UNIT-1 BROAD FEATURES OF ICA 2013

Structure:

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1.0 OBJECTIVES

After studying this module:

- You shall be able to Know the meaning of company
- Learn the broad features of the Companies Act 2013
- Understand how the Companies Act is implemented

1.1 INTRODUCTION

In general, company means an association of persons for a common object. The term 'company' is derived from the Latin word "com" means with or together, panis means bread, and originally referred to an association of persons who take their meals together. Company as a form of business is traditionally called 'joint-stock company'. "By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it for a common purpose. 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 which each member is entitled is his share. Shares are always transferable, although right to transfer them is often more or less restricted."1 However, joint contribution of capital is not sufficient to describe a company. In partnership firms also, the capital is brought jointly by the partners. Company different from partnership firms, is not merely an association of persons, it is an incorporated association of persons created by law to

carry on the expressly laid down objects. A company exists only in the contemplation of law. Law creates it and law alone can dissolve it. It may be formed by an Act of Parliament, or by Royal Charter, or by registration under company law. The essential feature of company is that it is an incorporated association created by the law. Chief Justice Marshal of U.S.A. has defined a company as "a person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence." Company as a form of doing business has its origin in 1600 A.D. when the East India Company was established by way of a Royal Charter in England. Subsequently, the legislative developments in the mid-nineteenth century in the UK give rise to the modern form of company. At present, the company has become the predominant form of doing business. This is on account of numerous advantages which a company has. Corporate laws world over have regulations regarding formation and functioning of companies. In India, the Companies Act of 2013 (known as the Indian Companies Act, 2013) contains the law relating to companies. The Companies Act being the Act of the Central Legislature (i.e. Parliament) applies to companies throughout India on a uniform basis.

1.2 INDIAN COMPANIES ACT 2013

The Companies Act, 2013 was passed to consolidate and amend the law relating to companies. The Act comprises of 7 schedules, 29 chapters and 470 sections. The Act extends to the whole of India. The Act of Parliament received the assent of the President on the 29th August, 2013.The Act shall be applicable from financial year 2014-15.

1.3 OBJECTIVES OF COMPANIES ACT 2013

Objectives As per the Results- Framework Document (RFD), Ministry of Corporate Affairs-(2013-2014), objectives of the Companies Act, 2013 are as follows:

- To provide simplified laws governing Corporate Sector and to facilitate effective compliances and enlightened regulatory regime.

- Online delivery of all registry related services with speed, certainty and transparency, access to public information and effectively monitoring of statutory compliance by the companies.

- Effective enforcement of `Companies Act' and other Acts coming under the domain of the Ministry of Corporate Affairs (MCA) for better Corporate Regulation and Governance.

- Protection of Investor and Promotion of Investor Education and Awareness for growth of Corporate Sector in the country.

- To develop capacity building and secure policy advisory support through Indian Institute of Corporate Affairs (IICA).

- To Promote Competition.

- To disseminate Corporate Sector Data/Official Statistics as per National Data Sharing and Accessibility Policy (NDSAP)

- Improving the functioning of Official Liquidators through application of e-Governance. 9. Developing and strengthening capabilities in Serious Fraud Investigation Office (SFIO).

1.4 NATURE AND SCOPE

The Companies Act is an Act of the Central Legislature. So, it applies to companies throughout India on a uniform basis (except that it is applicable to the States of Jammu & Kashmir, Goa, Daman & Diu and Sikkim subject to special provisions made and notifications issued by the Central Government).

The provisions of this Act are applicable to:

Companies incorporated under this Act or under any previous company law; Insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999;

Banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;

Companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;

Any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act; and

Such a body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification.

1.5 MACHINERY FOR ADMINISTRATION

The Central Government has the overall responsibility for administration and enforcement of the Companies Act. The Ministry of Corporate Affairs (MCA) of the Government of India is the nodal agency/authority given various powers under the Act. Most of the powers are vested to the authorities created under the Act.

- **National Company Law Tribunal (NCLT)**

The Companies Act, 2013 provides for the constitution of the National Company Law Tribunal (NCLT) and lays down its composition and power. Chapter XXVII (sections 407 to 434) relate to the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT). The implementation of the Amendment Act will mark the end of the High Court's jurisdiction over company matters. It will also abolish the Company Law Board (CLB) and BIFR. The NCLT will combine the work of all the Company Courts, the Company Law Board and BIFR, while NCLAT will substitute the appellate powers of the High Court. The NCLT and NCLAT have not yet been constituted. Therefore, the provisions relating to the NCLT are not applicable as of now.

The Tribunal shall consist of a President and such number of Judicial and Technical Members not exceeding sixty two, as the Central Government deems fit.

The qualifications for appointment of the President and members of the Tribunal have been laid down by the Act.

The President and every other Member of the Tribunal shall hold office for a term of three years from the date on which he enters upon his office but shall be eligible for re-appointment.

The powers of the Tribunal may be exercised by Benches, constituted by the President of the Tribunal, out of which one shall be a Judicial Member and another shall be a Technical Member.

The Tribunal may, after giving the parties to any proceeding before it, an opportunity of being heard, pass such orders thereon as it thinks fit.

Any person aggrieved by an order or decision of the Tribunal may prefer an appeal to the Appellate Tribunal.

The Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down in the Code of Civil Procedure, 1908 , but shall be guided by the principles of natural justice.

The Tribunal and the Appellate Tribunal shall have, for the purposes of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the matters as laid down by the Act.

Any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such decision or order.

- **Regional Directors**
  The Six Regional Directors are in-charge of the respective regions, each region comprising a number of States and Union Territories. They supervise the working of the offices of the Registrars of Companies and the Official Liquidators working in their regions. They also maintain liaison between the respective State Governments and the Central Government in matters relating to the administration of the Companies Act, 2013. Certain powers of the Central Government under the Companies Act have been delegated to the Regional Directors.

- **Registrar of Companies (ROC)**
  Registrars of Companies (ROCs) appointed under the Companies Act, 2013 covering various States and Union Territories are vested with the primary duty of registering companies floated in the respective States and the Union Territories and ensuring that such companies comply with statutory requirements under the Act. These offices function as registry of records, relating to the companies registered with them, which are available for inspection by members of the public on payment of the prescribed fee. The Central Government exercises administrative control over these offices

1.6 MEANING & DEFINITION OF COMPANY

Section 2(20) of the Companies Act defines a company as "company means a company incorporated under this Act or under any previous company law". "An existing company" means a company formed and registered under any of the former Companies Act. Thus, a company formed and registered under the Companies Act, 1956 or under any former Indian Companies Act is a company.

Note: Before passing of the Companies Act 2013, Indian Companies Act 1956, the Indian Companies Act 1850, the Indian Companies Act 1866, the Indian Companies Act 1882, and the Indian Companies Act 1913 were the enactments in India for registration and regulation of companies. These have since been repealed.

1.7 COMPANY AND BODY CORPORATE

'Body corporate' or 'corporate body' refers to a body which is incorporated under a statute and has a perpetual succession with a common seal, and is a legal entity separate from the members constituting it. The term 'body corporate' is wider than the 'company' and it includes:

- Companies registered under the Companies Act, 2013 or any former Indian Companies Act
- Foreign Companies
- Corporations formed under special Act of the Parliament or State Legislatures or of a foreign country
- Public financial institutions as defined in Section 2(72) of the Companies Act 2013 Nationalised Banks
- Limited Liability Partnerships registered under the Limited Liability Partnership Act, 2008.
- However, 'body corporate' does not include:
- A society registered under the Societies Registration Act, 1860; A corporation sole;
- A co-operative society registered under any law relating to co-operative societies, and
- Any other body not being a company as defined in the Companies Act, which the Central Government may, by notification in the Official Gazette, specify in this behalf.

Note: Company is a body corporate but all body corporates are not companies.

1.8 COMPANY AND CORPORATION

Corporation means a body or institution having an independent legal entity and enjoying perpetual succession. It may be of two types:

(i) Corporation sole, and
(ii) Corporation aggregate.

Corporation sole refers to a single person which is constituted as a perpetual office in respect of some functions e.g., a Public Trustee, President, Governor, Minister etc. It

is not taken as a body corporate for the purposes of this Act, but it is still a legal person and can be a member of a company.

Corporation aggregate means a group of individuals associated as one body having perpetual succession and an independent legal entity. It may be a trading or a non-trading corporation. It includes:

- Chartered companies (created by a Royal Charter)
- Companies incorporated by special Acts of Parliament or State Legislature
- Companies registered under the Companies Act
- Municipal Corporations, District Boards, Universities etc. (non-trading corporations)

1.9 LET US SUM UP

Company is an association created by the law. In India, the Indian Companies Act 2013 contains the law relating to companies.

The Act is a Central legislature passed by the Parliament and it received the assent of the President on the 29th August, 2013. T

The Act which is replacing the five decades old Companies Act 1956 shall be applicable from financial year 2014-15.

The objective of the Act is to provide simplified laws governing Corporate Sector and to facilitate effective compliances and enlightened regulatory regime.

The Central Government has the overall responsibility for administration and enforcement of the Companies Act.

The Ministry of Corporate Affairs (MCA) of the Government of India is the nodal agency/authority given various powers under the Act.

The Companies Act, 2013 has introduced National Company Law Tribunal and National Company Law Appellate Tribunal to replace the Company Law Board and Board for Industrial and Financial Reconstruction.

Company means a company formed and registered under the Indian Companies Act, 2013 or "an existing company". "An existing company" means a company formed and registered under any of the former Companies Act'. Company is a body corporate but all body corporates are not companies.

1.10 KEY WORDS

Legal Entity : Created by Law
Registrar of Companies : An administrative machinery responsible for undertaking registration of companies.
Incorporation : Registration with an authority
Limited Liability : When the liability is limited to the extent of share or contribution or capital

1.11 FURTHER READINGS

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1.12 TERMINAL QUESTIONS:

1. Define a Company in your own words and state its objectives.
2. Explain in detail the applicability of provisions laid down in companies act
3. Write Short Notes on:
   a) Company Law Board
   b) Registrar of Companies
   c) Body Incorporate

UNIT-2 TYPES OF COMPANIES

Structure

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  2.2.1 Statutory Companies
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2.4 Holding and subsidiary company
2.5 One Person Company
2.6 Government Company
2.7 Foreign company
2.8 Association a not for profit
2.9 Illegal association
2.10 Summary
2.11 Keywords
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2.13 Terminal Questions

2.0 OBJECTIVES

After studying this module, you shall be able to know:

- The various types of company
- Learn the various features of public company and private company
- Identify the holding and subsidiary company
- Understand a foreign company
- Identify an illegal association

2.1 INTRODUCTION

In this module we will understand various types of companies, their features and functionality. A company may be incorporated by either by a special Act of the legislature or under the Companies Act, 2013 or 1956. Accordingly, a company may be: (1) Statutory Company, or (2) Registered Company:

2.2 TYPES OF COMPANY

The Companies Act 2013 provides for the kind of companies that can be promoted and registered under the Act.

2.2.1 Statutory Company

A company formed by a special Act passed either by the Central or State Legislature is called a Statutory Company. Such companies are governed by their respective Acts. Although statutory companies are governed by the provisions of their special Acts, the provisions of the Companies Act, 2013 which are not inconsistent with the special Acts apply to these companies. These companies are usually formed to carry out some special public undertakings requiring extraordinary powers and privileges. The object of such companies is not so much to earn profit but to serve people. Though the liability of the members of such companies is limited, yet in most of the cases, they may not be required to use the word 'limited' as part of their names. Annual Report on the working of each such company is required to be placed on the table of the Legislature (Parliament or State Legislative Assembly as the case may be). The audit of such companies is conducted under the supervision, control and guidance of the Comptroller and Auditor General of India. Some of the important statutory companies are Reserve Bank of India, State Bank of India, Life Insurance Corporation of India, Industrial Finance Corporation, etc.

2.2.2 Registered Companies

Companies registered under the Indian Companies Act are known as Registered Companies. These companies are governed and regulated by the provisions of the Companies Act, Memorandum of Association and Articles of Association. These companies may be limited by shares or limited by guarantee or unlimited companies. 3.2.1. Companies Limited by Shares. A company having the liability of its members limited by the amount, if any, unpaid on the shares respectively held by them, is called as a company limited by shares [Sec.2 (22)]. For example if AB.Ltd. has a share capital of 10,000 shares of Rs. 10 each, and A has purchased 100 shares on which he has paid so far Rs. 6 per share, the maximum liability of A is only Rs. 4 per share (the unpaid amount). Also known as 'Limited Liability Company', a large majority of companies

registered in India belongs to this category. The last word of the name of such company is ‘Limited’ (Ltd. in short).

2.2.3 Company Limited by Shares

According to Section 2 (22) of the Companies Act 2013, a company that is limited by shares refers to a company that has the liability of the members is limited by such an amount that is unpaid on their respectively held shares. The company can enact this liability while the company is in existence or as it is ending.

2.2.4 Companies Limited by Guarantee

Company limited by guarantee, also called Guarantee Company is a company in which the liability of each member is limited to such amount as the members may voluntarily undertake under the memorandum of association to contribute to meet out the deficiency of the assets of the company in the event of its being wound up. The guaranteed amount may differ from member to member [Sec.2 (21)]. The amount guaranteed by each member is in the nature of a reserve capital. It cannot be called up except in the case of winding up of the affairs of the company. No charge can be created on the guarantee of the members. These companies may or may not have share capital. If the company has a share capital, liability of members shall be two-fold, firstly liable to pay the amount which remains unpaid on their shares plus the amount payable under the guarantee. The guarantee undertaken by the members would be payable only in the event of winding up of the company. Also referred as non-trading companies, the objective of these companies is not to earn profits. These companies are usually formed for the promotion of educational or scientific research or for any other kind of social or charitable purposes. Sports club, trade associations, NGOs are usually registered as guarantee companies.

2.2.5 Unlimited Companies

A company not having any limit on the liability of its members is termed as an unlimited company [Sec. 2 (92)]. In the case of an unlimited company, the liability of each member extends to the whole amount of the company’s debts and liabilities. An unlimited company may or may not have any share capital. In case it has any share capital, it can increase or reduce its share capital without any restriction. Such type of companies, though permitted by the Companies Act, is very few in the country. The registered companies (whether limited or unlimited) may be either private or public companies.

2.3 PRIVATE COMPANY AND PUBLIC COMPANY

2.3.1. Private Company

Private company as defined by Sec. 2 (68), means a company which has a minimum paid up capital of Rs 1 lakh or such higher paid-up capital as may be prescribed, and whose articles of association contains the following restrictions:

(a) restricts the right of members to transfer its shares;
(b) limits the number of its members to 200 (except in case of One Person Company) exclusive of members who are or were in the employment of the company (i.e. past or present employees of the company who are members in the company will not be counted for the limit of 200 members);
(c) prohibits any invitation to the public to subscribe for any securities of the company. A private limited company may be registered with only two members. A private limited company is required to add the words 'private' (or pvt.) as part of its name.

2.3.2 Public Company

[Sec. 2 (71)] Public company as defined by Sec. 2 (71) means a company which

(a) is not a private company ;
(b) has a minimum paid-up capital of Rs. 5 lakh or such higher paid-up capital as may be prescribed ;
(c) is a private company which is a subsidiary of a company which is not a private company (i.e. subsidiary of a public company whether constituted as a private company or public company shall be regarded as a public company). A public company must have a minimum of 7 members. The articles of association of public company does not contain the restrictions applicable to a private company. That is: shares of a public company are freely transferable: there is no restriction on the maximum number of members; a public company may invite the public to subscribe for its securities - shares, or debentures. However, a public company is under no legal binding to invite the public to subscribe to its shares or debentures.

2.3.3 Distinction between a Private and a Public Company

Following are the main points of distinction between a private and a public company:

- **Minimum number of members.** The minimum number of members required to form a private company is 2, whereas for a public company at least 7 members are needed.

- **Maximum number of members.** The maximum number of members in a public company is unlimited. But a private company cannot have more than 200 members excluding the past and present employees of the company.

- **Minimum paid up capital.** A private company must have a minimum paid up capital of Rs. 1 lakh whereas the minimum paid up capital prescribed for a public company is Rs 5 lakh.
- **Invitation to public.** A private company is prohibited to invite public to subscribe to its share capital. It need not issue a prospectus. But a public company can invite the public to subscribe to its shares or purchase its shares.

- **Deposits from public**. A private company cannot accept deposit from the public i.e. other than its shareholders, directors and their relatives. But a public can invite and/or accept deposits from the public.

- **Transferability of shares.** Articles of Association of a private company imposes restrictions on the transfer of shares. But the shares of a public company are freely transferable.

- **Directors.** A public company is required to have at least three directors while a private company may have only two. Directors of a private company need not retire by rotation. They may be appointed on a permanent basis for life. Unlike the public companies, the directors of a private company may be appointed en bloc by a single resolution.

- **Restrictions regarding managerial remuneration.** Restrictions with regard to the payment of managerial remuneration do not apply to private companies. Unlike the public companies which cannot pay more than 11% of the net profits by way of managerial remuneration, private companies are free to spend any amount on its management. Besides these points of distinction, a private limited company enjoys a large number of legal exemptions and privileges which are not available to public limited companies.

2.3.4 Conversion of a Private Company into a Public Company

Section 14 of the Company Act lay down the following modes in which a private company can become a public company. A private company may get itself converted into a public company by its own choice. In such a case it must

(i) Pass a special resolution for amending is articles so as to delete the restrictive clauses applicable to a private company.
(ii) Increase the paid up capital to at least Rs 5 lakh if it is less than that. Increase the number of members to 7 if it is less than 7.

(iii) Increase the number of directors to 3, if it is less than 3.
(iv) File within 15 days a copy of the special resolution for altering the articles.

The company shall cease to be a private limited company from the date of the alteration of the Articles and will become a public company.

A public company can also be converted into a private company by taking the following steps:

- The Articles of the company should be altered by passing a special resolution so as to include the restrictions, limitations and prohibitions imposed by the Act on private companies.

- The consent of the Tribunal must be obtained.

- The company must file with the Registrar a printed copy of the Articles as altered within 15 days of the receipt of the approval of the Tribunal. Such conversion of a private company into a public company or vice versa does not bring into existence a new company. Therefore, the conversion does not affect the legal personality of the company which continues to remain the same, in spite of the conversion.

2.4 HOLDING AND SUBSIDIARY COMPANIES

A company which controls another company is known as Holding company, and the company so controlled is termed as Subsidiary company. As per section 2 (87), a company shall be deemed to control another company in each of the following cases:

(1) If it controls the majority composition of the board of directors of another company. The composition of other company's board of directors shall be deemed to be controlled if it can, at its direction without the consent or concurrence of any other person, appoint or remove the holders of all or a majority of the directorships.

(2) If it holds majority of the shares of another company. For the purpose of control the company should hold more than half in nominal value of the equity shares of another company.

(3) A company shall be deemed to be the holding company of another company if another company is a subsidiary of the first mentioned company's subsidiary (i.e. subsidiary of the subsidiary).

Illustration Company B is a subsidiary of company A, and company C is a subsidiary of company B. Company C would be regarded as a subsidiary of company A. By virtue of the above provision, if company D is subsidiary of company C, company D will be a subsidiary of company B and consequently also of company A.

A private company which is a subsidiary of a public company is regarded as a public company. A subsidiary company cannot be a member of its holding company and any allotment or transfer of shares in the holding company to its subsidiary will be void. Section 129(3) of the Companies Act requires a holding company to attach to its Balance-Sheet, copies of the Balance Sheet, Profit & Loss Account, Director's Report and Auditors Report of each of its subsidiaries. Further, listed companies are required, as per the Accounting Standards, to prepare Consolidated Balance Sheet to give better information about the financial position of the group as a whole to the creditors, shareholders and public.

2.5 ONE PERSON COMPANY UNDER SECTION 2(62)

"One Person Company" means a company which has only one person as a member. (a) OPC may be registered as a private company with one member and at least one director [Sec3 (1)(c)]. (b) One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles [Sec 3]. (c) A One Person Company may be either: (a) a company limited by shares; or (b) a company limited by guarantee; or (c) an unlimited company.

2.6 GOVERNMENT COMPANY

Government Company means a company in which not less than 51 percent of the paid-up share capital is held by:

- The Central Government, or
- Any State Government or Governments, or
- Partly by the Central Government and partly by one or more State Governments.

Government Company includes a company which is a subsidiary of a Government Company

Holding of shares by municipal and other local authorities or statutory corporations (which are the government bodies) is not to be taken into consideration for this purpose. A Government company may be a private company or public company. A Government private company is not required to add the word 'private' as part of its name. A Government company is not an agent of the government as it is a juristic person different from its members (the government).

Specific Provisions regarding Government Companies

(a) The auditor of a government company is appointed or re-appointed by the Comptroller and Auditor General of India. The Comptroller and Auditor General of India has the power to direct the manner in which the company's accounts are to be audited by the auditor and give such other instructions regarding any matter relating to the performance of his functions as such. He can also conduct a supplementary test audit of the company's accounts by officers appointed by him. The auditor must submit a copy of his report to the Comptroller and Auditor-General and such report, with his comments thereon, shall be placed before the annual general meeting of the company.

(b) Where Central Government is a member of a Government company, it shall prepare an annual report on the working and affairs of the company within three months of the annual general meeting and place it along with the audit report and comments thereon before both Houses of Parliament. Where a State Government is a member of a Government Company, it shall present the annual report on the working of the company along with the audit report and comment thereon before the House(s) of the State Legislature.

(c) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification: shall not apply to any Government company; or shall apply to any Government company, only with such exceptions, modifications and adaptations, as may be specified in the notification.

2.7 FOREIGN COMPANIES

Foreign companies are companies incorporated outside India but (a) have established a place of business in India, or (b) had established a place of business in India prior to the commencement of the Companies Act, 1956 and continue to have the same. However, where not less than 50 per cent of the paid-up share capital of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act as if it were a company incorporated in India.

Obligations of a Foreign Company Document to be submitted: Within 30 days of the establishment of the place of business, a foreign company is required to deliver the following documents to the Registrar for registration

(a) a certified copy of the charter, statutes, or memorandum and articles of the company or other instrument constituting or defining the constitution of the company ; and, if the instrument is not in the English language, a certified translation thereof;
(b) the full address of the registered or principal office of the company ;
(c) a list of the directors and secretary of the company, containing the particulars of their names, usual residential addresses, nationality, business occupations, and other directorships held;
(d) the name and address or the names and addresses of some one or more persons resident in India, authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company ; and
(e) the full address of the office of the company in India which is to be deemed its principal place of business in India.

2.8 ASSOCIATION A NOT FOR PROFIT OR LICENSED COMPANIES

Where to the satisfaction of the Central Government an association-

(a) is about to be formed as a limited company for promoting commerce, art, 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 addition to its name of the word "Limited" or the words "Private Limited" (section 8).

Provisions of the Law Such associations, on registration enjoy all the privileges and obligations, of limited companies subject to the provisions of this section. The licence is granted by the Central Government on such conditions and subject to such regulations as it thinks fit, and those conditions and regulations shall be binding on the association to which the licence is granted. It is not necessary for the association to which a licence is so granted to use the word "Limited" or the words "Private Limited" as any part of its name, unless its articles otherwise provide. A partnership firm may be a member of any association or company licensed under this section, but on the dissolution of the firm, its membership of the association or company shall cease. The licence may at any time be revoked by the Central Government, and upon revocation the body shall cease to enjoy the exemption granted by this section. A body in respect of which a licence under this section is in force shall not alter the provisions of its memorandum with respect to its objects except with the previous approval of the Central Government signified in writing. These associations are not required to have a minimum paid up capital as required for companies.

Advantages of Section 8 companies

It is a privilege to the associations not for profit to enjoy the protection of limited liability without the word "Limited" as the last word of the name of the company. The privilege is confined to companies which could not distribute their profits among members. This privilege is frequently used by associations like chambers, clubs and others which pursue charitable objects. All the advantages of incorporation are enjoyed by such associations and yet they are free from indicating through their name that they are incorporated with limited liability. Their officers and members enjoy immunity from personal liability. Admission to membership is generally controlled through the decision of the governing body is through election, the right to contest may be given to a member who makes a donation. Section 25 companies are allowed to admit to membership even a partnership firm. They also enjoy many other exemptions from the operative provisions of the Companies Act. Many clubs are registered as Section 25 companies. They do not have a Board of Directors (as is the requirement for companies) but have a management committee which is elected annually.

2.9 ILLEGAL ASSOCIATION

Combination of persons for achievement of common objects is called an 'association'. In order to protect the public from the mischief of large trading associations, whose membership may go on constantly changing, section 464 provides for their compulsory registration.

According to section 464 every association consisting of more than 50 persons must either be registered as a company under the Companies Act or be formed according to the provisions of some other Indian Law. An association not so registered is an illegal association having no legal existence.
An association will be termed as an illegal association, when:

- The association consists of more than 50 members;
- The association is formed for carrying on a business with the objective of earning of profits; and
- The association is not registered as a company under the Companies Act or not formed according to the provisions of some other Indian law.

Exceptions: The provisions of illegal association are not applicable in the following cases:
Joint Hindu Family. Such a family can carry on the family business with more than 20 members without getting itself registered as a company under the Companies Act or any other law.

Associations not for Profit. Literary, scientific or religious associations, clubs, welfare, charitable and traders associations, or formation of a common fund for investment by trustees in certain securities, etc.

Consequences of an Illegal Association

Section 464 is a self-regulating provision in law because the government has not appointed any specific agency to enforce the prohibition laid down by this section. Moreover, the offence is non-cognizable, it cannot be investigated by the police under the criminal law. The consequences are:

- **No legal existence.** "The consequence of the illegality of the association/partnership is that its members have no remedy against each other for contribution or apportionment in respect of partnership dealings and transactions." An illegal association:

  (a) cannot enter into binding contracts
  (b) cannot sue any member or an outsider if the illegality becomes apparent
  (c) cannot be sued by a member or an outsider for it cannot contact any debts
  (d) cannot be wound up under the Act either at the instance of a creditor, a member or the association itself. Members individually or collectively of an illegal association cannot bring about a valid suit against another member or any other persons for any contract made by them.

Subsequent registration will not alter the position with regard to the past acts. Contracts made before registration cannot be validated and sued upon by subsequent registration. No cause of action can arise on the basis of an illegal association.

- **Unlimited personal liability.** Every member of an illegal association shall be personally liable for all the liabilities incurred by such business. It will be immaterial if the creditors had or had no knowledge of the illegality of the association.

- **Penalty.** Every member of an illegal association shall be punishable with a fine which may extend to Rs. 1,00,000. The penal provisions will apply only where a company is formed in contravention of this section and not where the illegality supervenes at a subsequent stage.

2.10 LET US SUM UP

- Statutory company is formed by special act passed by central or state legislature. Companies registered under the Indian companies act are known as Registered companies.

- There are various privileges enjoyed by a private company over a public company.
- One person company is a company which has only one person as a member.
- Government Company is a company in which at least 51% of the paid-up capital is held by the Government.
- Foreign company is a company incorporated outside India but having a place of business in India.
- Licenced companies are associations not for profit which have been granted licences by the Government.
- An illegal association is an association of more than 50 persons which carries a business without being registered under any law.

2.11 KEY WORDS

- **Non Profit Association :** These are called not-for-profit organizations or nonprofit organizations. They are formed for some idealistic purposes and provide service to its members and the public in general. Their aim may be educational, religious, charitable or social welfare of the people at large.

- **Statutory Company :** Statutory companies are public enterprises brought into existence by a Special Act of the Parliament. The Act defines its powers and functions, rules and regulations governing its employees and its relationship with government departments

- **Registered Company :** A company which has been officially set up and registered with the Registrar of Companies. Annual return. Certificate to commence business. Incorporate.

- **Private Company :** A company whose shares may not be offered to the public for sale and which operates under legal requirements less strict than those for a public company.

- **Public Company :** A public company is a corporation whose ownership is distributed amongst general public shareholders via the free trade of shares of stock on exchanges or over-the-counter markets

- **Holding Company :** A holding company is a company that owns other companies' outstanding stock. A holding company usually does not produce goods or services itself (with no eponymous consumer-facing brand at most times); rather, its purpose is to own shares of other companies to form a corporate group.

- **Subsidiary Company :** A subsidiary company is a company owned and controlled by another company. The owning company is called a parent company or

sometimes a holding company. A subsidiary's parent company may be the sole owner or one of several owners.

2.12 FURTHER READINGS

- Goode *Principles of Corporate Insolvency Law* (3rd Edn, Sweet & Maxwell 2013)
- Gullifer and Payne *Corporate Finance Law: Principles and Policy* (2nd Edn Hart Publishing, 2015) 5-41
- Janet Dine, Marios Koutsias *Company Law*(Macmillan International Higher Education 2014), 77
- In England, see *Ebrahimi v Westbourne Galleries* [1973] AC 360
- Banerjee. *A Company Law & Meetings (Taxman 2018)*

2.13 TERMINAL QUESTIONS

Q1: What are the various types of companies?

Q2: Discuss the features of Public Company & Private Company

Q3: Write Distinction between Holding Company & Subsidiary Company

Q4: Under Which Circumstances a Private company can be converted to a public company

Q5: Write Short Notes on

a) One Person Company
b) Government Company
c) Foreign Company
d) Illegal Association

UNIT-3 INCORPORATION OF COMPANY

Structure

3.0 Objectives
3.1 Introduction
3.2 Promotion
  3.2.1 Promoters
  3.2.2 Functions of a Promoters
  3.2.3 Duties & Liabilities of a Promoters
  3.2.4 Remuneration of Promoters
3.3 Incorporation of Company
3.4 Commencement of Business
3.5 Let's sum up
3.6 Keywords
3.7 Further Readings
3.8 Terminal Questions

3.0 OBJECTIVES

After studying this module, you shall be able to know

- How a company can be formed
- Understand the procedure for the formation of the company.
- Learn the various stages of company incorporation.
- Identify the preliminary contracts.

3.1 INTRODUCTION

The procedure for the formation of a company, from the time the idea of forming a company is first conceived till the company is actually formed and commences business, may be divided into three principal stages:

(i) Promotion
(ii) Incorporation
(iii) Commencement of business

3.2 PROMOTION

A company is set-up through the first stage, namely, idea scouting. In this stage a new business idea is evolved. Of course, the idea should be workable. This stage where the idea is formed and is put to work is known as promotion. The facilitator of this process

is known as the promoter. The promoter may work up the idea with the help of his own resources, influence or competence or he may, if necessary, take the help of technical and legal experts to bring a company into existence.

3.2.1 Promoters

The term 'promoter' is a term of business and not of law. Promoter is a person who conceives the idea of starting a business, plans the formation of a company and actually brings it into existence. He may be said to be "the father of the company who sees the prospects of gain in a business which he wishes to set up, and believes that the can persuade others too to think as he does."

A promoter is 'one who undertakes to form a company with reference to a given object and to set it going and who takes the necessary steps to accomplish that purpose. Palmer has defined company promoter as "a person who originates a scheme for the formation of the company, has the Memorandum and the Articles prepared, executed and registered, and finds the first directors, settles the terms of preliminary contracts and prospects (if any) and makes arrangements for advertising and circulating the prospectus and placing the capital." Thus, a promoter discovers, formulates and assembles a business proposition and brings about a company into existence for its development. They plan and decide upon the nature, scope and the extent of the business of the proposed company. They provide or secure the initial capital of the company, negotiate for the purchase of an existing business, instruct and direct the lawyers to prepare the necessary documents, select and arrange with persons to become directors, have the prospectus issued and approved, induce persons to buy shares, find funds for the registration fees and execute a score of other things involved in the formulation of a company.

A promoter may be an individual, a family, a firm, an association of persons, a company or even the government. A person may be a promoter, who has taken a much less active and dominating role. It may cover any individual or company that obtains a director, places shares or negotiates preliminary contracts. A promoter need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange the 'floating off of its capital' will equally be regarded as a promoter doing acts of purely ministerial nature or in a professional capacity for remuneration or fees are not promoters e.g., solicitors, valuers, etc. As per section 62(6) (a) of the Companies Act, promoter does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company. A person who only advances money to promoters for meeting out preliminary expenses is not a promoter. But a professional who brings financiers to the company are considered as promoters.

3.2.2 Functions of a Promoters

The main functions of a promoter are as follows:

- To conceive an idea of starting a business and explore its possibilities.
- To undertake detailed technical, economic and commercial feasibility of the business propositions. Help of experts may be taken for that.
- To conduct negotiations for the purchase of a business in case it is intended to purchase an existing business.
- To collect the requisite number of persons i.e. 2 in the case of a private company and 7 in the case of a public company, who can sign the memorandum and articles of the company and also agree to act as the first directors of the company. To decide the following:
    - the nature of the company
    - the location of its registered office
    - the amount and form of its capital
    - the underwriters of brokers for capital issue, if necessary
    - the bankers
    - the auditors
    - the legal advisers.
- To get the memorandum of association and articles of association drafted and printed. To enter into preliminary contracts with vendors, under writers etc.
- To arrange for the preparation of prospectus, its filing, advertisement and issue of capital.
- To pay preliminary expenses. To arrange funds required by the company including loans.

3.2.3 Duties & Liabilities of a Promoters

A promoter cannot an agent nor a trustee of a company which has not come into existence. The reason is that there was no principal or trust in existence for whom or for whose benefit the promoter has acted. But promoter has wide powers relating to the formation of the company. Law has put the relationship of the promoters with the company they bring into existence as well as with those whom they induce to become shareholders in it, as that of a fiduciary nature, the relationship based on utmost faith and confidence. “Those who accept and use such extensive powers are not entitled to disregard the interests of the corporation altogether. They must make a reasonable use of the powers which they accept from the legislature; and consequently they do stand, with regard to the corporation, when formed, in what is commonly called a fiduciary relation to some extent.”

This fiduciary relationship imposes an obligation on the promoters to disclose fully all material facts relating to the formation of the company. Though the fiduciary relationship really begins when the company is formed, the fiduciary obligation of a

promoter beings as soon as he sets out to act for or promoter the company.2 Promotes should not make any secret profits at the cost of the company without its knowledge and consent. The disclosure of all material facts, regarding contracts made and the profits earned by them from the formation of the company, should be made to an independent and competent board of directors. If the promoters fail to disclose complete facts, company may set aside the transaction and recover the benefit earned by them. A case is illustrated:

Thus, it is the duty of the promoters to provide the company with an independent board. However, if the board of directors is not independent from the company, as generally is the case, the disclosure to be effective must be to the would-be shareholders as a whole. The disclosure can be made to the members of the purchasing company by its articles or prospectus or any other method. If this has been done, absence of an independent board of directors will not invalidate the agreement. Secret profits or undisclosed benefits of any type received by the promoters can be recovered from them by the company.3 Company can proceed against the promoters for any damage caused to it on account of their fraud or breach of duty. The estate of deceased promoter shall remain liable in an action by a company for deceit or breach of trust if any benefit has accrued to the estate. A promoter can also be liable for any omission of fact (section 56) or false statement in the prospectus (section 62)

3.2.4 Remuneration of Promoters

The promoter has to incur the initial expenses in the process of formation of a company besides undergoing a good deal of arduous task. The promoter has, therefore a legitimate right to claim for both the expenses incurred by him as well as remuneration for the work done by him. The claim for expenses should be supported by vouchers and should be placed before the directors of the company when formed. However, there is no contractual obligation on the part of the company to pay him for these expenses unless the company has expressly agreed to pay after its formation for the services rendered by him before the formation of the company. The same is true about his remuneration. The promoter may be remunerated in any of the following ways: (a) Promoter may sell his own asset to the company for at profit for cash or shares in the company. (b) He may be given commission on the purchase price of the business taken over by the company. (c) He may be granted a lump sum as remuneration either in cash or in shares or debentures. The amount of remuneration payable or paid to the promoters is required to be disclosed in the prospectus issued by the company.

3.3 INCORPORATION OF COMPANY

Incorporation brings a company into existence as a separate corporate entity. The promoter has to take the following steps in this connection:

Steps to be taken to incorporate a new company

Select, in order of preference, at least one suitable name upto a maximum of six names, indicative of the main objects of the company. Ensure that the name does not resemble the name of any other already registered company and also does not violate the provisions of emblems and names (Prevention of Improper Use Act, 1950) by availing the services of checking name availability on the portal.

- Apply to the concerned Registrar of Companies (RoC) to ascertain the availability of name in e-Form 1A by logging in to the portal. A fee of Rs. 500/- has to be paid alongside and the digital signature of the applicant proposing the company has to be attached in the form. If proposed name is not available, the user has to apply for a fresh name on the same application.

- After the name approval the applicant can apply for registration of the new company by filing the required forms (Form 1, 18 and 32) within 60 days of name approval.

- Arrange for the drafting of the memorandum and articles of association by the solicitors, vetting of the same by RoC and printing of the same.

- Arrange for stamping of the memorandum and articles of association with the appropriate stamp duty.

- Get the Memorandum and Articles signed by at least 7 subscribers (2 in case of a private company) in his/her own hand, his/her father's name, occupation, address and the number of shares subscribed for and witnessed by at least one person.

- Ensure that the Memorandum and Article is dated on a date after the date of stamping.

- Login to the portal and fill the following forms and attach the mandatory documents listed in the eForm:

- Submit the eForms after attaching the digital signature, pay the requisite filing and registration fees and send the physical copy of Memorandum and Article of Association to the RoC. After processing of the Form is complete and Corporate Identity is generated and the Certificate of Incorporation would be issued by the Registrar of Company.

Documents and Forms to be submitted for Incorporation/Registration of a Company

The promoter has to file the following documents with the required fees to the Registrar of Companies of the State in which the registered office of the company is to be situated:

a) the memorandum and articles of the company duly signed by all the subscribers to the memorandum in such manner as may be prescribed;

b) a declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of the company, and by a person named in the articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;

c) an affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

d) the address for correspondence till its registered office is established;

e) the particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body corporate, such particulars as may be prescribed;

f) the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed; and

g) the particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Obtaining certificate of incorporation.

Upon receipt of these documents and the requisite fees, the Registrar will examine them and satisfying himself that the requirement of the Companies Act are met, issue a certificate of incorporation in the prescribed form to the effect that the proposed

company is incorporated under this Act. On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate. If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be liable for action under section 447.

Consequences of certificate of incorporation.

Section 9 of the Companies Act provides, "From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the Memorandum and other persons as may from time to time be the members of the company, shall be a body corporate by the name contained in the Memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name. Thus, the consequences are:

(1) The certificate of incorporation brings the company into existence from the date mentioned in the certificate.
(2) It is conclusive evidence of the fact that the company has been duly incorporated.
(3) It grants legal personality, corporate existence and perpetual succession to the company.
(4) The subscribers to the Memorandum together with such other persons, as may from time to time become members of the company, become a body corporate with a distinct entity from such members having a perpetual succession with a common seal and with the liability of the members is limited to the amount for the time being unpaid on the shares held by them.
(5) The Memorandum and Articles of Association become binding upon the members and the company as if they have been signed by the company and by each member.

Conclusiveness of Certificate of Incorporation

Certificate of incorporation is conclusive evidence with regard to the proper and regular registration and formation of a company. It cannot be challenged even if irregularities prior to registration are subsequently discovered. It is considered as conclusive even if it was legally impossible that the company could have been properly registered, e.g., signatures of all the members were forged or where instead of seven only six members had really signed or the persons signing were incompetent to enter into contracts etc. The date appearing on the certificate of incorporation is conclusive even if it is wrong.

The validity of the certificate of incorporation cannot be disputed on any grounds whatsoever. However, where, at any time after the incorporation of a company, it is proved that the company has been incorporated by furnishing any false or incorrect

information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration shall each be liable for action under section 447.

Similarly, grant of the certificate of incorporation to the company will not make the objects of the company legal if they are otherwise illegal.

3.4 COMMENCEMENT OF BUSINESS

A company having a share capital shall not commence any business or exercise any borrowing powers unless:

(a) a declaration is filed by a director in such form and verified in such manner as may be prescribed, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him and the paid-up share capital of the company is not less than Rs 5 lakh in case of a public company and not less than R 1 lakh rupees in case of a private company on the date of the making of this declaration; and

(b) the company has filed with the Registrar a verification of its registered office.

(c) If any default is made in complying with the requirements of this section, the company shall be liable to a penalty which may extend to Rs 5,000 and every officer who is in default shall be punishable with fine which may extend to Rs 1,000 for every day during which the default continues.

Where no declaration has been filed with the Registrar within a period of 180 days of the date of incorporation of the company and the Registrar has reasonable cause to believe that the company is not carrying on any business or operations, he may initiate action for the removal of the name of the company from the register of companies.

3.5 LET'S SUM UP

- Promotion is the stage of conceiving an idea of forming a company to do business and working on that idea.
- Promoters stand in a fiduciary relationship with the company promoted by them.
- Preliminary contracts may be adopted by a company under the Specific Relief Act.
- Incorporation of a company requires certain documents to be filed with the Registrar of Companies.

- Incorporation brings a company into existence.
- Commencement of business by a company requires filing of a prescribed declaration and verification of registered office of the company.

3.6 KEYWORDS

- **Incorporation :** The incorporation of a company refers to the legal process that is used to form a corporate entity or a company. An incorporated company is a separate legal entity on its own, recognized by the law.
- **Commencement :** It gives your entity a legal identity as well as provides you with other benefits. Obtaining Certificate of Commencement of Business is one of the steps you need to follow between registering and running your business.

- **Promoter:** A corporate promoter is a firm or person who does the preliminary work incidental to the formation of a company, including its promotion, incorporation, and flotation, and solicits people to invest money in the company, usually when it is being formed.

3.7 FURTHER READINGS

- "The World Price of Insider Trading" by Utpal Bhattacharya and Hazem Daouk in the Journal of Finance, Vol. LVII, No. 1 (Feb. 2002)
- Larson, Aaron (20 July 2016). "Where To Incorporate Your Business". *ExpertLaw.com*. Retrieved 3 April 2018.
- "Corporations". *Wex*. Cornell Law School. Retrieved 3 April 2018
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- Sharma JP (2012), "An easy approach to Corporate Laws" Ane Books Pvt. Ltd. New Delhi, India.
- Kuchhal MC (2009), "Corporate Laws" Shree Mahavir Book Depot (Publishers), New Delhi, India

3.8 MODEL QUESTIONS

Q1 : Explain the procedure of formation of a company
Q2 : Discuss the various stages of company formation.
Q3 : Write the functions of a Promoter.

UNIT-4 MEMORANDUM OF ASSOCIATION

Structure

4.0 Objectives
4.1 Introduction
4.2 Meaning & Purpose
4.3 Clauses
  4.3.1 Name
  4.3.2 Situation
  4.3.3 Object
  4.3.4 Liability
  4.3.5 Capital
  4.3.6 Association
4.4 Alteration in Memorandum of Association
4.5 Doctrine of Ultra Vires
4.6 Let's sum up
4.7 Key Words
4.8 Further Readings
4.9 Terminal Questions

4.0 OBJECTIVES

After studying this module, you shall be able to

- Understand the purpose of the Memorandum of Association
- Know various clauses of Memorandum of Association
- Apprehend the procedure for alteration of various clauses of Memorandum of Association
- Learn the doctrine of ultra-vires

4.1 INTRODUCTION

Memorandum of association is the main document of a company which defines its objects. It lays down the fundamental conditions upon which alone the company is allowed to be formed. It may be termed as the charter or the constitution of the company since it governs the relationship of the company with the outside world.

4.2 MEANING & PURPOSE

According to Section 2(56) of the Companies Act, Memorandum means "Memorandum of Association as originally framed or as altered from time to time in pursuit of any previous companies law or of this Act". Any provisions contained in the Memorandum of Association will be void to the extent to which they are repugnant to the provisions of the Companies Act. Memorandum of Association has two purposes: Firstly, the intending investor who wants to put his money into the company, shall know the activities in which his money would be invested by the company and the accompanying risk involved.

Memorandum of association provides a protection to the shareholders and other investors by ensuring that their money would be employed only for specified purposes. Secondly, any person dealing with the company shall know without reasonable doubt, whether the contractual relation into which he contemplates entering with the company is one relating to a matter within its corporate objects.

Memorandum of Association, thus, defines the field of investment and scope of risk to the investors. It also explains the range of the company's activities and enterprise.

The Memorandum of Association must be printed, divided into paragraphs, numbered consecutively and signed by each subscriber (seven or more in the case of a public company, two or more in the case of a private company) who must add his name, address and description in the presence of at least one witness, who is to attest the signatures.

Memorandum of Association is a public document, therefore, every person who deals with the company is presumed to have sufficient knowledge of its contents. It is open for public inspection. A company, on being required by a member, is bound to provide him with a copy of its memorandum on payment of prescribed fee. The copy must be sent within a week.

4.3 CLAUSES

Memorandum of association must have the following clauses:

- Name Clause
- Situation Clause
- Objects Clause
- Liability Clause
- Capital Clause
- Association Clause or Subscription Clause

4.3.1 Name Clause :

A Company is a legal entity and it must have a name to establish its identity. Name Clause in the Memorandum of Association confers protection against subsequent company registration in the same or closely similar name. it secures to the company de facto monopoly of corporate trading under a particular name.
A company may have any name except –

- a name which is identical with or which closely resembles the name of another company so as to deceive or mislead the prospective customer of one, trading with the other.

- a name, which in the opinion of the Central Government is undesirable or will mislead the public and its use has been, therefore, prohibited by the Government under the Emblems and Names (Prevention of Improper Use) Act, 1950.

- the last word of the name must be 'limited' in the case of public companies and 'private limited' in the case of private limited companies. It is not necessary that the word 'company' should form part of the name.

The name of every company together with the address of its Registered Office must be painted or affixed outside the premises wherever its business is carries on, in a conspicuous position, in letters easily legible in one of the local languages. [Sec. 12(3)]]

The name of the company including the registered office must also be mentioned in all letters, negotiable instruments, orders, receipts and other documents written or executed by the company. [Sec. 12(3)]]

Every company must have its name together with the address of its Registered Office engraved on its seal and have it mentioned on all official papers and publications. [Sec. 12(3)].

In case a company fails to observe the provisions of Section 12(3), it may have very serious consequences for its officers. For example, an officer signing, on behalf of the company, any bill of exchange, promissory note or cheque on which name of the company does not appear as per the above provisions, shall be personally responsible to the holder of such an instrument in case the company fails to make payment. Besides that, he can also be subject to a fine which may extend up to Rs 1000 per day till the default continues.

4.3.2 Situation Clause :

Memorandum of Association must state the name of the State in which the registered office of the company is to be situated. It will fix up the domicile of the company.

Registered office of a company is the place of its residence for the purposes of delivering or addressing any communications, service of any notice or process of Court of Law and for determining the question of jurisdiction in any action against the company. It is the place where all the statutory books, records and registers of the company shall be maintained.

4.3.3 Object Clause :

It is the most important clause in the Memorandum of Association. It defines and limits the scope of the operations of the company. It explains to the members the scope of the activity of the company where their capital will be employed. It gives protection to the shareholders by ensuring that the funds raised for specified businesses are not going to be risked in another. The outside public dealing with the company is informed of the extent of the powers of the company. A company can exercise only such powers as are either expressly stated therein or as may fairly be implied therefrom, including matters incidental or consequential to the powers so conferred.

The objects of the company must be lawful and well defined. The objects must not be against the provisions of the Companies Act. The memorandum should state the objects of the company and not its powers.

According to Section 4(C) the Memorandum of Association of a company must state the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

In case of a company in existence immediately before the commencement of the Companies Act, 2013 – 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).

4.3.4 Liability Clause

Liability clause mentions the liability of members of the company. In case of a company limited by shares, Memorandum of Association must have a clause to the effect that the liability of the members is limited to the extent of the amount of the unpaid portion of the shares held by him. The Memorandum of Association a company limited by guarantee must state the amount which each member undertakes to contribute to the assets of the company in the event of its being wound up. [section 4 (1) (d)] In a limited company, however, the liability of the directors or any director or manager, however may be unlimited, if so provided by the memorandum

4.3.5 Capital Clause

Memorandum of Association of a limited company having a share capital must state the amount of the share capital with which the company is to be registered which is usually called authorized or nominal capital. Further, division of registered share capital into shares of a fixed amount is also required to be given in the memorandum. Each subscriber must take at least one share and write opposite his name the number of shares he takes.

4.3.6 Association Clause

This clause states that the persons subscribing their signatures at the end of the Memorandum are desirous of forming themselves into an association in pursuance of the Memorandum. Memorandum of Association must be signed by seven or more persons in the case of a public company and by two or more persons in the case of a private company. Signatures shall be attested by witnesses. There may be one witness for all signatures but one subscriber cannot be a witness to the signatures of another. Full description, address, occupation, etc. of the subscribers and witnesses must be written. In the case of a company having a share capital, each subscriber is also required to take at least one share and to write opposite his name the number of shares he agrees to take. Subscribers are required to pay for these shares after the company is incorporated. They must also sign articles of association of the company

It is not necessary that all signatories should have any personal beneficial interest in the shares subscribed for by them. They need not be independent or unconnected. All of them may be nominees of a single person and their subscribing names may be merely a formality. Subscribers to the Memorandum of should, however, be competent to contract. A minor or a partnership firm cannot be a subscriber to the Memorandum. A company may be a subscriber of another company. No subscriber can withdraw his name on any ground whatsoever once a company has been incorporated even on the ground that he/she was induced to sign the memorandum by misrepresentation**.**

4.4 ALTERATION IN MEMORANDUM OF ASSOCIATION

- **Alteration in the name clause can be effected in the following ways:**

(i) A company can change its name at any time in the course of its business by (a) passing a special resolution, and (b) obtaining the approval of the Central Government in writing to the change. However,

(ii) No approval from the Central Government is required where the only change in the name of a company is the addition thereto or, as the case may be the

deletion there from, of the word "Private", consequent on the conversion of a public company into a private company or vice versa.

(iii) If, by inadvertence, or otherwise a company on its first registration or on its registration by a new name, has been registered by a name identical with or too resembling with the name of another company previously registered it may, by ordinary resolution and with the previous approval of the Central Government, in writing, change its name.

The new name must be notified to the Registrar, who will enter the new name in the register in the place of the former name, and shall issue a fresh certificate of incorporation with the necessary alterations embodied therein. The change of name shall be complete and effective only on the issue of such a certificate. The Registrar shall also make necessary alterations in the memorandum. It is to be noted that change of name will neither affect any rights or obligation of the company nor render any legal proceedings by or against the company defective in any way

Memorandum of association can be altered only to the extent to which such alteration is necessary and in accordance with the provisions of the Companies Act (Section13).

- **Alteration in the Situation Clause.**

Change in the registered office of a company can be affected in the following ways:

(i) Change of registered office outside the local limits the city, town or village where such office is situated. This can be done by passing a special resolution by the company and a notice of the change in the registered office in the prescribed form is to be given to the Registrar within 15 days of the passing of the resolution. (Sec. 13)

(ii) Change of registered office from one city, town or village to another, within the same State. The procedure is the passing of a special resolution of the members of the company in general meeting. Confirmation of the Regional Director however is required where the change is from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies. At present it is applicable only to the States of Tamil Nadu and Maharashtra, each of which has two offices at Chennai and Coimbatore, and Mumbai and Pune, respectively.

(iii) Change of Registered Office from one State to another A company cannot shift its registered office from one State to another as a matter of course.

The company has to follow the following procedure:

- ➢ Passing of a special resolution of the members of the company in general meeting.
- ➢ Confirmation by the Central Government on petition is to be obtained. Before confirming the alteration, the Central Government must be satisfied-
  (a) that sufficient notice has been given to every holder of debentures of the company, and to every other person or class of persons whose interests will, in the opinion of the Central Government, be affected by the alteration; and

  (b) that, with respect to every creditor who, in the opinion of the Central Government, is entitled to object to the alteration, and who signifies his objection in the manner directed by the Central Government, either his consent to the alteration has been obtained or his debt or claim has been discharged or has been determined, or has been secured. The Central Government 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 of appearing before the Central Government and state his objections and suggestions, if any, with respect to the confirmation of the alteration.

The Central Government shall 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. The Central Government 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.

- ➢ Alteration is to be registered. The company shall have to file a certified copy of the order of the Central Government confirming the alteration with the Registrar of each of the States. The Registrar of each such State shall register the same, and shall certify under his hand the registration thereof. The Registrar of the State from which such office is transferred shall send to the Registrar of the other State all documents relating to the company registered, recorded or filed in his office.

- **Alteration in the Objects Clause**

In case of companies which have not raised money through prospectus, objects can be changed any time by passing a special resolution. A special resolution is passed by the company through postal ballot and the notice in respect of the resolution for altering the objects shall contain the following particulars:

The total money received

- the total money utilized for the objects stated in the prospectus;
- the unutilized amount out of the money so raised through prospectus,
- the particulars of the proposed alteration or change in the objects;
- the justification for the alteration or change in the objects;
- the amount proposed to be utilised for the new objects;
- the estimated financial impact of the proposed alteration on the earnings and cash flow of the company;
- the other relevant information which is necessary for the members to take an informed decision on the proposed resolution;
- the place from where any interested person may obtain a copy of the notice of resolution to be passed.
- the details, as may be prescribed, in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;
- the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

The Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution

- **Alteration in the Liability Clause**

Ordinarily it cannot be altered so as to make the liability of the members unlimited. However, with the authority of the Articles of Association, a company may pass special resolution altering liability clause of the Memorandum of Association so as to make the liability of directors or of any one director or manager unlimited. But, in such a case any person holds office as a director or manager before such alteration shall not be liable until the expiry of his present term or unless he has accorded his consent to his liability becoming unlimited. Alterations, which are likely to impose additional liability on a member or which are likely to compel a member to buy additional shares of the company after the date on which he became a member, not be made except with the consent of the member concerned in writing. However, in case a company happens to be a club or any other association and the alteration requires the member to pay recurring or periodical subscriptions or charges at a higher rate, the member will be bound by the alteration although he does not agree in writing to be bound by the alteration.

- **Alteration of the Capital Clause**

  Alterations in the capital clause of the Memorandum of Association may be of the following type: Alteration of the share capital. (Sec. 61) Reduction of the share capital. (Sec.66)

- **Alteration of the share capital**
  A limited company having a share capital may, alter its share capital as follows

  a) increase its share capital by the issue of new shares;
  b) consolidate or sub- divide its share capital into shares of larger or smaller denominations;
  c) convert its fully paid - up shares into stock, and re-convert that stock into fully paid - up shares of any denomination;
  d) cancel shares which have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled. A company can make these alterations by passing an ordinary resolution if it is authorised by the Articles of Association to do so. Such alterations must be notified and a copy of the resolution filed with the Registrar within 15 days of the date of the passing of the resolution.

- **Reduction of Share Capital.**

  To provide protection to interests of the investors especially creditors of companies, reduction of the share capital is permissible with strict stipulation of the law. A company limited by shares or a company limited by guarantee and having a share capital, may, reduce its share capital by adopting any of the following methods of reduction:

  a) extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;
  b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost, or is unrepresented by available assets ; or
  c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company.

4.5 DOCTRINE OF ULTRA VIRES

'Ultra' means beyond, and 'vires' means powers. Memorandum of Association of a company defines the powers of a company. Any act done contrary to or in excess of

the scope of the activity of the company as laid down by its memorandum of association is ultra-vires the company, i.e., beyond the legal powers and authority of the company, and shall be wholly void and not binding on the company. Acts ultra-vires the company can neither be legalised nor ratified even with the unanimous consent of all the members of the company. This doctrine tries to protect the interest of the investors and creditors. A company only has the capacity to do those acts which fall within its objects as set out in its memorandum of association or are reasonably incidental to the attainment of such objects.

Acts of a company may also be ultra-vires the Articles or ultra-vires the powers of the directors. Acts ultra-vires the Articles can be valid and made binding upon the company by altering the Articles of Association with special resolution at a general meeting. Alteration of Article of Association with retrospective effect, if to the benefit of the company, shall be valid. An act beyond the scope of the powers of the directors, may also be ratified by the general body of the shareholders.

However, the doctrine of ultra-vires should not be unreasonably understood and applied. It does not restrain a company from doing such things which are reasonably fair and incidental to its objects or which it is authorised to do under the Companies Act.

There is difference between objects and powers. Powers are not to be stated in the memorandum. Even if they are stated, they can be used only to achieve the objects of the company. In no case, they can become independent objects by themselves

➢ **Effects of ultra-vires transactions**

Following are the effects of ultra-vires transactions:

- **Injunction**: Any member of the company can bring injunction against the company to restrain it from doing ultra-vires acts.

- **Personal liability of directors**: The directors of the company are personally liable to make good those funds of the company which they have used for ultra vires purposes. It is the duty of the directors of the company to employ funds and properties of the company for the purposes laid down in the memorandum of association of the company.

- **Contracts void**: Any contract which is ultra-vires the company, will be void and of no effect whatsoever. " An ultra vires contract being void ab initio, cannot become intra vires by reason of estoppel, lapse of time, ratification, acquiescence or delay"1. However, if the contract is only ultra-vires the powers

of the directors but not ultra-vires the company, it may ratify such a contract in the general meeting and thereby be bound by it.

- **Ultra-vires acquisition of property**: When money of a company is spent ultra vires in acquiring a property, the right of the company over that property would be secure. This is because the property represents corporate capital, though acquired wrongly. However, where the payment for an ultra vires acquired property/asset has not been made, the vendor can obtain a tracing order to recover the property from the hands of the company. A company cannot be allowed to benefit from such transactions at the cost of the other party.

- **Ultra vires borrowings**: A bank or other person lending to companies for purposes ultra-vires the memorandum cannot recover the money under that loan agreement. But nothing prevents the company from repaying that money. The lender is also entitled to a tracing order, and if the money lent is traced in specie or into any investment held by the company, the lender can recover it from the company. Further, if that money is used by the company in discharging any debts or liabilities of the company, the lender will, on accounts of principle of subrogation, step into the shoes of the creditors whose claims have been paid off by the company and acquire their rights against the company.

- **Ultra vires lending**: If the money has been lent by the company, and the lending is ultra-vires and the contract is void. No action can be brought on it, but the company can sue for recovery of its money. This is because the borrower who has made a promise to repay that money cannot be allowed to refrain from paying it back on the grounds that it is without authority.

4.6 LET'S SUM UP

- Memorandum of Association is the main document of a company which defines its objectives.
- It has 6 clauses – Name clause, Situation Clause, Objects Clause, Liability Clause, Capital Clause, and Association Clause.
- A company can make alterations in its Memorandum of Association by following a prescribed procedure.
- The doctrine of ultra vires implies that any act done contrary or in excess of the scope of the activity of the company as laid down by the memorandum is void and cannot be adopted by a company.
- Doctrine of ultra-vires provides protection to the investors of the company

4.7 KEY WORDS

- **Memorandum of Association :** A Memorandum of Association (MOA) is a legal document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders.

- **Alteration of MOA :** Alteration of Memorandum of Association of a Company. MEANING: The expression "alter" means to modify/change or vary; to make or become different in some respect. As per Section 2(3) of the Companies Act, 2013 (the Act) "alter" and "alteration" shall include the making of additions, omissions and substitutions.

- **Doctrine of ultra-vires :** The Doctrine of Ultra Vires is a fundamental rule of Company Law. It states that the objects of a company, as specified in its Memorandum of Association, can be departed from only to the extent permitted by the Ac

4.8 FURTHER READINGS:

- Kuchhal MC (2013), "Modern Indian Company Law" Shree Mahavir Book Depot (Publishers), New Delhi, India.
- Sharma JP (2014), "Governance, Ethics and Social Responsibility of Business" Ane Books Pvt. Ltd. New Delhi, India.
- Black's Law Dictionary, 8th edition (2004), ISBN 0-314-15199-0
- Prasad, Suresh. "Complete list of Sections of the Companies Act, 2013"
- "Commencement Notification Of Companies Act 2013"(PDF). Ministry of Corporate Affairs, India. Archived (PDF) from the original on 11 January 2014. Retrieved 11 January2014.

4.9 TERMINAL QUESTIONS

Q1 What is purpose of Memorandum of Association ?
Q2 Discuss the Clauses of Memorandum of Association
Q3 Explain the various procedures of alteration of memorandum of association
Q4 Write a note on doctrine of ultra-vires

UNIT-5 ARTICLES OF ASSOCIATION & PROSPECTUS

Structure

5.0 Objectives

5.1 Introduction

5.2 Meaning & Scope of AOA

5.3 Relationship with AOA

5.4 Content of Article of Association

5.5 Difference between Article & Memorandum

5.6 Binding Effect of Memorandum & Article of Association

5.7 Alterations of Articles

5.8 Constructive Notice for Memorandum & Articles

5.9 Doctrine of Indoor Management

5.10 Prospectus & its Content

5.11 Let's sum up

5.12 Key Words

5.13 Further Readings

5.14 Terminal Questions

5.0 OBJECTIVES

After studying this module, you shall be able to

- To know the meaning and scope of Articles of Association.
- To understand the procedure of the alterations in the article.
- To learn binding effects of memorandum and articles.
- To identify the cases when protection under the doctrine of indoor management is provided

5.1 INTRODUCTION

Articles of Association is an important document of a company. It contains rules, regulations and bye-laws for the internal administration of the company. Articles regulate the internal management of the company and also govern the relationship between the company and its constituent members by prescribing their rights and obligations.

5.2 MEANING & SCOPE OF AOA

Section 2(5) of the Companies Act defines articles of association as follows: "Articles means the articles of association as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act"

5.3 RELATIONSHIP WITH AOA

Relationship between Memorandum and Articles Memorandum is the charter of the company. It describes the constitution of the company and defines the scope of its activities and powers. Articles lay down the rules and regulations to manage its affairs. Articles of a company are subordinate to the provisions of the Memorandum. Memorandum contains the area beyond which company cannot go; within that area the shareholders may make such regulations for their internal working as they think fit. Articles can be used to explain the objects laid down by the Memorandum, but never to extend them. They cannot modify the provisions of the Memorandum. Memorandum contains conditions for the use of the creditors, shareholders and the outside public. Articles constitute a contract between the company and its members in the capacity of members. It is difficult to alter the clauses of the Memorandum. But the articles can easily be altered by passing a special resolution and may even be altered retrospectively. Unlike Memorandum, articles need not be construed too meticulously.

5.4 CONTENT OF ARTICLE OF ASSOCIATION

The Articles of Association of a company usually deal with the following matters:

(i) Definition of important terms and phrases.
(ii) Share capital and the rights attached to different classes of shares.
(iii) Procedure as to the making of calls and forfeiture of shares.
(iv) Appointment of managerial personnel e.g., directors, managing directors etc., their rotation, powers and duties.
(v) Rules as to
    (a) transfer and transmission of shares
    (b) general meetings
    (c) common seal of the company
    (d) dividend, reserves and capitalisation of profits
    (e) accounts and audit
    (f) lien on shares
    (g) remuneration of managerial personnel
    (h) issue of redeemable preference shares
    (i) winding up of the company

Regulations contained in the Articles of Association must not go beyond the powers of the company as laid down by the Memorandum of Association nor violate any of the requirements of the Companies Act. All clauses in the Articles ultra-vires the Memorandum or the Act shall be null and void.

5.5 DIFFERENCE BETWEEN ARTICLE & MEMORANDUM

The Memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of creditors, and the outside public, as well as of the shareholders. The Articles of Association are internal regulations of the company."

- The main points of difference between memorandum and articles are as follows: 1. Memorandum of Association is the charter of the company. It contains those fundamental conditions upon which alone the company is granted incorporation. Articles of Association contain the rules and regulations framed to govern the internal management of the company.

- Different clauses of the Memorandum cannot be easily altered. They can be altered for specified purposes and in accordance with the mode prescribed by the Act. Alteration of some of them requires the permission of the Tribunal/Company Law Board while in other cases sanction of the court is necessary. In case of Articles of Association, a company has inherent power to alter it. Members can alter the articles by passing a special resolution provided other conditions are satisfied. Permission of the court or the government is not required for ordinary alterations.

- Memorandum defines the objects and powers of the company. It fixes up the scope and the extent of the activities of the company. Articles form the bye-laws of the company and provide those regulations by which the objects and powers of the company can be carried out.

- Memorandum of Association cannot include any clause contrary to the provisions of the Companies Act. Articles of Association is subsidiary to both the Companies Act and the Memorandum of Association. Articles cannot be framed in contravention of the provisions of the Companies Act and the Memorandum.

- Though both the public documents, yet Memorandum define the relation between the company and the outsiders, while the Articles regulate the relation between the company and the members or member's alone or members inter se.

- Acts done by a company beyond the scope of the Memorandum are absolutely void and cannot be ratified even by a unanimous vote of all the shareholders. But acts of

a company beyond the Articles are simply irregular and not void and can easily be confirmed or subsequently ratified by the shareholders.

5.6 BINDING EFFECT OF MEMORANDUM & ARTICLE OF ASSOCIATION

Section 10 of the Companies Act provides: "Subject to the provisions of this Act, the Memorandum and Articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the Memorandum and Articles."

Thus, the Articles bind the company to its members, the members to the company and the members to each other. They constitute a contract between a company and its members in respect of their rights and liabilities as members.

Binding the company to its members.
The company is bound to the members to observe and follow the articles. In case the company commits a breach of the articles, members can restrain the company from doing so, by bringing an injunction against the company. Members may sue to restrain a company from doing any ultra-vires or illegal acts or from acting on a resolution obtained by fraud or which is inconsistent with the Articles. Members may also sue the company for the enforcement of their personal right under the Articles, e.g., right to receive divided which has been declared. However, only a shareholder or a member of the company, in the capacity of a member and not in any other capacity, can enforce the rules and regulations contained in the Articles.

Case Study : *The case of Wood v Odessa Waterworks Co. provides a n illustration of binding of articles on the company to its members. The articles of the Waterworks Co. provided that 'the directors may, with the sanction of the company in general meeting, declare a dividend to be paid to the members'. Instead of paying the dividend in cash to the shareholders a resolution was passed to give them debenture bonds. In an action by a member to restrain the directors from acting on the resolution, the Court held: "The question is whether that which is proposed to be done in the present case is in accordance with the articles of association of the company. Those articles provide that the directors may, with the sanction of a general meeting, declare a dividend to be paid to shareholders. Prima facie that means to be paid in cash. The debenture bonds proposed to be issued are not a payment in cash." Accordingly the directors were restrained from acting on the resolution*

Binding on members in their relations to the company.
Articles of Association is a 'contract of the most sacred character' between the company and each member, binding the members to the company under a statutory covenant. All money payable by any member to the company under the Memorandum

or Articles shall be a debt due from him to the company. Articles are taken to be signed and agreed to be observed by each member. Members are bound by the articles just as if every one of them had contracted to conform to them. A company can sue its members for the enforcement of its Articles as well as for restraining their breach. A case in point is:

Case Study : *Borland's Trustees v. Steel Bros. & Co. Ltd. (1901) The articles of association of the company provided that in the event of the bankruptcy of a member his shares would be sold at a price to be fixed by the directors." Borland became bankrupt. His trustee in bankruptcy wanted to sell these shares at their true value contended that he was not bound by the articles. It was held bound to abide by the provisions of the company's articles*

Binding between members

The contractual force given to the articles is limited to the matters arising out of company's relationship of the members as members and does not extend beyond the company relationship. The articles constitute a contract between each member and the company. The articles do not regulate their rights inter se. Such rights can only be enforced by or against a member through the company. However, this is not without exceptions. Courts have extended the articles to constitute a contract between individual members qua members and that without joining the company as a party to the action.

Case Study : *The case of Rayfield and Hands (1960) is a pointer to the issue. Rayfield was a shareholder in a company. He was required to inform the directors in the event of his intention to transfer the shares. The directors were required to take the shares at a fair value. Rayfield informed the directors in accordance with the articles. The directors contended that they were not bound to take and pay for Rayfield's shares and the articles could impose no such obligation on them. The court set aside this argument by treating the directors as members and compelled them to take Rayfield's shares at a fair value. The court also held that it was not necessary for Rayfield to join the company for bringing a suit against the directors.*

No binding in relation to outsiders.

The memorandum and articles do not constitute a contract between the company and the third party. Neither the company nor the members of the company is bound to the outsiders to give effect to the provisions of the memorandum and articles.

Case Study : *In Browne v La Trinidad, the articles of the company contained a clause to the effect that Browne should be a director and should not be removable. He was, however, removed and had brought an action to restrain the company from excluding him. It was held that there was no contract between Browne and the company. No*

outsider can enforce articles against the company even if they purport to give him certain rights.

Thus, an outsider cannot take advantage of the Articles to found a claim thereon against the company. Even a member enjoying certain rights in a capacity other than a member cannot enforce them against the company. The member would be an outsider for those 'outside rights'.

5.7 ALTERATIONS OF ARTICLES

A company has an inherent power to alter its articles. Section 14 of the Companies Act conferred the power of alteration to the company which states that a company may alter its articles by passing a special resolution to this effect. A company may even change its Articles with retrospective effect. Any provision making Articles unalterable is regarded as bad in law. Company cannot deprive itself, by an express provision in the Articles or independent contract, of the power to alter its articles. However, there are certain limitations or restrictions on the power of the company to alter its articles of association. These are as follows

- Articles can be altered only by a special resolution. Articles can never be altered by an ordinary resolution even if they provide for such a procedure.

- Alteration can neither be beyond the provisions of the Companies Act nor the memorandum of association. Articles may, however, be altered to explain ambiguous portions or to supplement the memorandum with regard to those things upon which it is silent.

- Alteration of articles seeking to take away the company's power to alter its articles, would be void as being contrary to the provisions of the Act. But an Article prescribing a special method for passing the special resolution for altering the Articles will be valid.

- Alternation seeking to impose an additional liability on a member of the company after the date on which he became a member, to take shares more than what he has already taken or to pay any more money than what he is liable to pay on his shares shall not be binding upon him unless he agrees in writing to such an alteration except in case where the company is a club or any other association and the alteration of Articles provides for increase in the rate of subscription by the members.

- Alteration should not be illegal or against public policy besides not being contrary to any other statute in force.

- The power to alter the Articles must be exercised by the shareholders in good faith for the benefit of the company as a whole.2 Alterations made bona fide and in the interests of the company shall be valid even if they are likely to affect adversely the personal interests of some of the members of the company. Alteration of Articles so as to give power to the directors to require any shareholder who competed with the company's business to transfer his shares at full value is valid and binding upon the members of the company for it will be beneficial to and in the interest of the whole company.3 Alteration of Articles shall not be valid if it has been made for the benefit of an aggressive, vindictive or fraudulent majority.

- Certain provisions of the Articles cannot be altered except with the prior approval of the Central Government. These include conversion of a public company into a private company.

- A company can alter its articles even if it causes a breach of an agreement with the outsider. It cannot be prevented by injunction from altering its articles which constitute a breach of contract, although it may be able to pay damages, if it acts upon them. The remedy of the outsider depends on this fact whether his contract is purely on the terms in the articles or it is an independent contract. In the former case, the alteration will be operative and outsider will have no remedy against the company. While in the latter case, the company can repudiate the contract by altering its articles, but will be liable for the damages caused to the third party on account of such breach. This is because "a company cannot by altering articles cause a breach of contract."

5.8 CONSTRUCTIVE NOTICE OF THE MEMORANDUM AND ARTICLES

Memorandum and Articles are public documents. These are available for public inspection in the Registrar's office. Persons dealing with the company are deemed to be aware of the contents of the memorandum and articles and taken to have understood them according to their proper meaning. This presumed notice is called constructive notice. A person dealing with the company in a way contrary to the provision of the Memorandum and Articles will have to bear the consequences of the lapse.

Case Study : *The case of Kotla Venkatswamy v Rammurthy illustrates the rule: The Articles of Association of a company required all contracts, deeds etc. must be signed by the managing directors, the secretary and a working director. A mortgage deed was executed on behalf of the company in favour of Rammurthy. The deed contained only the signatures of the secretary and a working director. It was held that the company was not liable to pay the money under the deed since it was expected from Rammurthy to see before accepting the deed that it had been signed by the persons as required by the company's articles.*

5.9 DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management seeks to provide a protection to the outsiders by requiring the persons in charge of the management of the company to do all the things according to the procedure prescribed by the Articles of Association. It affords the outsiders to assume that things have been done in accordance with the provisions and the procedure laid down in the Articles of Association. The duty of observing internal managerial procedure such as regarding constitution of the Board, quorum, voting, internal resolutions and regulations etc.has been imposed upon those who are responsible for the management of the affairs of the Company. Company in all such cases shall continue to be liable to third parties even if the internal formalities are found not to have been completed. As per the doctrine of indoor management, "persons dealing with the company are bound to read the registered documents and to see that the proposed dealings are apparently regular and consistent with the Memorandum and Articles, therewith. But they are not bound to do any more, they need not inquire into the regularity of internal proceedings of the company."6 They need not enquire whether proper procedure has been followed for the delegation of the authority to the person with whom the outsider is dealing. An outsider is not required to investigate the compliance of all the rules of internal management. This is because a person can be presumed to know the constitution of the company as revealed by the public documents, but not what may or may not have taken place within doors that are closed to him.

Thus, outsiders are bound to know only the external position of the company and are not bound to know the 'indoor management'. In the absence of the aforesaid rule the people in business would feel shy in dealing with companies. If the persons dealing with the company are compelled to see the internal management of the company to ensure that nothing has been done wrong, then it would cause a great hindrance to the smooth running of the wheels of commerce. The doctrine of indoor management operates opposed to that of the rule of constructive notice. The doctrine also known as the Turquand rule has been applied in a number of cases.

Exceptions to the Doctrine of Indoor Management :

The doctrine of indoor management is subject to the following exceptions when the protection under the rule may not be given to the persons dealing with the company.

Knowledge of irregularity. The protection of the doctrine is not afforded to a person who had the actual or constructive knowledge of the irregularity besetting the transaction. In Howard v Patent Ivory Co., for example, the directors of the company had the authority to borrow up to £ 1000 without sanction of the resolution at the general meeting. Directors lent to the company £ 3500 without any resolution passed. It was held that the company would be bound only by £ 1000. The Turquand rule was

not applied as the directors ought to know that the resolution was not passed so could not claim ignorance and protection.

Suspicious circumstances. When the circumstances surrounding a dealing are suspicious and therefore invite further enquiries, then it becomes the duty of the person intending to have dealing with the company to make proper enquiries and satisfy himself/herself. If the person does not do so, the protection under the rule may not be given to him/her. Suspicion may arise owing to unusual magnitude of transaction or unusual haste to finalise a transaction, or an officer of the company acting beyond his apparent authority. In Anand Bihari Lal v Dinshaw & Co. the plaintiff accepted a transfer of property of the Company from its accountant. The transfer was held to be void. In the absence of a properly executed power of attorney, the plaintiff could not assume that the accountant has the power to sell the property of the company. Forgery. The doctrine of indoor management is not applicable to forgeries committed by the employees of the company. This is because the doctrine regularizes the irregularities not the illegalities.

Forgery is illegal and therefore void ab initio. The case of Ruben v Great Fingall Consolidated provides clarity on the issue. In this case, Secretary of the company forged the signatures of the two directors and after affixing the seal of the company, issued it to Ruben. The Company denied the Certificate. The plaintiff contended that he had no means to know whether the signatures are genuine or forged, and therefore it is a part of the internal management of the company. But it was held that the rule of indoor management has never been extended to a forgery

5.10 PROSPECTUS & ITS CONTENT

A prospectus is a document issued by the company inviting the public and investors for the subscription of its securities. A prospectus also helps in informing the investors about the risk of investing in the company. A Prospectus is required to be issued only after the incorporation of the company.

Section 2(70) of the Companies Act, 2013 defines a prospectus as A prospectus means Any documents described or issued as a prospectus and includes any notices, circular, advertisement, or other documents inviting deposit for the public or documents inviting offers from the public for the subscription of shares.

Contents of a prospectus:

- Address of the registered office of the company.
- Name and address of company secretary, auditors, bankers, underwriters etc.
- Dates of the opening and closing of the issue.

- Declaration about the issue of allotment letters and refunds within the prescribed time.
- A statement by the board of directors about the separate bank account where all monies received out of shares issued are to be transferred.
- Details about underwriting of the issue.
- Consent of directors, auditors, bankers to the issue, an expert's opinion if any.
- The authority for the issue and the details of the resolution passed therefore.
- Procedure and time schedule for allotment and issue of securities.
- Capital structure of the company.
- Main objects and present business of the company and its location.
- Main object of public offer and terms of the present issue.
- Minimum subscription amount payable by way of premium, issue of shares otherwise than on cash.
- Details of directors including their appointment and remuneration.
- Disclosure about sources of promoter’s contribution.
- Particulars relation to management perception of risk factors specific to the project, gestation period of the project, extent of progress made in the project and deadlines for completion of the project.

5.11 LET'S SUM UP

- Article of association is a document which contains rules, regulations and bye-laws for the internal administration of the company.
- Memorandum and Articles bind the company and members to each other.
- Section 14 of the Companies Act allows a company to alter its articles by passing a special resolution to this effect.
- The doctrine of indoor management provides protection to the persons dealing with a company when internal procedures as laid down by the articles of association are not complied with.

5.12 KEY WORDS

- **Doctrine of Indoor Management :** The doctrine of indoor management means that a company's indoor affairs are the company's problem. Therefore, this rule of indoor management is important to people dealing with a company through its directors or other persons.

- **Articles of Association :** Articles of association are a document that specifies the regulations for a company's operations and defines the company's purpose. The document lays out how tasks are to be accomplished within the organization, including the process for appointing directors and the handling of financial records.

5.13 FURTHER READINGS

- David Needle., Business In Context: An Introduction To Business And Its Environment (Revised Edition), Thomas Rennie, 2004.
- David P. Baron, Business And Its Environment, Pearson Education, 2006.
- Thomas Childs Cochran And Harold I. Sharlin, Business And Its Environment: Essays For Thomas C. Cochran, Greenwood Press, 1983.
- Patrick J. Cihon and James O. Castagnera, Employment and Labor Law, South-Western College.
- Richard Schaffer, Beverley Earle, and Filiberto Agusti, International Business Law and Its Environment, South-Western College, 2005.

5.14 TERMINAL QUESTIONS

Q1 What do you mean by the Articles of Association ?

Q2 Explain the alteration of Article of Association

Q3 Write down the circumstances when protection under the doctrine of indoor management is provided.

Q4 Discuss the doctrine of Indoor Management.