any business, it cannot alter its objects under this clause
- The true legal position, observed the Delhi High Court, is that the business must remain substantially the same, and the additions, alterations and changes should only be steps-in-aid to improve the efficiency of the company. [Delhi Bharat Grain Merchant Assn. Ltd., In re. (1974) 44 Comp. Cas. 214 (Delhi)].
- To attain its main purpose by new or improved means [Section 17(1)(b)]
- The expression used is 'to attain its main purpose'. Under this head an alteration can be made only to enable the company to attain its main purpose, not any purpose [Kirkadly Café Co. 1921 SC 681].
- To enlarge or change the local area of its operation [Section 17(1)(c)]
- When the alteration was intended to enlarge the area of the company's operation, the order of confirmation imposed a condition that the company's name indicating that its business was carried on in a particular area should be changed. [In Indian Mechanical Gold Extracting Company, In re. (1891) 3 Ch. 538].
- In this case, the company's business was confirmed to 'India'. It wanted to enlarge its operations. It was permitted to do so on the condition that the word 'Indian' was also dropped from its name.

- To carry on some business, which under existing circumstances, may conveniently or advantageously be combined with the business of the company [Section 17(1)(d)]
- This clause has a wide scope and allows a company to diversify, the only condition being that the alteration should not be prejudicial to or destructive of the existing business.
- 'It is essentially a business proposition, whether an additional business can or cannot be conveniently carried on under existing circumstances, with the business of the company. The additional business, of course must not be destructive of or inconsistent with the existing business, it must leave the existing business substantially what it was before, but the additional business may be one which is different from the original business and yet may well be conveniently and advantageously combined with the business which is being carried on.'
- However in New Asiatic Insurance Co. Ltd. In re. (1967) 37 Comp. Cas. 331 (Punj.) it was held that confirmation of alteration of objects is not to be refused only because new business is wholly different from existing business.
- To restrict or abandon any of the objects specified in the memorandum.
- For deleting any portion of the objects clause, the procedure laid down in this clause have to be followed. The word 'restrict or abandon' have been held as not including in the case of a charitable company, substitution of one kind of beneficiary of charity with another. [Hampstead Garden Suburb Trust Ltd., In re., (1908) 2 Ch. 287].
- To sell or dispose of the whole or any part of the undertaking or any of the undertakings [Section 17(1)(f)].
- To amalgamate with any other company or body corporate [Section 17(1)(g)]

- A company doing jute business can alter its memorandum so as to do business in rubber if that can conveniently and efficiently be carried on with the existing business [Juggilal Kamlapat Jute Mills Co. Ltd. v. Registrar of Companies (1966) 1, Comp. L.J. 292].
- In the matter of Geo Rubber Exports Limited (Company Petition No. 90/17/SRB/1991 decided on 20.8.1991) the Company Law Board dealt with the question whether the alteration of object clause of Memorandum of Association was in accordance with the provisions of Section 17(1) of the Act in case where the company was not carrying on any business at the time of alteration. The Board observed that there was no prohibition in Section 17 that the company should not be allowed to change its objects clause to enable it to take some new business unless it has actually translated any of its objects as set out in the Memorandum of Association into business. What is contemplated in Section 17(1)(d) is that if there is some existing business, it has to be ensured that the new business to be embarked upon can conveniently or advantageously be combined with the existing business under the existing circumstances and the new business is not inconsistent with or destructive of the existing business. In the instant case it had become difficult for the company which was incorporated for carrying on the business of Rubber Products to start that business because of adverse international market conditions. It therefore had altered its objects clause to carry on the business of a aqua farming, marine products. The CLB observed that if alteration was passed by a special resolution of shareholders and there was no objection from any creditor or shareholder and there was no objection from any other person and the business proposed to be carried on is not illegal, the company can alter its memorandum, even before starting any business.
- However, it was held that a distillery business cannot successfully petition for being allowed to combine cinema business, because this cannot conveniently and efficiently be carried on together [Punjab Distillery Industries Ltd. v. Registrar of Companies (1963) 83 Comp. Cas. 811].

- ALTERATION OF LIABILITY CLAUSE
- Ordinarily, the limited liability clause of a company *cannot be altered* so as to make the liability unlimited, unless the articles permit such alteration by a special resolution to make the liability of the directors or of any one director or manager unlimited. In such case, however, the liability of the person holding office as director or manager before such alteration shall not be made unlimited until the expiry of this present term. His liability for the unexpired period of the present term can be made unlimited only if he gives his consent to his liability becoming unlimited (Section 323). Section 32 permits an unlimited company to register as a limited company. On alteration, the Registrar shall close the former registration of the company and the new registration shall take effect as if it were the first registration. The registration of an unlimited company as a limited company shall not, however, affect any debts, liabilities, obligations or contracts incurred or entered into, before the conversion. The whole procedure for forming a new company will have to be followed in respect of the above sections.

- # ALTERATION OF CAPITAL CLAUSE
- A company can make the following types of alterations by an ordinary resolution, if authorised by its articles to do so (Section 94):

- Increase its share capital by issue of new shares;

- consolidate existing shares into shares of larger denomination;
- sub-divide its shares or any of them into shares of smaller amount than is fixed by memorandum such that the proportion between the amount paid and unpaid shall remain the same.
- convert fully-paid shares into stock or vice versa; and
- cancel unissued shares and to that extent diminish the amount of its share capital. Such cancellation shall not, however, be deemed as reduction of share capital.
- All such alterations do not require the confirmation by the Company Law Board. These alterations are, however, required to be notified giving details of the share consolidated, divided, converted, sub-divided, redeemed or cancelled or the stock reconverted, as the case may be, and a copy of the resolution should be filed with the Registrar within 30 days of the passing of the resolution.
- The Registrar shall record the notice and make any alteration which may be necessary in the company' memorandum or articles or both. It must be noted that cancellation of shares does not amount to reduction of share capital.

- Increase in Share Capital is subject to the fullfilment of the following conditions:

- The articles of the company should contain powers authorising the company to increase its capital.
- A resolution must be passed by the company in a general meeting. An ordinary resolution will do.
- A notice of increase in capital is required to be filed by the company with the Registrar within 30 days after the passing of the resolution and the Registrar shall thereupon record the increase and also make any alterations which may be necessary in the company's article or memorandum or both.The notice to be given to the Registrar should include particulars of the class of shares affected and the conditions, if any, subject to which the new shares have been or are to be issued.

- The share capital of a company shall stand increased automatically without the procedure mentioned above being followed in the following circumstances:

- Where the Central Government has, by an order made under Sub-section (4) of Section 81 of the Act, directed that any debenture or loan or any part thereof shall be converted into shares of the company.
- Where any public financial institution, in pursuance of option attached to debentures issued or loans raised by the company, proposes to convert such debentures or loans or part thereof into shares in the company, and such conversion results an increase in the authorised share capital in the company, and the Central Government issues a direction in this behalf.

Reduction of capital: Share capital of a company can be reduced in any of the following ways:

- By extinguishing or reducing the liability on share capital not paid-up;
- By refunding surplus of the paid-up capital;
- By writing off the lost capital;
- By any other method approved by the Court.
- A company can reduce its share capital by any of the above mentioned methods, only when the following conditions are fulfilled:
- The articles of the company permit such a reduction.
- The company passes a special resolution for reducing share capital.
- The company also obtains confirmation of the resolution by the Court.
- Being a domestic affair, the Companies Act permits the companies to decide the extent, mode etc. of reduction of its share capital. With a view, however, to safeguard the interests of the creditors and the minority shareholders as also to ensure that the scheme of reduction is fair and reasonable, it is provided that the scheme of reduction of the company shall be subject to the approval of the Court. Before putting its seal of confirmation on the scheme, it is the duty of the Court to see that the procedure adopted is formally correct, the creditors are not prejudiced and the scheme is fair and equitable between the different classes of shareholders.
- However, the above mentioned procedure is not called for:
- Where redeemable preference shares are redeemed in accordance with the provisions of Section 80.
- Where any shares are forfeited for non-payment of calls.

- DOCTRINE OF ULTRA VIRES
- In the case of a company whatever is not stated in the memorandum as the objects or powers is prohibited by the doctrine of ultra vires. As a result, an act which is ultra vires is void, and does not bind the company. Neither the company nor the other contracting party can sue on it. Also, as stated earlier, the company cannot make it valid, even if every member assents to it.

- Ultra vires the Director : - The general rule is that an act which is ultra vires the company is incapable of ratification. An act which is intra vires the company but outside the authority of the directors may be ratified by the company in proper form [Rajendra Nath Dutta v. Shilendra Nath Mukherjee, (1982) 52 Comp. Cas. 293 (Cal.)].

- The rule is meant to protect shareholders and the creditors of the company. But if the act is ultra vires (beyond the powers of) the directors only, the shareholders can ratify it. Or if it is ultra vires the articles of association, the company can alter its articles in the proper way.

Whether a transaction is ultra vires the company, it can be decided on the basis of the following:

- if a transaction entered into by a company falls within the objects, it is not ultra vires and hence not void;
- if a transaction is outside the capacity of the company, it is ultra vires;
- if a transaction is in excess or abuse of the company's powers, such transaction will be set aside by the shareholders;
- if a third party who has knowledge that a transaction entered into is ultra vires the company but was in excess of the company's powers, cannot enforce such transactions.

- Effects of ultra vires Transactions

- Void ab initio – The ultra vires acts are null and void ab initio. The company is not bound by these acts. Even the company cannot sue or be sued upon [Ashbury Railway Carriage and Iron Company v. Riche (Supra)].
- Ultra vires contracts are void ab initio and hence cannot become intra vires by reason of estoppel or ratification.

- Injunction: The members can get an injunction to restrain the company wherein ultra vires act has been or is about to be undertaken [Attorney General v. Gr. Eastern Rly. Co., (1880) 5 A.C. 473].

- Personal liability of Directors: It is one of the duties of directors to ensure that the corporate capital is used only for the legitimate business of the company and hence if such capital is diverted to purposes foreign to company's memorandum, the director will be personally liable to replace it. In Jehangir R. Modi v. Shamji Ladha, [(1866-67) 4 Bom. HCR (1855)], the Bombay High Court held: "A shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have by them been employed in transactions that they have no authority to enter into, without making the company a party to the suit".

- In case of deliberate misapplication, criminal action can also be taken for fraud.
- However, a distinction must be drawn between transactions which are ultra vires the company and the transactions which are ultra vires the directors, where the directors exceed their authority and do something, the same may be ratified by the general body of the shareholders. Provided the company has the capacity to do that transaction as per its memorandum of association.
- Where a company's money has been used ultra vires to acquire some property, the company's right over such property is held secure and the company will be the right party to protect the property. This is because, though the property has been acquired for some ultra vires object it represents the money of the company.
- Ultra vires borrowing does not create the relationship of creditor and debtor and the only possible remedy in such case is in rem and not in personam [In Re. Madras Native Permanent Fund Ltd., (1931) 1 Comp. Cas. 256 (Mad.)].

Article of Association

The Article of Association or just Articles are the rules, regulations and bye – laws for the internal management of the affairs of a company. They are framed with the object of carrying out the aims and objects as set out in the Memorandum of Association.

The Articles are next in importance to the Memorandum of Association which contains the fundamental conditions upon which alone a company is allowed to be incorporated. They are as such subordinate to, and controlled by, the Memorandum.

In framing the articles of a company care must be taken to see that regulation framed do not go beyond the powers of the company itself as contemplated by the Memorandum of Association.

Contents of article

Articles usually contain provisions relating to the following matters:

1. Share capital, rights of shareholders, and variation of these rights, payment of Commissions, share certificates.
2. Lien on shares.
3. Calls on shares.
4. Transfer of shares.
5. Transmission of shares.
6. Forfeiture of shares.
7. Conversion of shares into stock.
8. Share warrants.
9. Alteration of capital.
10. General meeting and proceedings thereat.

11-Voting rights of members, voting and poll, proxies.

12.Directors, their appointment, remuneration, qualifications, powers and proceedings of Board of directors.

13. Manager.

14. Secretary.

15. Dividend and reserves.

16. Accountants, audit and borrowing powers.

17. Capitalisation of profits.

18. Winding up.

Companies which must have their own articales Sec 26

- The following companies shall have their own Articles, namely,
- (a) Unlimited companies,
- (b) Companies limited by guarantee,
- (c) Private companies limited by shares.
-
- The Article shall be signed by the subscribers of the Memorandum and registered along with the Memorandum.
- A public company may have its own Articles of Association. If it does not have its own Articles, it may adopt Table **A** given in Schedule 1 to the Act.

Regulations required in case of an unlimited company, a company limited by guarantee and a

Private company-

(Sec.27)

1. *Unlimited company.* In the case of an unlimited company, the Articles shall state—

(a) The number of members with which the company is to be registered, and

(b) if it has a share capital, the amount of share capital with which the company is to be registered.

2. *Company limited by guarantee.* In the case of a company limited by guarantee the Article shall state the numbers of members with which the company is to be registered.

2. ***Private company***. In the case of a private company having a share capital, the Articles shall contain provisions which-

(a)restrict the right to transfer shares,

(b) limit the number of its members to 50 (not including employee-members), and

prohibit any invitation to the public to subscribe for any shares in, or debentures of, the company.

Adoption and application of Table A (Sec. 28). There are three alternative forms in which a public company may adopt Articles:

1. It may adopt Table A in full.
2. It may wholly exclude Table A and set out its own Articles in full
3. It may frame its own Articles and adopt part of Table A.

In other words, unless the Articles of a public company expressly exclude any or all provisions of Table A, Table A shall automatically apply to it.

Form of Articles in the case of other companies (Sec.29).

The Articles of any company, not being a company limited by shares, shall be in such one of the forms in Table **C, D,** and **E** in schedule 1 to the act, as may be applicable, or in a Form as near there to as circumstances admit. Further, in so far as they are not inconsistent with the provisions contained in the Form in any of the Table **C,D** and **E** adopted by the company.

Form and signature of Articles (Sec. 30). The Articles shall be---

(a) Printed

(b) Divided into paragraphs and,

(c) signed by each subscriber of the Memorandum (who shall add his address, description and occupation,if any) in the presence of at least 1 witness who will attest the signature and likewise add his address, description and occupation, if any.

The Articles of Association printed on computer laser printer should be accepted by the Registrar for registration of a company provided they are neatly and legibly printed (Press Note, issued by the department of company Affairs, dated 22-6-1993)

ALTERATION OF ARTICLES

Companies have been given very wide powers to alter their Articles. The right to alter the Articles is so important that a company cannot in any manner, either by express provision in the Article or by an independent contract, deprive itself of the power to alter its Articles. Any clause in the Articles that restricts or prohibits alteration of Articles is invalid. If, for example, the Article of a company contain any restriction that the company shall not alter its Articles, it will be contrary to the Companies Act and, therefore, inoperative.

Procedure of alteration (Sec. 31).

A company may, by passing a special resolution, alter its Article any time. Again any Article may be adopted which could have been lawfully included originally. A copy of every special resolution altering the Articles shall be filed with the Registrar within 30 days of its passing and attached to every copy of the Articles issued thereafter. Any alteration so made in the Articles shall be as valid as if originally contained in the Articles.

Limitations to alteration

1. Must not be inconsistent with the Act. The alteration of the Articles must not be inconsistent with, or go beyond, the provisions of the Companies Act. For example, the Articles cannot be altered so as to give power to a company to purchase it's own shares.
2. Must not conflict with the memorandum. The alteration of the Articles must not exceed the power given by the memorandum, or conflict with the provisions of the memorandum. If it does, it will be ultra virus and wholly void and inoperative.
3. Must not sanction anything illegal. The alteration must not purport to sanction anything which is illegal. But if it is legal and it is not clearly prohibited by the memorandum, it may be held to be valid even where it alters the whole structure of the company.

4. Must be for the benefit of the company. The alteration must be made bona fide for the benefit of the company as a whole. That the power of alteration must be "exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities."

Brown V. British Abrasive Wheel company limited, (1919) 1ch. 290. A company was in financial difficulties. The majority of the share holder were willing to provide more capital if the remaining 2 Percent shareholders would sell them there shares. The majority then passed a special resolution altering the Articles so as to enable 9/10ths of the shareholders to buy out any other shareholders. Held, the alteration of the Articles could be restrained as it was designed to allow the majority to do compulsorily what they could not do by agreement and it was not for the benefit of the company as a whole.

5. Must not increase liability of members (Sec. 38). The alteration must not in any way increase the liability of the existing members to contribute to the share capital of, or otherwise pay money to, the company unless they agree in writing before or after the alteration is made. But where the company is a club or association, the Articles may be altered to provide for subscription or charges at a higher rate.

6. Alteration by special resolution only. The alteration can be made only by a special resolution. Even clerical errors in the Articles should be, set right by a special resolution (Evans V. Chapman,(1902) 18 L.T.506).

7. Approval of Central Government when a public company is converted into a private company. The alteration in the Articles which has the effect of converting a public company into a private company can be made only if it is approved by the Central Government. Where this alteration has been approved by the Central Government, a printed copy of the Articles as altered shall be filled by the company with the Registrar within 1 month of the date of receipt of order of the approval.

8. Breach of contract. A company is not prevented from altering its Articles even if such an alteration would result in breach of some contract. The affected party may, however, file a suit for damages for breach of contract.

9. Must not result in expulsion of a member. An assumption by the Board of directors of a company of any power to expel a member by amending its Articles is illegal and void. Any provision in the Articles conferring such a power on the Board of directors is repugnant to the various provisions in the companies Act pertaining to the rights of a member in a public limited company.

10. No power of the Tribunal to amend Articles. The tribunal has no power to amend or rectify the Articles even where there is a mistake or drafting error which the Tribunal would rectify in the case of any other contract (Evans V. Chapman, (1902) 18 L.T.R. 506). The Tribunal can only declare some clause to be ultra vires (Scott V. Frank Scott (London) Ltd. (1940) ch. 794)

11. Alteration may be with retrospective effect. The Articles may be altered with retrospective effect and the fact that some members suffer a detriment does not make it void.

ARTICLES AND MEMORANDUM ---- THEIR RELATON

The Articles are subordinate to Memorandum. The Article can not give powers to a company which are not conferred by the Memorandum nor can they purport to create rights which are inconsistent with the Memorandum. This is no because the object of the Memorandum is to state the purpose for which the company has been established, while the Articles provide the manner in which the internal management of the company is to be carried.

1. The Memorandum must be read in conjunction with Articles. This is the case when it is necessary---

   (a) to explain any ambiguity in the terms of the Memorandum, or

   (b) to supplement the Memorandum upon any matter about which it is silent except as regards matters which must by Statute be provided by the Memorandum.

The Articles may explain or supplement the Memorandum, but cannot extend or enlarge its scope.

3. The terms of the Memorandum cannot be modified or controlled by the Articles. If, however, there is any ambiguity in the Memorandum, the Articles may be referred to for clarification. But so far as the fundamental conditions in the Memorandum are concerned, they cannot be explained with the aid of the Articles.

Difference between Memorandum and Article of Association

Memorandum of Association	Articles of Association
1.It is the charter of the company Indicating the nature of its business, Its nationality, and its capital. It also defines the company's relationship with outside world.	1. They are the regulations for the internal management of the company and are subsidiary to the Memorandum.
2. It defines the scope of the activities of the company, of the company, or the area beyond which the actions of the company cannot go.	2. They are the rules for carrying out the objects of the company as set out in the Memorandum.
3. It being the charter of the company Is the supreme document.	3. They are the subordinates to the Memorandum. If there is a conflict between the Articles and Memorandum, the latter will prevails.

Memorandum of association	Articles of association
4. Every company must have its own Memorandum.	4. A company limited by shares need not have Articles of its own. In such a case. Table A applies.
5. There are strict restrictions on its alteration. Some of the conditions of incorporation contained in it cannot the National Company Law Tribunal.	5. They can be altered by a special resolution, to any extent, provided they do not conflict of with the Memorandum and the Companies Act.
6. Any act of the company which is Ultra vires the Memorandum is wholly Void and cannot be ratified even by whole body of shareholders.	6. Any act of the company which is ultra vires the Articles (but is intra vires the Memorandum) can be confirmed by the shareholder.

Legal effects of Memorandum and Articles

The Memorandum and Article when registered bind a company

and the members thereof to the same extent as if they had been

signed by the company and each member. The effect of these provisions is to constitute, through the Memorandum and the Articles of a company. The legal implications of these documents may be discussed as to how far these documents bind:

1. Members to the company.
2. Company to the members.
3. Members inter se.
4. Company to the outsiders.

1 Members to the company

The Memorandum and the Articles constitute a binding contract between the members and the company [Hanuman Prasad Gupta Vs Hiralal . A.I.R. (1971) S.C. 206]. The effect of this is that each member is bound to the company as if each member has actually signed the Memorandum and the Articles.

For Example:- Borland's Trustee Vs. Steel Bros. & Co. Ltd., (1901) Ch.279. The Articles of company as altered provided that the shares of any member who became bankrupt should be sold to certain persons at a fair price. B, a shareholders became bankrupt and his trustee in bankruptcy claimed that he was not bound by the altered Articles. Held , the Articles were a personal contract between B and the rest of the members, and B and his trustee were bound.

2. **Company to the members**.

A company is bound to the individual members in terms of their ordinary rights as members, e.g. the right to receive notice of general meetings, the right to receive dividend, etc. The company can exercise its rights as against any member, only in accordance with the provisions in the Memorandum and the Articles. A member can obtain an injunction restraining the company from doing an ultra vires act.

Example: - Wood Vs. Odessa Waterworks co., (1889) 42 Ch. D.636. The Articles of W. co. provided that the directors may, with the sanction of the company at general meeting, declare a dividend to be paid to the members. A resolution was passed to give the shareholders debenture bonds instead of paying the dividend in cash.

3. **Members inter se.**

As between the members inter se (among themselves) the memorandum and the articles of association constitute a contract between them and are also binding on each member as against the other or others. Such a contract can, however be enforced through the medium of the company.

4. Company to the outsiders.

The Articles do not constitute any binding contract as between a company and an outsider. An outsider cannot take advantage of the articles to found a claim against the company. This is based on the general rule of law that a stranger to a contract cannot acquire any rights under the contract. Thus, if a right is conferred by the articles on a person in any capacity other than that of the member. It cannot be enforced against the company.

For Example: - Eley Vs Positive govt. security life Ass. Co., [1876] 1. EX. D. 88. The Articles of a company provided that E should be the solicitor of the company for life and could be removed from office only for misconduct. E took office and became a shareholder. After some time the company dismissed him without alleging misconduct. E sued the company dismissed him without alleging misconduct. E sued the company for damages for breach of contract. Held, the articles did not constitute any contract between the company and the outsider and as such no action could lie.

Constructive Notice Of Memorandum and Articles

Every outsider dealing with a company is deemed to have notice of the contents of the Memorandum and the Articles of Association. These documents on registration with the registrar, assume the character of public documents. This is known as constructive notice of Memorandum and Articles.

Office of registrar is a public office. The Memorandum and the Articles are open and accessible to all. It is the duty of every person dealing with a company to inspect these documents and see that it is within the powers of the company to enter into the proposed contract. Likewise special resolutions, when registered with the registrar, and particulars of charges registered with the registrar, become public documents, so that an outsider is on notice of their contents in the same way as he is of the Articles and the Memorandum. [Irvine Vs. Union Bank of Australia, (1877) 2 App. Cas. 366]

Presumption that outsider has read Memorandum and Articles. Lord Hatherley observed in this regard in Mahony Vs. East Holyford Mining Co., (1875) L.R. 7 H.L. 869 as follows :

"But whether he actually reads them or not it will be presumed that he has read them. Every joint stock company has its Memorandum and Articles of Association… open to all who are minded to have any dealings whatsoever with the company and those who so deal with them must be affected with notice of all that is contained in these two documents."

DOCTRINE OF INDOOR MANAGEMENT

There is one limitation to the doctrine of constructive notice of the Memorandum and the Articles of the company. The outsiders dealing with the company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regularly done. They are presumed to have read these documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more ; they need not inquire into the regularity on the internal proceedings as required by the Memorandum and the Articles. They can presume that all is being done regularly. This limitation of the doctrine of constructive notice is known as the "doctrine of indoor management", or the rule in Royal British Bank Vs. Turquand, or just Turquand Rule.

Thus, whereas the doctrine of constructive notice protects the company against outsiders, the doctrine of indoor management seeks to protect outsiders against the company.

For example: - Royal British Bank Vs. Turquand, (1856) 6 E. & B. 327. the directors of a company had issued a bond to T. They had the power under the Articles to issue such bond provided they were authorized by a resolution passed by the shareholders at a general meeting of the company. No such required resolution was passed by the company. Held, T could recover the amount of the bond from the company on the ground that he was entitled to assume that the resolution had been passed.

The gist of the rule is that persons dealing with limited liability companies are not bound to inquire into the regularity of the internal proceedings and will not be affected by irregularities of which they had no notice.

The rule is based on public convenience and justice :

First, the Memorandum and the Articles are public documents. They are open to inspection by everybody. But the details of internal proceedings are not open to public inspection. An outsider is presumed to know the constitution of a company, but not what may or may not have taken place within the doors that are closed to him.

Secondly, the lot of creditors of a limited liability company is not a particularly happy one : it would be unhappier still if the company could escape liability by denying the authority of the officers to act on its behalf.

Exceptions to the doctrine of indoor management

1. *Knowledge of irregularity*. Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management. He may in some cases be himself a part of the internal procedure.

   T.R. Pratt(Bombay) Ltd. Vs. E.D. Sassoon & co. Ltd. A.I.R. (1936) Bombay 62. Company A lent money to a company B on a mortgage of its assets. The procedure laid down in the Articles for such transactions was not compiled with. The directors of two companies were the same. Held, the lender of notice of the irregularity and hence the mortgage was not binding.

2. *Negligence.* Where a person dealing with a company could discover the irregularity if he had made proper inquiries, he cannot claim the benefit of the rule of indoor management. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.

For Example: - Anand Bihari Lal Vs. Dinshaw & co., A.I.R.(1942) Oudh 417. The plaintiff, in this case, accepted a transfer of a company's property from its accountant. Held, the transfer was void as such a transaction was apparently beyond the scope of the accountant's authority. The plaintiff should have seen the power of attorney executed in favour of the accountant by the company.

3. *Forgery.* The rule in Turquand's case does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

For example: - Ruben Vs. Great Fingall consolidated co., (1906) A.C. 439. The secretary of a company issued a share certificate under the company's seal with his own signature and the signature of a director forged by him. Held, the share certificate was not binding on the company. The person who advanced money on the strength of this certificate was not entitled to be registered as holder of the shares.

4. *Acts outside the scope of apparent authority.* If an officer of a company enters into a contract with a third party and if the act of the officer is beyond the scope of his authority, the company is not bound.

For Example: - Kreditbank Cassel Vs. Schenkers Ltd., (1927) 1 K.B. 826. A branch manager of a company drew and endorsed bills of exchange on behalf of the company in favour of a payee to whom he was personally indebted. He had no authority from the company to do so. Held, the company was not bound.

COMPANY

CHAPTER

PROMOTERS

Promoters

- The first persons who control a company's affairs are its promoters. It is they who conceive the idea of forming the company, with reference to a given object and then to set it going.
- It is they who take the necessary steps to incorporate the company, provided with share and loan capital and acquire the business or property which it is to manage.

Functions of a Promoter

- The promoter of a company decides its name and ascertains that it will be accepted by the registrar of companies.
- He settle the detail of the company's Memorandum and Article, the nomination of directors, solicitor, bankers, auditors and secretary and the registered office of the company.
- He arranges for the printing of the memorandum and Article, the registration of the company, the issue of prospectus ,where a public issue is necessary. He is, in fact, responsible for bringing the company into existence for the object which he has in view.

Legal Status of a Promoter

While the accurate description of a promoter may be difficult, his legal position is quite clear. A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company and therefore requires full disclosure of the relevant facts, including any profit made as held by Lord Cairns in Erlanger v. New Sombrero Phosphate Co. (39 LT 269

Lindley L.J. describes :

" Although not an agent for the company, nor a trustee for it before its formation, the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is well settled that a promoter of a company is accountable to it for all moneys secretly obtained by him from it just as the relationship of the principal and agent or the trustee and cestui que trust had really existed between him and the company when the money was obtained".

Fiduciary position of a Promoter

- The fiduciary position of a promoter may be summed up as follows:

1. Not to make any profit at the expense of the company. The promoter must not take, either directly or indirectly, any profit at the expense of the company which is being promoted. if any secret profit is made in violation of this rule, the company may ,on discovering it, compel him to account for and surrender such profit.
2. To give benefit of negotiation to the company.
3. To make full disclosure of interest or profit.
4. Not to make unfair use of position.

Duty of promoter as regards Prospectus.

The promoter must see in connection with the prospectus, if any is issued , that the prospectus

- Contains the necessary particulars,
- Does not contain any untrue or misleading statements or dose not omit any material fact.

Remuneration of Promoters

A promoter takes remuneration for his services in one of the following ways:-

- He may sell his own property at a profit to the company for cash or fully-paid shares provided he makes a discloser to this effect.
- He may be given an option to buy a certain number of shares in the company at par.
- He may take a commission on the shares sold.
- He may be paid a lump sum by the company.

Pre- Incorporation or Preliminary Contracts

The promoters of a company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated. Such contracts are called pre-incorporation or preliminary contracts. The promoters generally enter into such contracts as agents for the company about to be formed . The legal position is that “two consenting parties are necessary to a contract whereas the company ,before incorporation, is a non entity.” The promoter can’t ,therefore act as agent for a company which has not yet come into existence . As such the company is not liable for the acts of the promoters done before its incorporation.

Position of promoters as regards pre-incorporation contracts

- Company not bound by pre-incorporation contract. A company, when it come into existence, is not bound by a pre-incorporation contract even where it takes the benefit of the contract entered into on its behalf.
- Company cannot enforce pre-incorporation contract. A company cannot, after incorporation, enforce the contract made before its incorporation. The leading case on the point is:
- Natal Land and Colonisation Co. Ltd vs Pauline Colliery and Development Syndicate Ltd. (1904) A.C. 120. THE n Company agreed with an agent of the P Syndicate Ltd. Before its formation to grant a mining lease to the Syndicate. The Company refused to grant the lease. Held, there was no binding contract between the Company and the Syndicate.

Cont.

- Promoters personally liable. The promoters remain personally liable on a contract made on behalf of a company not yet in existence. Such a contract is deemed to have been entered into personally by the promoters.
- Kelner vs Baxter, (1866) L.R. 2 C.P. 174. A hotel company was about to be formed and persons responsible for the new company stock on behalf of the proposed company, payment to be made on 28th January, 1866. the company was incorporated on 20th February 1866. the goods were consumed in the business and the company went into liquidation before the debt was paid. The persons signing the agreement were sued on the contract. Held, the persons sinning were promoters and personally liable on their signatures.

Ratification of a pre-incorporation

- A company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at at the time of the contract by the agent.
- Where a contract is made on behalf of a company known to both the parties to be non-existence. The contract is deemed to have been entered into personally by the promoters. The company can if it desires, enter into a new contact, after its incorporation with the other party and
  - If the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end : and
  - If the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Specific performance of pre-incorporation contract

Secs. 15 and 16 of the Specific Relief Act, 1963 deal with this point. When the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation, specific performance may be obtained by, or enforced against, the company : provided that the company has accepted the contract and has communicated such acceptance to the other party to the contract

Provisional contracts

- Provisional contracts refer to contracts entered into by a public company after its incorporation but before it is issued the certificate to commence business.
- According to Sec. 149 (4), any contract made by a company before the date at which it is entitled to commence business shall be provisional only, and shall not be binding on the company until that date, and on that date it shall become binding. If the company is unable to obtain the certificate to commence business , the provisional contract automatically lapses ; if it gets the certificate, the provisional contract ratification of the contract by the company ; the contact becomes binding automatically.

COMPANY

CHAPTER

DIRECTOR

DIRECTORS

- The directors of a company are its eyes, ears, brain, hands, nerves and other essential limbs, upon whose efficient functioning depends the success of the company. The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives as contained in the Memorandum, muster resources for achieving the company objectives and control, guide and direct and manage the affairs of the company. Directors, as a body, frame the general policy of the company, direct its affairs, appoints the company officers, ensure that they carry out their duties and recommend to the shareholders regarding distribution of dividend.

Definition of Director

- Section 2(13) defines a ‘director’ as including “any person occupying the position of director by whatever name called”.

TYPES OF DIRECTORS

There are mainly two types of company directors. They are

- (i) Executive Directors or whole-time directors with their designations as managing directors, executive directors and technical directors; and
- (ii) Non-executive or part-time directors who are professionals and for their livelihood do not depend upon one company but serve on the Boards of directors of a number of companies.

- As per clause 49 of the Listing Agreement which deals with good Corporate Governance Practices, every company, to which this clause applicables shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the Board of directors comprise of non-executive directors.
- The number of independent directors would depend whether the Chairman is executive or non-executive.
- In case of a non-executive Chairman, at least one-third of Board should comprise of independent directors and
- in case of an executive Chairman, at least half of Board should comprise of independent directors.

- For this purpose the expression‘Independent directors’ means directors who apart from receiving director’s remuneration, do not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in judgement of the Board may affect independence of judgment of the director. Except in the case of Government companies, institutional directors on the boards of companies should be considered as independent directors whether the institution is an investing institution or a lending institution.

TYPES OF DIRECTORS

Inside Directors

Inside directors are those directors who are in the whole time employment of a company. This category includes a Managing Director, Whole-time Director, Technical Director, Executive Director, etc.

Outside Directors

Outside directors are those directors, who are not in the whole-time employment of a company and as such are not associated with its day-to-day working. They include professional directors, nominated directors and statutory directors. They are also sometimes described as non-management or non-executive directors as distinguished from inside directors who are also known as management directors or executive directors.

- ***Professional Directors***
- Professional directors are specialists in different fields of management with extensive experience and capability of assisting in improving a given organisation. They are in a good position to offer constructive suggestions in formulating the company's policies. Their income is derived principally from sitting fees that they receive from the companies on whose boards they serve.
- *Nominee Directors*
- Nominee directors are appointed by financial institutions or banks, which extend term loans and/or working capital assistance or any other type of financial assistance to companies. Nominee directors are a powerful tool of project supervision, monitoring and control, particularly following the issue of Government guidelines enjoining financial institutions to nominate directors on the boards of companies enjoying substantial assistance.

- ***Special Directors or Executive Directors***

- A special director or an executive director is a full-time employee of a company and is given this designation in appreciation of his merit and his usefulness to the company. Such directors may not be the members of the Board and as such they cannot be called directors within the meaning of the provisions of the Companies Act, 1956. However, the Department of Company Affairs has, vide Circular No. 2/82, advised companies to desist from giving designations as 'Special Director', 'Director Administration', etc., to their executives, who are not members of the Board, as such designations give an impression to the public at large and those dealing with the companies and the executives that they are full-fledged directors entitled to act as such on behalf of the company.

- ***Independent Directors***

- In Clause 49 of the listing agreement, the term "Independent Directors" has been defined as under:-

- 'Independent director' shall mean non-executive director of the company who apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies; who is not related to promoters or management at the board level or at one level below the board; who has not been an executive of the company in the immediately preceding three financial years;

- Who is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.
- Who is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and
- Who is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.
- *Explanation* (ii): Institutional directors on the boards of companies shall be considered as independent directors whether the institution is an investing institution or a lending institution.

- ***Interested Directors***

- "Interested Director" means any director whose presence cannot, by reason of Section 300, count for the purpose of forming a quorum at a meeting of the Board, at the time of the discussion or vote on any matter.

- ***Government Directors***

- The Central Government has the power to appoint directors under Section 408 of the Act. The detailed provisions in this regard have been discussed later in this study lesson.

- ***Whole-time Director***

- According to *Explanation to Section* 269(1), a "Whole-time Director" includes a director in the whole-time employment of the company". Thus, a "whole-time director" means a director who devotes all his time and attention to the management of the company. Where a director is appointed to act as Technical Director, Legal Director, Works Director and Sales Director on full time basis he is a whole-time director of the company. A whole-time director is also a managerial person [See Section 268(1)].

Managing Director

A Managing Director, as defined in Section 2(26) of the Act, means a director who, by virtue of an agreement with the company, or of a resolution passed by the company in a general meeting or by its Board of directors or by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him, and includes a director occupying the position of a Managing Director, by whatever name called.

The definition makes it clear that the managing director's powers must be substantial so as to give him a discretion and power to decide matters such as buying and selling, appointment of employees, and the managing director must exercise his powers subject to the superintendence, control and directions of the company's Board of directors. But the power to perform acts of routine administrative character alone, such as affixing the common seal of the company to any document or drawing and endorsing cheques on company's account in any bank or drawing and endorsing other negotiable instruments or signing of share certificates or directing the registration of transfer of shares will not make a director a managing director.

LEGAL POSITION OF DIRECTORS

It is very difficult to define the position of director. Section 252 of the Act makes it obligatory on every public company to have at least three directors and on every other company to have at least two directors. The Act does not lay down any qualification for a person to become a director. However, it lays down disqualifications.

Director as an Agent

The true position of company directors is that of agent and apart from the provisions of the various corporate laws, which bind them, confer certain rights upon, impose certain obligations on them and make them liable for defaults for violations thereof. Their real relationship with the company is governed by the arrangement of agency as governed by the Contract Act.

- **This position was established long back in *Ferguson* v. *Wilson* (1966) L.R. 2 Ch., wherein it was held that "the company itself cannot act in its own person for it has no person; it can only act through directors and the case is as regards those directors merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable; where the liability would attach to the principal and principal only, the liability is the liability of the company".**
- **In the aforesaid case, F applied for, and by resolution of the Board was allotted certain shares in a railway company. At the time of allotment all the shares in the company had been allotted with the result that the company was unable to place F on the register of members as the holder of shares in the company. F sued W, as director of the company, claiming *inter alia* that W should transfer some of his own shares to F and pay damages. Held F's claim failed on the ground that the directors of a company acting in the normal course of their duties are agents for their company and incur no personal liability.**

Director as officer :- For certain matters under the companies act, the directors are treated as officers of the company and as such they are liable for certain penalties.

Section 179 of the Income Tax Act, 1961, **imposes personal liability for tax arrears upon every director** of a private company who cannot prove that the default was not due to his neglect, misfeasance or breach of duty. Personal liability of the directors might arise where they contract in their own name or fail to exclude personal liability, they will also be personally liable if they contract on behaf of the company without using the word "Limited" or the words "Private Limited" as part of the name. It is in the interest of the directors to make clear, while signing on behalf of the company that they are signing as agents.

It is important to remember that it is the Board of directors as a collective body that is the agent of the company and so if the **Board acts as agent that binds the company, a single director will have no authority to bind the company**, unless such powers are, specifically delegated to him by the Board of directors. If the directors exceed their powers, that is to say, if the contract made by them is *ultra vires* their powers, themselves, then such contract, if made with a member of the company is only voidable; and if made with an outsider who had no notice of the want of authority, binds the company but the company may claim damages for breach of implied warranty or authority [*Elkington and Co.* v. *Hunder* (1892) 2 Ch. 452]. The company may, however, ratify an act, *ultra vires* the directors, by a resolution at a general meeting.

- **To some extent, directors are also trustees for the properties of the company and of the rights which are conferred on them by law and conventions.**

- **"A trustee is a person who is the owner of the property, deals with it as principal, as owner and a master, subject only to an equitable obligation to account to some person to whom he stands in relation of trustee" [*Smith* v. *Anderson* (1880) 15 Ch. D. 247].**

- **Directors stand in fiduciary position towards the company in regard to the powers conferred on them by the Companies Act and by the articles of the company and also with regard to the funds of the company, which are under their control.**

Director as an employees

- **Barring directors in the whole-time employment of the company, like the managing director, executive director, technical director, etc., directors are not in the employment of the company and they are not entitled to any remuneration beyond what is allowed to them by the Act, i.e. fee for attending meetings of the Board and its committees.**
  - **But there is nothing to prevent a director from being a servant of the company under the special contract of service which he may enter into with the company.**

To sum up, directors are trustees of the moneys of the company, but not of the debts due to the company. They are trustees also in respect of powers of the company that are conferred upon them, e.g. powers of: (a) issuing and allotting shares, (b) approving transfers of shares; (c) making calls on shares; and (d) forfeiting shares for non-payment of calls. They must exercise these powers solely for the benefit of the company. Since, however, they are not trustees for the company in the legal sense as aforesaid, the rules of law which apply in case of such trustees do not in all respects apply to them. They may, accordingly, avail themselves of the provisions of the Limitation Act or the Companies Act, as the case may be, for escaping any liability that may be sought to be enforced against them.

- However, it must be remembered that directors are trustees for the company and not for the individual shareholders.

Qualification and Disqualification

The Companies Act, 1956 does not lay down any qualifications for a person to be appointed as a director of a company. However, it mentions disqualifications of directors, which are contained in Section 274 of the Act.

A person shall not be capable of being appointed director of a company, if—

- **A person of unsound mind;**
- **An un-discharged insolvent;**
- **If he has applied to be adjudicated as an insolvent and his application is pending;**
- **he has been convicted by a Court of any offence involving moral turpitude [Foreign Exchange regulation Act]and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence;**

Qualification and Disqualification

If he has not paid any call in respect of the shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

If an order disqualifying him for appointment as director has been passed by Court in pursuance of Section 203 and is in force unless the leave of the Court has been obtained for his appointment in pursuance of that section; or

such person is already a director of a public company which, has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after first day of April 1999; or

If has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more:

Restriction on Number of Director

Every public company shall have at least 3 director and every other company shall have at least 2 directors

If a company has a paid up capital of 5 crore or more and one thousand or more small shareholders then at least one directors must be appointment by "small shareholder i.e shareholders holding shares of nominal value of Rs 20,000/-

No person to be a director for more than 15 companies ,

In calculating 15 number following directorships are excluded a) private company which is neither a subsidiary nor a holding company of a public company b) an unlimited company c) an association of person not carrying on business for profit or which prohibits the payment of a dividend.

If a person who is already a director of 15 compaines has been appointed as director of another company than he has to within 15 day vacate the office of director of any company of his choice so as to bring number equal or below 15.