Unit 1 Notes

The concept of 'Company' or 'Corporation' in business is not new, but was dealt with, in 4th century BC itself, at the time of 'Arthashastra'. It has evolved over time according to the needs of society and business dynamics. The word Company is made of two Latin words

"Com" meaning "coming together" and "panis" meaning "bread". Company originally referred to group of people who took their meal together.

MEANING AND DEFINITION OF A COMPANY

a "company" means a company incorporated under this Act or under any previous company law [Section 2(20)].

In popular parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking. A company is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law and clothing it with legal personality.

The word 'corporation' is derived from the Latin term 'corpus' which means 'body'. Accordingly, 'corporation' is a legal person created by a process other than natural birth.

It is, for this reason, sometimes called artificial legal person. As a legal person, a corporate is capable of enjoying many rights and incurring many liabilities of a natural person.

An incorporated company owes its existence either to a Special Act of Parliament or to company law. Public corporations like Life Insurance Corporation of India, SBI etc., have been brought into existence through special Acts of Parliament, whereas companies like Tata Steel Ltd., Reliance Industries Limited have been formed under the Company law i.e. Companies Act, 1956 which is replaced by the Companies Act, 2013.

NATURE AND CHARACTERISTICS OF A COMPANY

(i) Corporate personality

A company incorporated under the Act is vested with a corporate personality so it bears its own name, acts under name, has a seal of its own and its assets are separate and distinct from those of its members. It is a different 'person' from the members who compose it. Therefore it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. Its members are its owners however they can be its creditors simultaneously. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital.

The case of Salomon v. Salomon and Co. Ltd., (1897) A.C. 22

The above case has clearly established the principle that once a company has been validly constituted under the Companies Act, it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member holds a large or small proportion of the shares

The case of Lee v. Lee's Air Farming Ltd. (1961) A.C. 12 (P.C.),

The above case illustrates the application of the principles established in Salomon's case. In this case, a company was formed for the purpose of aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company. He voted himself the managing director and got himself appointed by the articles as chief pilot at a salary. He was killed in an air crash while working for the company. His widow claimed compensation for the death of her husband in the course of his employment. The company opposed the claim on the ground that Lee was not a worker as the same person could not be the employer and the employee. The Privy Council held that Lee and his company were distinct legal persons which had entered into contractual relationships under which he became the chief pilot, a servant of the company. In his capacity of managing director he could, on behalf of the company, give himself orders in his other capacity of pilot, and the relationship between himself, as pilot and the company, was that of servant and master. Lee as a separate person from the company he formed and his widow was held entitled to get the compensation. In effect the magic of corporate personality enabled him (Lee) to be the master and servant at the same time and enjoy the advantages of both.

(ii) **Company as an artificial person**

A Company is an artificial person created by law. It is not a human being but it acts through human beings. It is considered as a legal person which can enter into contracts, possess properties in its own name, sue and can be sued by others etc. It is called an artificial person since it is invisible, intangible, existing only in the contemplation of law. It is capable of enjoying rights and being subject to duties.

(iii) Company is not a citizen

The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India. In State Trading Corporation of India Ltd. v. C.T.O., A.I.R. 1963 S.C. 1811, the Supreme Court held that the State Trading Corporation though a legal person, was not a citizen and can act only through natural persons. Nevertheless, it is to be noted that certain fundamental rights enshrined in the Constitution for protection of "person", e.g., right to equality (Article 14) etc. are also available to company. Section 2(f) of Citizenship Act, 1955 expressly excludes a company or association or body of individuals from citizenship.

(iv) Company has Nationality and Residence

Though it is established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence.

(v) Limited Liability

The privilege of limited liability for business debts is one of the principal advantages of doing business under the corporate form of organisation." The company, being a separate person, is the owner of its assets and bound by its liabilities.

a shareholder is liable to pay the balance, if any, due on the shares held by him, when called upon to pay and nothing more, even if the liabilities of the company far exceed its assets. This means that the liability of a member is limited. For example, if A holds shares of the total nominal value of 1,000 and has already paid Rs.500/- (or 50% of the value) as part payment at the time of allotment, he cannot be called upon to pay more than Rs. 500/-, the amount remaining unpaid on his shares. If he holds fully-paid shares, he has no further liability to pay even if the company is declared insolvent. In the case of a company limited by guarantee, the liability of members is limited to a specified amount of the guarantee mentioned in the memorandum.

Exception to limited liability

When the company is incorporated as an Unlimited Company under Section 3(2)(c) of the Act

(vi) Perpetual Succession

An incorporated company never dies, except when it is wound up as per law. A company, being a separate legal person is unaffected by death or departure of any member and it remains the same entity, despite total change in the membership. Perpetual succession, means that the membership of a company may keep changing from time to time, but that shall not affect its continuity.

(vii) Separate Property

A company being a legal person and entirely distinct from its members, is capable of owning, enjoying and disposing of property in its own name.

(viii) Transferability of Shares

The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company.
Section 44 of the Companies Act, 2013 enunciates the principle by providing that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the articles.

Memorandum

As per Section 2(56) of Companies Act, 2013 memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of this Act.

Memorandum of Association is a legal document that contains specific information regarding the working of the company, it also defines the scope of activities of the company.

Memorandum of Association is also called the charter of the company which contains the rights and duties of the members and their relation with the company.
Every individual who wants to start his or her business wants to have a legal identity for its company, a memorandum of association contains all the necessary documents that are required to give legal identity to the company.

Features of Memorandum of Association

- A memorandum of association states the nature of business activities to be conducted by the company.
- It is prepared by the promoters of the company.
- A memorandum of association is signed by at least 7 people in case of a public company and 2 people in case of a private company.
- It is submitted to the registrar of companies for registration that is for getting a certificate of incorporation.
- It is an unalterable charter as changes are made with great difficulty.
- It is a public document and can be inspected by any individual as and when necessary
- Any act done beyond the powers of the memorandum of association ultra vires the act.

Importance of Memorandum of Association

- A memorandum of association is an essential document without which no company could be registered.
- A memorandum of association also works as a guide for all the members of the company including the directors, it includes the objectives of the company, it also contains the limitation which restricts the power of the company.
- All the investors are protected by the memorandum of association as there is always a risk involved when a person invests money in a company.
- It makes outsiders know whether a particular company is eligible to make transactions or accept it.

Contents of Memorandum of Association

Section 4 of the Companies Act, 2013 mentions the following major contents which are required for a memorandum of association namely:

- Name Clause- The name of the company must not be similar to an existing company. A company must not use any name which is connected with the government. A private company with limited shares should end its name with private limited.
- Office Clause -According to this clause every company must mention in the memorandum the state in which the office is registered.
- **Objects Clause** - The purpose of the company for which it has been set up is determined by the objects clause. If certain activities of the companies are not included in the object clause then the company is not legally bound to conduct those activities.
- Liability Clause- **The liability clause** of memorandum of association mentions the liability of each member, whether the liability of its members is limited by shares or limited by guarantee or it is unlimited.
- Subscription Clause- According to this clause, the Memorandum must mention the amount of capital and the shares that have been taken by each member or subscriber. Various statutory provisions regarding this clause are:
    - The memorandum must be signed by the subscriber in the presence of at least one witness.
    - Each subscriber must take at least one share.
    - Quantity of shares that the member has taken must be mentioned.

The Doctrine of Ultra Vires

Every memorandum of a company has a certain object clause which mentions the reason why the company has been incorporated. It is expected that the company will act according to the object clause and will not act outside the object clause, if the company does any act which is not a part of the object clause then that act of the company would be declared ultra vires. The literal meaning of this doctrine is **acts done beyond power**. An ultra vires act is void and cannot be ratified by the directors even if they want to ratify it.

Need for Ultra Vires

The doctrine of Ultra Vires was particularly introduced to protect the interests of creditors and shareholders, the object clause is considered the preamble of the company, and therefore anything was done which is inconsistent with the preamble will definitely be termed as void. It also helps the creditors to see whether their money is invested in an appropriate way and place. It also helps the company to avoid the situation of insolvency as it ensures that the assets of the company are put in the prescribed manner because if they are not put in a prescribed manner then there is a risk that the company might lose its assets and become insolvent. this doctrine is also essential to curb the unlimited powers of the directors, it ensures and guides the directors to act in an authorized way.

Evans v. Brunner Mond and Company (1921)

In this case, a company was incorporated for carrying on a business for manufacturing chemicals. The object clause in the memorandum authorized the company to make any such decision that may be incidental for the fulfilment of the above-stated business. Through a special resolution, the company was also authorized to distribute a certain amount of money from the surplus to any university in the U.K as the company wishes to do for promoting scientific development and research.

This clause was challenged in the court on the ground that the above power to grant money was against the objective clause in the memorandum and thus ultra vires.

However, the directors of the company were able to prove that the above practice was somehow connected to their business as it was difficult to get trained men and the money was given to encourage scientific development and research so that more trained personnel could be produced and the company could easily recruit them.

The Court held that the expenditure authorized by the company was necessary for the company's continued progress and therefore the act was not ultra vires.

Constructive Notice Of Memorandum

The memorandum and articles of association of every company are registered with the Registrar of the Companies. The office of the Registrar is a public office and consequently the memorandum and articles become public documents.

They are open and accessible to all. It is, therefore, the duty of every person dealing with the company to inspect its public documents and make sure that his contract is in conformity with their provisions. But whether a person actually reads them or not, he is to be in same position as if he had read them. He will be presumed to know the contents of those documents. This kind of presumed notice is called constructive notice.

The effect of this rule is that a person dealing with the company is taken not only to have read those documents but to have understood them according to their proper meaning. He is presumed to have understood not merely the company's powers but also those of its officers. Further, there is constructive notice not merely of the memorandum and articles, but also of all the documents, which are required by the Act to be registered with the Registrar.
Legal effect: If a person's deals with a company in a manner which is inconsistent with the provisions contained in MOA and AOA own risk and cost and shall have to bear the consequences thereof.
The effect of the doctrine of constructive notice may be summed up as follows:

1. Ultra Vires Acts

   According to doctrine of constructive notice, every person dealing with the company is presumed to have the knowledge of the contents of the memorandum and therefore if an act is ultra vires the company, he cannot claim relief on the ground that he was unaware of the fact that the act is beyond the memorandum (i.e., ultra vires the company)

2. Acts Beyond The Authority Of Directors

   If there is lack of authority of the directors or other agents of the company, it is evident from the public documents like articles and other regulations, the person dealing with the company will be presumed to have the notice of the lack of authority and therefore he cannot hold company bound by the act of the directors or other agents.

3. Inconsistent Agreements

   Person dealing with the company is presumed to have the notice of the contents of the articles and consequently he cannot make a contract with the company which purports to override any rights created by the articles. The doctrine of constructive notice protects the company but not the outsider dealing with the company.

4. **Doctrine Of Indoor Management**

   Indoor Management restricts the operation of constructive notice to the public documents of the company. The role of the doctrine of indoor management is opposed to that of the rule of constructive notice. Accordingly, a person dealing with the company is bound to read only the public documents. If his contract is consistent with them, the company is bound. He will not be affected by any irregularity in the internal management of the company.

   According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association. Shareholders, for example, need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner. The doctrine helps protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

   The foundation of the rule was laid down in the case of Royal British Bank v. Turquand2 Turquand, a company, had a clause in its constitution that allowed the company to borrow money once it had been approved and passed by resolution (decision) of the shareholders at a general meeting. Turquand entered into a loan

with the Royal British Bank and two of the co- directors signed and attached the company seal to the loan agreement. Loan had not been approved by the shareholders. Company defaulted on their payments and the bank sought restitution. Company refused to repay claiming that the directors had no right to enter into such an arrangement. It was held that the Turquand was entitled to assume that the resolution was passed. The Company was therefore bound by the rule. Doctrine is also popularly known as the Turquand rule'.