

# **THE COMPANIES ACT, 2013**

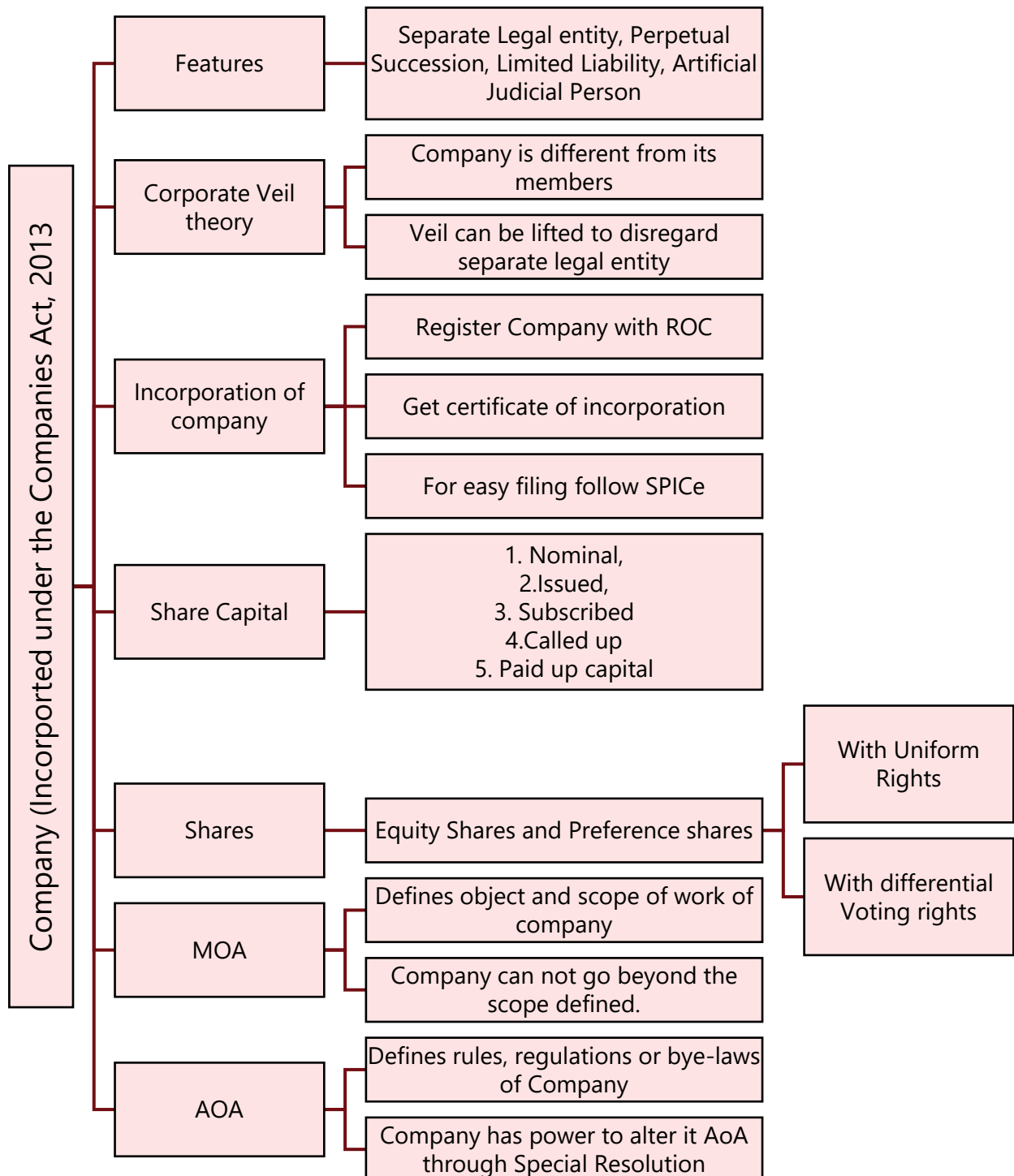


## **LEARNING OUTCOMES**

**After studying this chapter, you would be able to understand-**

- ◆ Company form of Business Organisation and its features
- ◆ Corporate veil theory
- ◆ Classes of companies under the Companies Act
- ◆ Registration of companies
- ◆ Memorandum of Association and Articles of Association

## CHAPTER OVERVIEW





## INTRODUCTION

The Companies Act, 2013 was enacted to consolidate and amend the law relating to the companies. The Companies Act, 2013 was preceded by the Companies Act, 1956.

Due to changes in the national and international economic environment and to facilitate expansion and growth of our economy, the Central Government decided to replace the Companies Act, 1956 with a new legislation. The Companies Act, 2013 contains 470 sections and seven schedules. The entire Act has been divided into 29 chapters. A substantial part of this Act is in the form of Companies Rules. The Companies Act, 2013 aims to improve corporate governance, simplify regulations, strengthen the interests of minority investors and for the first time legislates the role of whistle-blowers and provisions relating to class action suit. Thus, this enactment seeks to make our corporate regulations more contemporary.



### Applicability of the Companies Act, 2013:

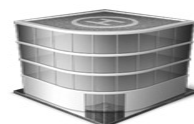
The provisions of the Act shall apply to-

- ◆ Companies incorporated under this Act or under any previous company law.
- ◆ Insurance companies (except where the provisions of the said Act are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999)
- ◆ Banking companies (except where the provisions of the said Act are inconsistent with the provisions of the Banking Regulation Act, 1949)
- ◆ Companies engaged in the generation or supply of electricity (except where the provisions of the above Act are inconsistent with the provisions of the Electricity Act, 2003)
- ◆ Any other company governed by any special Act for the time being in force.
- ◆ Such body corporate which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.



## 1. COMPANY: MEANING AND ITS FEATURES

**Meaning:** According to Chief Justice Marshall, "a corporation is an artificial being, invisible, intangible, existing only in contemplation of law. Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as accidental to its very existence.



In the words of professor Haney, "A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal." This definition sums up the meaning as well as the features of a company succinctly.

However, the Act defines the term company a bit differently. Section 2(20) of the Companies Act, 2013 defines the term 'company'. "Company means a company incorporated under this Act or under any previous company law". As we shall progress under the chapter, the meaning of the term company will be understood by the students.

### Features of a Company

Separate Legal Entity	
• Legally separate from the members	
Perpetual succession	
• Change in members does not affect existence of Company	
Limited Liability	
• Liability of Company is different from liability of members	
Artificial Juridical Person	
• Company can act through human agency only	
• Company can contract, sue and be sued in its own name	

We have seen the definition given to company from a layman's point of view and legal point of view. But the company form of organization has certain distinctive features that help us to understand the realms of a company. Following are the main features:

- I. **Separate Legal Entity:** There are distinctive features between different forms of organisations and the most striking feature in the company form of organisation vis-à-vis the other forms of business organisations is that it acquires a unique character of being a *separate legal entity*. In other words, when a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. Its existence is distinct and separate from that of its members. A company can own property, have bank account, raise loans, incur liabilities and enter into contracts.
  - (a) It is at law, a person which is different from the subscribers to the memorandum of association. Its personality is distinct and separate from the personality of those who compose it.

- (b) Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members.

A company is capable of owning, enjoying and disposing of property in its own name. Although the capital and assets are contributed by the shareholders, the company becomes the owner of its capital and assets. The shareholders are not the private or joint owners of the company's property.

**A member does not even have an insurable interest in the property of the company. The leading case on this point is of *Macaura Vs. Northern Assurance Co. Limited (1925)*:**

**Fact of the case**

Macaura (M) was the holder of nearly all (except one) shares of a timber company. He was also a major creditor of the company. M insured the company's timber in his own name. The timber was lost in a fire. M claimed insurance compensation. Held, the insurance company was not liable to him as no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest in them. Hence in this case, since the timber was not insured in the company's name, M could not claim the compensation from insurance company.

- II Perpetual Succession:** Members may die or change, but the company goes on till it is wound up on the grounds specified by the Act. The shares of the company may change hands infinitely but that does not affect the existence of the company. Since a company is an artificial person created by law, law alone can bring an end to its life. Its existence is not affected by the death or insolvency of its members.

**Example 1:** Many companies in India are in existence for over 100 years. This is possible only due to the fact that the company has perpetual existence. There was a company which has 7 members and all of them died in an aircraft. Despite this the company still exists unlike partnership form of business.

- III Limited Liability:** The liability of a member depends upon the kind of company of which he is a member. We know that company is a separate legal entity which is distinct from its members.

- (i) Thus, in the case of a *limited liability company*, the debts of the company in totality do not become the debts of the shareholders. The liability of the members of the company is limited to the extent of the nominal value of shares held by them. In no case can the shareholders be asked to pay anything more than the unpaid value of their shares.

- (ii) In the case of a *company limited by guarantee*, the members are liable only to the extent of the amount guaranteed by them and that too only when the company goes into liquidation.
- (iii) However, if it is an unlimited company, the liability of its members is unlimited as well.

#### IV Artificial Legal Person:

- (1) A company is an artificial person as it is created by a process other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual.
- (2) Further, the company being a separate legal entity can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. It can sue and be sued in its own name. It can do everything which any natural person can do except be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.
- (3) As the company is an *artificial person*, it can act only through some human agency, viz., directors. The directors cannot control affairs of the company and act as its agency, but they are not the “agents” of the members of the company. The directors can either on their own or through the common seal (of the company) can authenticate its formal acts.
- (4) Thus, a company is called an artificial legal person.

**V Common Seal:** A company being an artificial person is not bestowed with a body of a natural being. Therefore, it works through the agency of human beings. Common seal is the official signature of a company, which is affixed by the officers and employees of the company on its every document. The common seal is a seal used by a corporation as the symbol of its incorporation.

The Companies (Amendment) Act, 2015 has made the common seal optional by omitting the words “and a common seal” from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. Rational for this amendment is that common seal is seen as a relic of medieval times. Even in the U.K., common seal has been made optional since 2006. This amendment provides that the documents which need to be authenticated by a common seal will be required to be so done, only if the company opts to have a common seal. **In case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.**

## 2. CORPORATE VEIL THEORY

(i) **Corporate Veil:** Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

The term Corporate Veil refers to the concept that members of a company are shielded from liability connected to the company's actions. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors. In other words, they enjoy corporate insulation.

Thus, the shareholders are protected from the acts of the company.

The **Salomon Vs. Salomon and Co Ltd.** laid down the foundation of the concept of corporate veil or independent corporate personality.

In *Salomon vs. Salomon & Co. Ltd.* the House of Lords laid down that a company is a person distinct and separate from its members. In this case one Salomon incorporated a company named "Salomon & Co. Ltd.", with seven subscribers consisting of himself, his wife, four sons and one daughter. This company took over the personal business assets of Salomon for £ 38,782 and in turn, Salomon took 20,000 shares of £ 1 each, debentures worth £ 10,000 of the company with charge on the company's assets and the balance in cash. His wife, daughter and four sons took up one £ 1 share each. Subsequently, the company went into liquidation due to general trade depression. The unsecured creditors to the tune of £ 7,000 contended that Salomon could not be treated as a secured creditor of the company, in respect of the debentures held by him, as he was the managing director of one-man company, which was not different from Salomon and the cloak of the company was a mere sham and fraud. **It was held by Lord Mac Naughten:**

*"The Company is at law a different person altogether from the subscribers to the memorandum, and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustees for them. Nor are the subscribers, as members, liable, in any shape or form, except to the extent and in the manner provided by the Act."*

Thus, this case clearly established that company has its own existence and as a result, a shareholder cannot be held liable for the acts of the company even though he holds virtually the entire share capital. The whole law of corporation is in fact based on this theory of separate corporate entity.

**Now, the question may arise whether this Veil of Corporate Personality can even be lifted or pierced.**

Before going into this question, one should first try to understand the meaning of the phrase "lifting the veil". It means looking behind the company as a legal person, i.e., disregarding the

corporate entity and paying regard, instead, to the realities behind the legal facade. Where the Courts ignore the company and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the Courts are willing to lift the corporate veil and that too, when questions of control are involved rather than merely a question of ownership.

**(ii) Lifting of Corporate Veil:** The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- (1) **To determine the character of the company i.e. to find out whether co-enemy or friend:** In the law relating to trading with the enemy where the test of control is adopted. The leading case in this point is ***Daimler Co. Ltd. vs. Continental Tyre & Rubber Co.***, if the public interest is not likely to be in jeopardy, the Court may not be willing to crack the corporate shell. But it may rend the veil for ascertaining whether a company is an enemy company. It is true that, unlike a natural person, a company does not have mind or conscience; therefore, it cannot be a friend or foe. It may, however, be characterised as an enemy company, if its affairs are under the control of people of an enemy country. For this purpose, the Court may examine the character of the persons who are really at the helm of affairs of the company.
- (2) **To protect revenue/tax:** In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue. ***[S. Berendsen Ltd. vs. Commissioner of Inland Revenue]***
  - (i) Where corporate entity is used to **evade or circumvent tax**, the Court can disregard the corporate entity ***[Juggilal vs. Commissioner of Income Tax AIR (SC)]***.
  - (ii) In ***[Dinshaw Maneckjee Petit]***, it was held that the company was not a genuine company at all but merely the assessee himself disguised under the legal entity of a limited company. The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan. The Court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.
- (3) **To avoid a legal obligation:** Where it was found that the sole purpose for the formation of the company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction ***(The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar vs. The Associated Rubber Industries Ltd., Bhavnagar and another)***.



***Workmen of Associated Rubber Industry Ltd., v. Associated Rubber Industry Ltd.:***

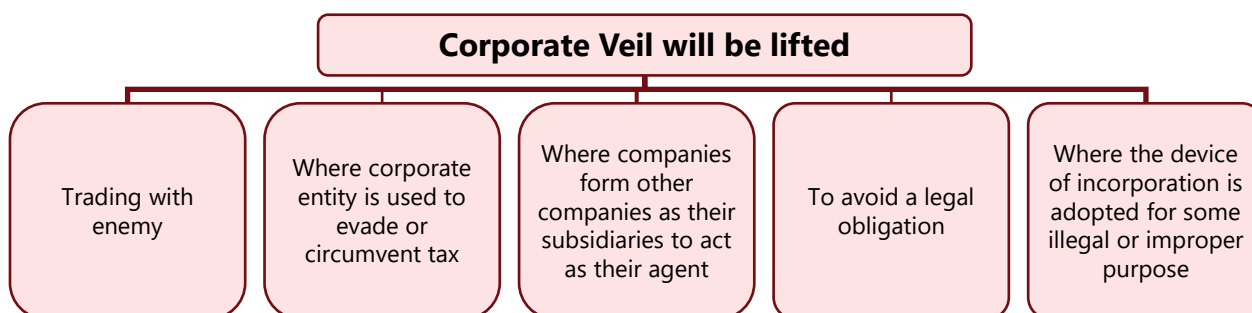
The facts of the case are that "A Limited" purchased shares of "B Limited" by investing a sum of ₹ 4,50,000. The dividend in respect of these shares was shown in the profit and loss account of the company, year after year. It was taken into account for the purpose of calculating the bonus payable to workmen of the company. Sometime in 1968, the company transferred the shares of B Limited, to C Limited a subsidiary, wholly owned by it. Thus, the dividend income did not find place in the Profit & Loss Account of A Ltd., with the result that the surplus available for the purpose for payment of bonus to the workmen got reduced.

Here a company created a subsidiary and transferred to it, its investment holdings in a bid to reduce its liability to pay bonus to its workers. Thus, the Supreme Court brushed aside the separate existence of the subsidiary company. The new company so formed had no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company and serving no purpose except to reduce the gross profit of the principal company so as to reduce the amount paid as bonus to workmen.

- (4) **Formation of subsidiaries to act as agents:** A company may sometimes be regarded as an agent or trustee of its members, or of another company, and may therefore be deemed to have lost its individuality in favour of its principal. Here the principal will be held liable for the acts of that company.

In the case of ***Merchandise Transport Limited vs. British Transport Commission (1982)***, a transport company wanted to obtain licences for its vehicles but could not do so if applied in its own name. It, therefore, formed a subsidiary company, and the application for licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the parent and the subsidiary were one commercial unit and the application for licences was rejected.

- (5) **Company formed for fraud/improper conduct or to defeat law:** Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations. [***Gilford Motor Co. vs. Horne***]





### 3. CLASSES OF COMPANIES UNDER THE ACT

The growth of the economy and increase in the complexity of business operation in the corporate world has led to the emergence of different forms of corporate organizations. To regulate them, the Companies Act, 2013 has broadly classified the companies into various classes.

A company may be incorporated as a one-person company, private company or a public company, depending upon the number of members joining it. Again, it may either be an unlimited company, or may be limited by shares or by guarantee or by both. On the basis of control, companies can be classified as associate company, holding company and subsidiary company. Some other forms of classification of companies are foreign company, government company, small company, dormant company, nidhi company and company formed for charitable objects.

Companies may be classified into various classes on the following basis:

#### 1. On the basis of liability:

- (a) **Company limited by shares:** Section 2(22) of the Companies Act, 2013, defines that when the liability of the members of a company is limited by its memorandum of association to the amount (if any) unpaid on the shares held by them, it is known as a company limited by shares.

It thus implies that for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings. His separate property cannot be encompassed to meet the company's debt.

It may be worthwhile to know that though a shareholder is a co-owner of the company, he is not a co-owner of the company's assets. The ownership of the assets remains with the company, because of its nature as a legal person. The extent of the rights and duties of a shareholder as co-owner is measured by his shareholdings.

- (b) **Company limited by guarantee:** Section 2(21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.

Thus, the liability of the member of a guarantee company is limited upto a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

The **common features** between a 'guarantee company' and 'the company having share capital' are legal personality and limited liability. In the latter case, the member's liability is limited by the amount remaining unpaid on the share, which each member holds. Both of them have to state in their memorandum that the members' liability is limited.

However, the point of **distinction** between these two types of companies is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the latter case, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

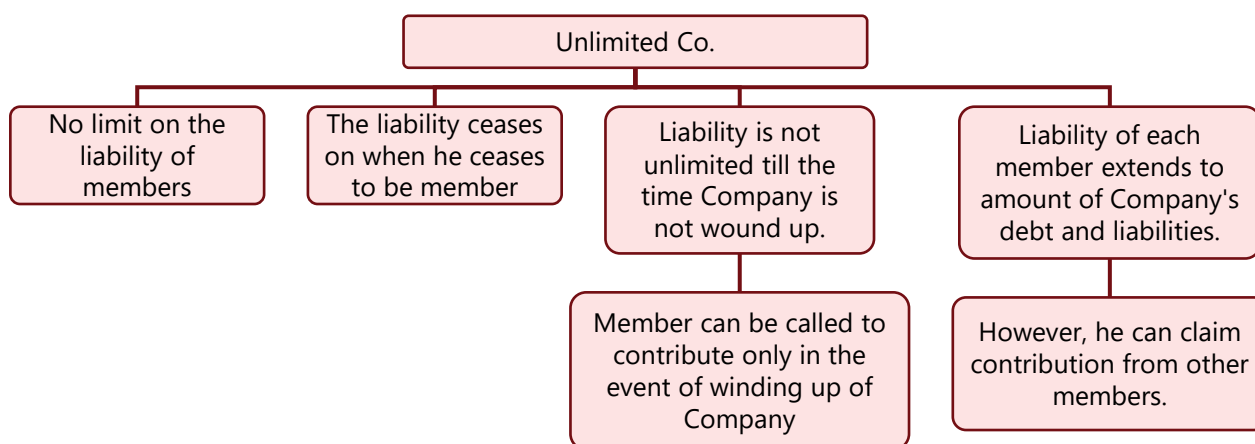
It is clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be held from other sources like endowment, fees, charges, donations, etc.

In ***Narendra Kumar Agarwal vs. Saroj Maloo***,

The Supreme Court has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

- (c) **Unlimited company:** Section 2(92) of the Companies Act, 2013 defines unlimited company as a company not having any limit on the liability of its members. In such a company, the liability of a member ceases when he ceases to be a member.

The liability of each member extends to the whole amount of the company's debts and liabilities but he will be entitled to claim contribution from other members. In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share. So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company. The creditors can institute proceedings for winding up of the company for their claims. The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited.



## 2. On the basis of members:

- (a) **One person company:** The Companies Act, 2013 introduced a new class of companies which can be incorporated by a single person.

Section 2(62) of the Companies Act, 2013 defines one person company (OPC) as a company which has only one person as a member.

One person company has been introduced to encourage entrepreneurship and corporatization of business. OPC differs from sole proprietary concern in an aspect that OPC is a separate legal entity with a limited liability of the member whereas in the case of sole proprietary, the liability of owner is not restricted and it extends to the owner's entire assets constituting of official and personal.



The procedural requirements of an OPC are simplified through exemptions provided under the Act in comparison to the other forms of companies.

According to section 3(1)(c) of the Companies Act, 2013, **OPC is a private limited company** with the minimum paid up share capital as may be prescribed and having one member.

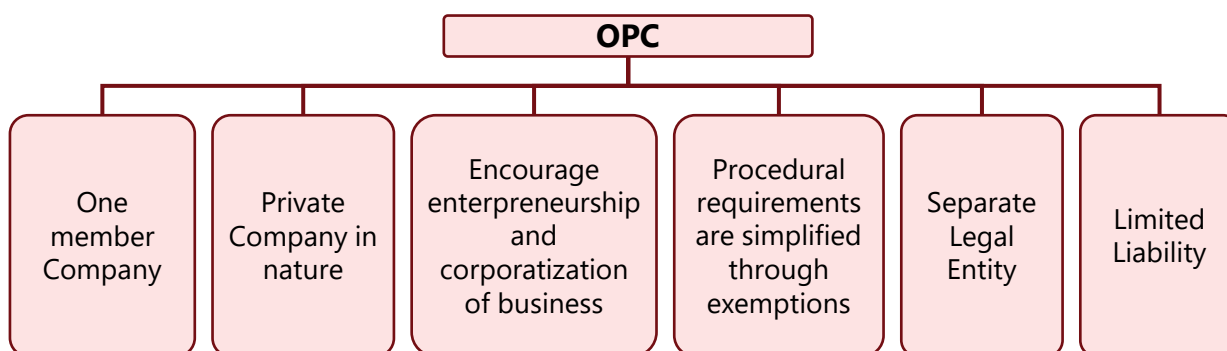
### OPC (One Person Company) - significant points

- ◆ Only one person as member.
- ◆ Minimum paid up capital – no limit prescribed.
- ◆ The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
- ◆ The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of

companies at the time of incorporation of the company along with its e-memorandum and e-articles.

- ◆ Such other person may be given the right to withdraw his consent.
- ◆ The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar.
- ◆ Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
- ◆ Only a natural person who is an Indian citizen whether resident in India or otherwise and has stayed in India for a period of not less than 120 days during the immediately preceding financial year
  - shall be eligible to incorporate a OPC;
  - shall be a nominee for the sole member of a OPC.
- ◆ No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
- ◆ No minor shall become member or nominee of the OPC or can hold share with beneficial interest.
- ◆ Such Company cannot be incorporated or converted into a company under section 8 of the Act. Though it may be converted to private or public companies in certain cases.
- ◆ Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporate.

Here the member can be the sole member and director.



- (b) Private Company [Section 2(68)]:** "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

- (i) restricts the right to transfer its shares;
- (ii) except in case of One Person Company, limits the number of its members to two hundred:

**Provided** that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

**Provided further** that—

- (A) persons who are in the employment of the company; and
  - (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,
- shall not be included in the number of members; and
- (iii) prohibits any invitation to the public to subscribe for any securities of the company;

#### **Private company - significant points**

- ◆ No minimum paid-up capital requirement.
- ◆ Minimum number of members – 2 (except if private company is an OPC, where it will be 1).
- ◆ Maximum number of members – 200, excluding present employee-cum-members and erstwhile employee-cum-members.
- ◆ Right to transfer shares restricted.
- ◆ Prohibition on invitation to subscribe to securities of the company.
- ◆ Small company is a private company.
- ◆ OPC can be formed only as a private company.

**Small Company:** Small company given under the Section 2(85) of the Companies Act, 2013 which means a company, other than a public company—

- (i) **paid-up share capital** of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
- (ii) **turnover** of which as per profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

**Exceptions:** This clause shall not apply to:

- (A) a holding company or a subsidiary company;
- (B) a company registered under section 8; or
- (C) a company or body corporate governed by any special Act.

***For the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed rupees four crores and rupees forty crores respectively. [Companies (Specification of definition details) Amendment Rules, 2022, w.e.f. 15<sup>th</sup> September, 2022]***

**Small Company –significant points**

- ◆ A private company
- ◆ Paid up capital – not more than ₹ 4 crores  
and  
Turnover – not more than ₹ 40 crores.
- ◆ Should not be – Section 8 company  
– Holding or a Subsidiary company

**(c) Public company [Section 2(71)]:** “Public company” means a company which—

- (i) is not a private company; and
- (ii) has a minimum paid-up share capital, as may be prescribed:

**Provided** that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles;

**Public company - significant points**

- ◆ Is not a private company (Articles do not have the restricting clauses).
- ◆ Shares freely transferable.
- ◆ No minimum paid up capital requirement.
- ◆ Minimum number of members – 7.
- ◆ Maximum numbers of members – No limit.
- ◆ Subsidiary of a public company is deemed to be a public company.

According to section 3(1)(a), a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company.

### 3. On the basis of control:

#### (a) **Holding and subsidiary companies:** 'Holding and subsidiary' companies are relative terms.

A company is a holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies. [Section 2(46)]

For the purposes of this clause, the expression "company" includes any body corporate.

Whereas section 2(87) defines "subsidiary company" in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

For the purposes of this section —

- (I) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (II) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
- (III) the expression "company" includes any body corporate;
- (IV) "layer" in relation to a holding company means its subsidiary or subsidiaries.

**Example 2:** A will be subsidiary of B, if B controls the composition of the Board of Directors of A, i.e., if B can, without the consent or approval of any other person, appoint or remove a majority of directors of A.

**Example 3:** A will be subsidiary of B, if B holds more than 50% of the share capital of A.



**Example 4:** B is a subsidiary of A and C is a subsidiary of B. In such a case, C will be the subsidiary of A. In the like manner, if D is a subsidiary of C, D will be subsidiary of B as well as of A and so on.

**Status of private company, which is subsidiary to public company:** In view of Section 2(71) of the Companies Act, 2013 a Private company, which is subsidiary of a public company shall be deemed to be public company for the purpose of this Act, even where such subsidiary company continues to be a private company in its articles.

- (b) **Associate company [Section 2(6)]:** In relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation. — For the purpose of this clause —

- (a) the expression “significant influence” means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;
- (b) the expression “joint venture” means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

#### 4. On the basis of access to capital:

- (a) **Listed company:** As per the definition given in the section 2(52) of the Companies Act, 2013, it is a company which has any of its securities listed on any recognised stock exchange.

Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

Whereas the word securities as per the section 2(81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

**Example 5:** Scan Steel Rods Limited is a Public Limited Company whose shares are listed in the Stock Exchange, Kolkata. Hence Scan Steel Rods Limited is a Listed Company. The reason for calling it “Listed” is because the company and the Stock Exchange have signed a Listing Agreement for trading of shares in the capital market.

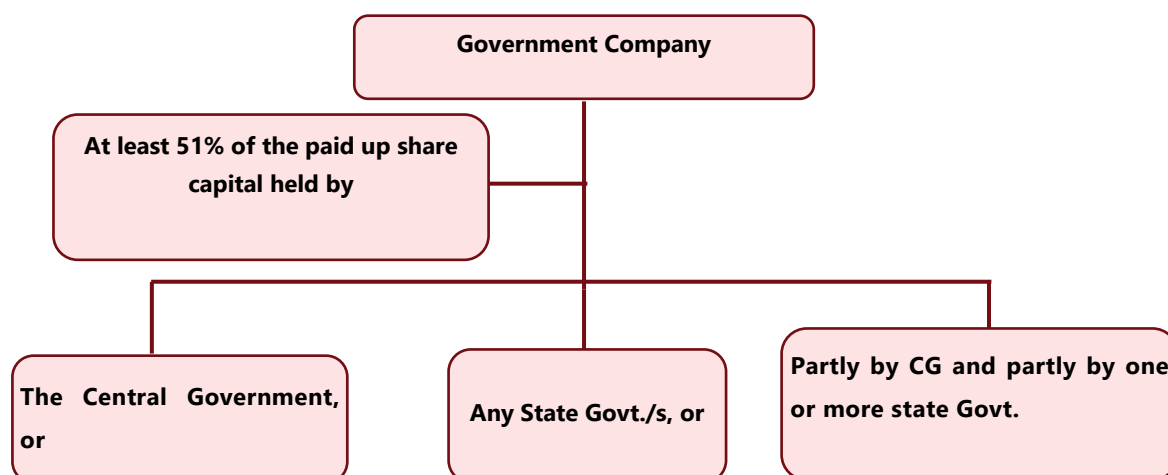
- (b) **Unlisted company** means company other than listed company.

## 5. Other companies:

(a) **Government company [Section 2(45)]:** Government Company means any company in which not less than 51% of the paid-up share capital is held by-

- (i) the Central Government, or
- (ii) by any State Government or Governments, or
- (iii) partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

**Explanation:** For the purposes of this clause, the "paid up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued.



(b) **Foreign Company [Section 2(42)]:** It means any company or body corporate incorporated outside India which—

- (i) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (ii) conducts any business activity in India in any other manner.

(c) **Formation of companies with charitable objects etc. (Section 8 company):**

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to

- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.

- Such company intends to apply its profit in
- promoting its objects and
- prohibiting the payment of any dividend to its members.

**Examples** of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

**Power of Central government to issue the license–**

- (i) Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.
- (ii) The registrar shall on application register such person or association of persons as a company under this section.
- (iii) On registration the company shall enjoy same privileges and obligations as of a limited company.

**Revocation of license:** The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

**Order of the Central Government:** Where a licence is revoked then the Central Government may, in the public interest order that the company registered under this section should be amalgamated with another company registered under this section having similar objects, to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order, or the company be wound up.

**Penalty/punishment in contravention:** If a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be

punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees.

Provided that when it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447.

### **Section 8 Company- Significant points**

- ◆ Formed for the promotion of commerce, art, science, religion, charity, protection of environment, sports, etc.
- ◆ Requirement of minimum share capital does not apply.
- ◆ Uses its profits for the promotion of the objective for which it is formed.
- ◆ Does not declare dividend to members.
- ◆ Operates under a special licence from Central Government.
- ◆ Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.
- ◆ Licence revoked if conditions contravened.
- ◆ On revocation, Central Government may direct it to
  - Converts its status and change its name
  - Wind – up
  - Amalgamate with another company having similar object.
- ◆ Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- ◆ Requirement of minimum number of directors, independent directors etc. does not apply.
- ◆ Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- ◆ A partnership firm can be a member of Section 8 company.

Formation	<ul style="list-style-type: none"> <li>•To promote Charitable objects</li> </ul>
Application of profits	<ul style="list-style-type: none"> <li>•To promote its objects</li> <li>•No payment of dividends out of profits</li> </ul>
Type of Co.	<ul style="list-style-type: none"> <li>•Limited Liability</li> <li>•Without the addition of words "Ltd" or "Pvt Ltd."</li> </ul>
How status is granted	<ul style="list-style-type: none"> <li>•The CG can grant such status</li> <li>•However, CG has delegated the power to grant licence to ROC</li> </ul>
Revocation of licence	<ul style="list-style-type: none"> <li>•CG may revoke licence</li> <li>•If conditions of section 8 are contravened, or</li> <li>•affairs of the company are conducted fraudulently, or prejudicial to public interest</li> </ul>
Effect of revocation of licence	<ul style="list-style-type: none"> <li>•Co has to use words "Ltd." or "Pvt Ltd."</li> </ul>

- (d) **Dormant company (Section 455):** Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

**"Inactive company"** means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

**"Significant accounting transaction"** means any transaction other than—

- (i) payment of fees by a company to the Registrar;
- (ii) payments made by it to fulfil the requirements of this Act or any other law;
- (iii) allotment of shares to fulfil the requirements of this Act; and
- (iv) payments for maintenance of its office and records.

- (e) **Meaning of Nidhi Companies [Section 406(1) of the Companies Act, 2013]:** In this section, "Nidhi" or "Mutual Benefit Society" means a company which the Central

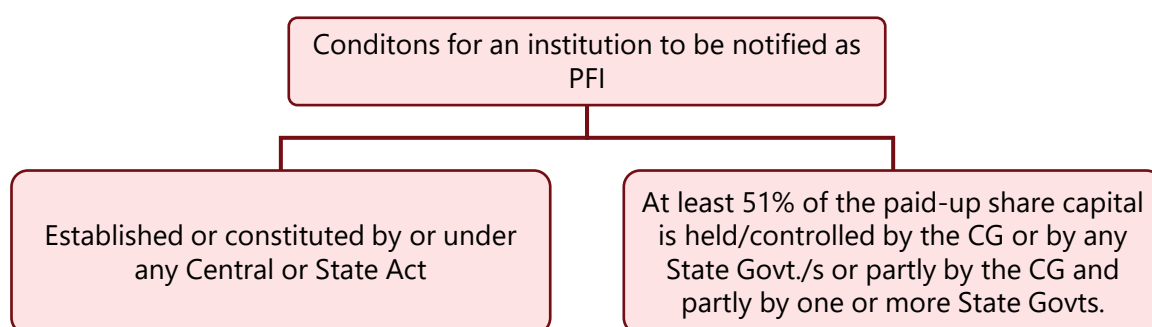
Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be. Nidhi Companies are created mainly for cultivating the habit of thrift and savings amongst its members.

**(f) Public Financial Institutions (PFI):** By virtue of Section 2(72) of the Companies Act, 2013, the following institutions are to be regarded as public financial institutions:

- (i) the Life Insurance Corporation of India, established under the Life Insurance Corporation Act, 1956;
- (ii) the Infrastructure Development Finance Company Limited,
- (iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;
- (iv) institutions notified by the Central Government under section 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act;
- (v) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

**Conditions for an institution to be notified as PFI:** No institution shall be so notified unless—

- (A) it has been established or constituted by or under any Central or State Act other than this Act or the previous Companies Law; or
- (B) not less than fifty-one per cent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.





## 4. MODE OF REGISTRATION/INCORPORATION OF COMPANY

**PROMOTERS:** The Companies Act, 2013 defines the term “Promoter” under section 2(69) which means a person—

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) in accordance with whose advice, directions, or instructions the Board of Directors of the company is accustomed to act.

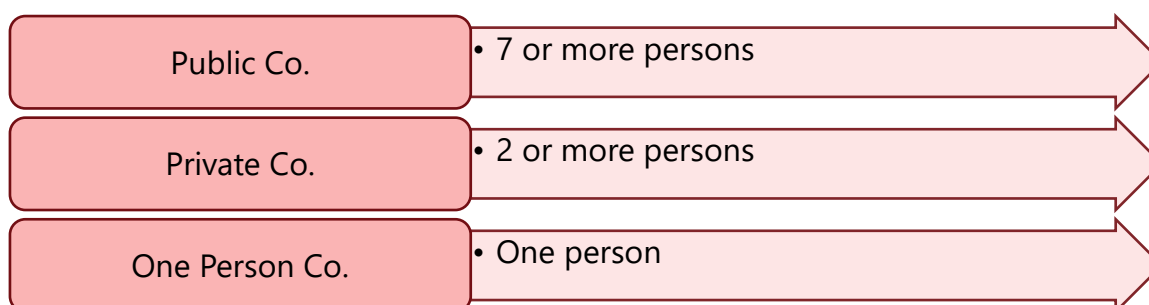
In simple terms we can say,

- ✓ Persons who form the company are known as promoters.
- ✓ It is they who conceive the idea of forming the company.
- ✓ They take all necessary steps for its registration.
- ✓ It should, however, be noted that persons acting only in a professional capacity e.g., the solicitor, banker, accountant etc. are not regarded as promoters.

**FORMATION OF COMPANY:** Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company.

In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration.

In the same way, 2 or more persons can form a private company and one person can form one person company.



**INCORPORATION OF COMPANY:** Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

- (1) **Filing of the documents and information with the registrar:** For the registration of the company following documents and information are required to be filed with the registrar within whose jurisdiction the registered office of the company is proposed to be situated-
- ◆ the memorandum and articles of the company duly **signed by all the subscribers** to the memorandum.
  - ◆ a **declaration by person who is engaged in the formation of the company** (an advocate, a chartered accountant, cost accountant or company secretary in practice), **and by a person named in the articles** (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.
  - ◆ a **declaration from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles stating that-**
    - he is not convicted of any offence in connection with the promotion, formation or management of any company, or
    - 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 last 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;
  - ◆ the **address for correspondence** till its registered office is established;
  - ◆ the **particulars** (names, including surnames or family names, residential address, nationality) **of every subscriber** to the memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.
  - ◆ the **particulars** (names, including surnames or family names, the Director Identification Number, residential address, nationality) **of the persons mentioned in the articles as the subscribers to the Memorandum** and such other particulars including proof of identity as may be prescribed; and
  - ◆ 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.



Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company [*The Companies (Incorporation) Rules, 2014*].

- (2) **Issue of certificate of incorporation on registration:** The Registrar on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.
- (3) **Allotment of Corporate Identity Number (CIN):** 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.
- (4) **Maintenance of copies of all documents and information:** The company shall maintain and preserve at its registered office copies of all documents and information as originally filed, till its dissolution under this Act.
- (5) **Furnishing of false or incorrect information or suppression of material fact at the time of incorporation (i.e. at the time of Incorporation):** 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 for fraud under section 447.
- (6) **Company already incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact (i.e. post Incorporation):** Where, at any time after the incorporation of a company, it is proved that the company has been got 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 under this section shall each be liable for action for fraud under section 447.
- (7) **Order of the Tribunal:** Where a company has been got incorporated by furnishing 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 Tribunal may, on an application made to it, on being satisfied that the situation so warrants,—
  - (a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

- (b) direct that liability of the members shall be unlimited; or
- (c) direct removal of the name of the company from the register of companies; or
- (d) pass an order for the winding up of the company; or
- (e) pass such other orders as it may deem fit:

Provided that before making any order,—

- ◆ the company shall be given a reasonable opportunity of being heard in the matter; and
- ◆ the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

### **Simplified Proforma for Incorporating Company Electronically (SPICe)**

The Ministry of Corporate Affairs has taken various initiatives for ease of business. In a step towards easy setting up of business, MCA has simplified the process of filing of forms for incorporation of a company through Simplified Proforma for incorporating company electronically.

**EFFECT OF REGISTRATION:** Section 9 of the Companies Act, 2013 provides for the effect of registration of a company.

According to Section 9, from the date of incorporation (mentioned in the certificate of incorporation), the subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum. Such a registered company shall be capable of exercising all the functions of an incorporated company under this Act and having perpetual succession 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.

From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators; and there comes into existence a binding contract between the company and its members as evidenced by the Memorandum and Articles of Association [*Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjunwala*]. It has perpetual existence until it is dissolved by liquidation or struck out of the register. A shareholder who buys shares, does not buy any interest in the property of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.

A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the

legal person begins to function as an entity. A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members **[State Trading Corporation of India vs. Commercial Tax Officer]**.

It may be noted that under the provisions of the Act, a company may purchase shares of another company and thus become a controlling company. However, merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company and each company is a separate juristic entity **[Spencer & Co. Ltd. Madras vs. CWT Madras]**.

As has been stated above, the law recognizes such a company as a juristic person separate and distinct from its members. The mere fact that the entire share capital has been contributed by the Central Government and all its shares are held by the President of India and other officers of the Central Government does not make any difference in the position of registered company and it does not make a company an agent either of the President or the Central Government **[Heavy Electrical Union vs. State of Bihar]**.

**EFFECT OF MEMORANDUM AND ARTICLES:** As per Section 10 of the Companies Act, 2013, where the memorandum and articles when registered, shall 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 an agreement to observe all the provisions of the memorandum and of the articles. All monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.



## 5. CLASSIFICATION OF CAPITAL

The term Capital has a variety of meanings. It means one thing to economists; another to accountants and still another to businessmen and lawyers. In relation to a company limited by shares, the word capital means share-capital, i.e., the capital or figure in terms of so many rupees divided into shares of fixed amount. In other words, the contributions of persons to the common stock of the company form the capital of the company. The proportion of the capital to which each member is entitled, is his share. A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.

In the domain of Company Law, the term 'capital' is used in the following senses:

- (a) **Nominal or authorised or registered capital:** This form of capital has been defined in section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. Thus, it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the

maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty. It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

- (b) **Issued capital:** Section 2(50) of the Companies Act, 2013 defines “issued capital” which means such capital as the company issues from time to time for subscription. It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.

Schedule III to the Companies Act, 2013, makes it obligatory for a company to disclose its issued capital in the balance sheet.

- (c) **Subscribed capital:** Section 2(86) of the Companies Act, 2013 defines “subscribed capital” as such part of the capital which is for the time being subscribed by the members of a company.

It is the nominal amount of shares taken up by the public. Where any notice, advertisement or other official communication or any business letter, bill head or letter paper of a company states the authorised capital, the subscribed and paid-up capital must also be stated in equally conspicuous characters. A default in this regard will make the company and every officer who is in default liable to pay penalty extending ₹ 10,000 and ₹ 5,000 respectively. [Section 60].

- (d) **Called-up capital:** Section 2(15) of the Companies Act, 2013 defines “called-up capital” as such part of the capital, which has been called for payment. It is the total amount called up on the shares issued.

- (e) **Paid-up capital** is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

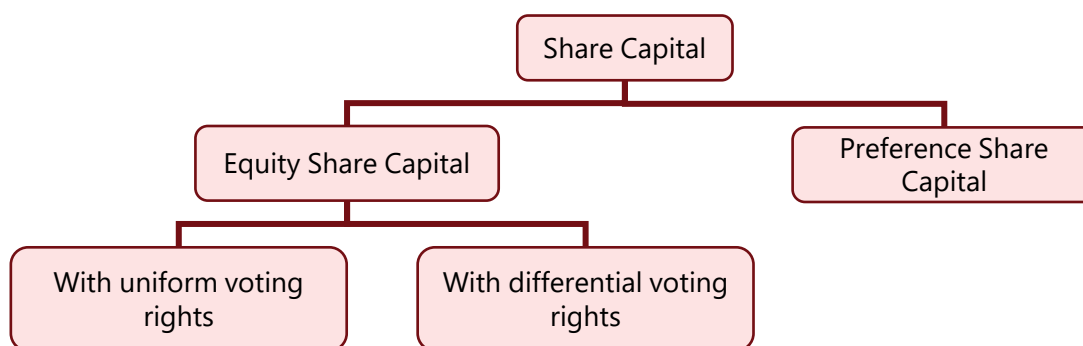
## 6. SHARES

- (I) **Nature of shares:** Section 2(84) of the Companies Act, 2013 defines the term ‘share’ which means a share in the share capital of a company and includes stock. A share thus represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company. It is a measure of the interest in the company’s assets to which a person holding a share is entitled.



**Share is an interest in the company:** Farwell Justice, in *Borland Trustees vs. Steel Bors. & Co. Ltd.* observed that “a share is not a sum of money but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a

sum of money of a more or less amount". You should note that the shareholders are not, in the eyes of law, part owners of the undertaking. The undertaking is somewhat different from the totality of the shareholders. The rights and obligations attaching to a share are those prescribed by the memorandum and the articles of a company. It must, however, be remembered that a shareholder has not only contractual rights against the company, but also certain other rights which accrue to him according to the provisions of the Companies Act.



**Shares are a movable property:** According to section 44 of the Companies Act, 2013, the shares or debentures or other interests of any member in a company shall be movable property transferable in the manner provided by the articles of the company.

**Shares shall be numbered:** Section 45 provides, every share in a company having a share capital, shall be distinguished by its distinctive number. This implies that every share shall be numbered.

However, this shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

**(II) Kinds of share capital:-** Section 43 of the Companies Act, 2013 provides the kinds of share capital. According to the provision the share capital of a company limited by shares shall be of two kinds, namely:—

**(i) Equity share capital —**

- (1) with voting rights; or
- (2) with differential rights as to dividend, voting or otherwise in accordance with prescribed rules;

**Example 6:** It is to be noted that, Tata Motors in 2008 introduced equity shares with differential voting rights called 'A' equity shares in its rights issue. In the issue, every 10 'A' equity shares carried only one voting right but would get 5 percentage points more dividend than that declared on each of the ordinary shares. Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common

shares having full voting. Other companies which have issued equity shares with differential voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others.

**(ii) Preference share capital:**

However, this Act shall not affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

**According to explanation to section 43:**

1. **“Equity share capital”**, with reference to any company limited by shares, means all share capital which is not preference share capital;
2. **“Preference share capital”**, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—
  - (a) **payment of dividend**, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
  - (b) **repayment**, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

**Exception:** In case of private company - Section 43 shall not apply where memorandum or articles of association of the private company so provides.



## 7. MEMORANDUM OF ASSOCIATION

The Memorandum of Association of company is in fact its charter; it defines its constitution and the scope of the powers of the company with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

**Object of registering a memorandum of association:**

- ◆ It contains the object for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go.
- ◆ It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities it can engage in.

A memorandum is a public document under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.

- ◆ The shareholders must know the purposes for which his money can be used by the company and what risks he is taking in making the investment.

A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum. If it does so, it would be ultra vires the company and void.

**As per Section 4, Memorandum of a company shall be drawn up in such form as is given in Tables A, B, C, D and E in Schedule I of the Companies Act, 2013.**

**Table A** is a form for memorandum of association of a company limited by shares.

**Table B** is a form for memorandum of association of a company limited by guarantee and not having a share capital.

**Table C** is a form for memorandum of association of a company limited by guarantee and having a share capital.

**Table D** is a form for memorandum of association of an unlimited company.

**Table E** is a form for memorandum of association of an unlimited company and having share capital.

The memorandum and articles of a company must be as close to model forms, as possible, depending upon the circumstances.

**Content of the memorandum:** The memorandum of a company shall state—

- (a) the name of the company (**Name Clause**) with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act.

The name including phrase 'Electoral Trust' may be allowed for Registration of companies to be formed under section 8 of the Act, in accordance with the Electoral Trusts Scheme, 2013 notified by the Central Board of Direct Taxes (CBDT). For the Companies under section 8 of the Act, the name shall include the words foundation, Forum, Association, Federation, Chambers, Confederation, council, Electoral trust and the like etc. [*The Companies (Incorporation) Rules, 2014*].

As per MCA notification dated 5th June, 2015, a Government company's name must end with the word "Limited". In the case of One Person Company, the words "One Person Company", should be included below its name.

- (b) the State in which the registered office of the company (**Registered Office clause**) is to be situated;
- (c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof (**Object clause**);

If any company has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities after complying with all the provisions as applicable to change of name.

- (d) the liability of members of the company (**Liability clause**), whether limited or unlimited, and also state,—

- **in the case of a company limited by shares**, that the liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
- **in the case of a company limited by guarantee**, the amount up to which each member undertakes to contribute—
  - to the **assets of the company in the event of its being wound-up** while he is a member or within one year after he ceases to be a member for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
  - to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

- (e) the amount of authorized capital (**Capital Clause**) divided into share of fixed amounts and the number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.
- (f) the detail of the subscribers to be formed into a company. The Memorandum shall conclude with the **association clause**. Every subscriber to the Memorandum shall take atleast one share, and shall write against his name, the number of shares taken by him.

In the case of OPC, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

The memorandum must be printed, divided into paragraphs, numbered consecutively, and signed by at least seven persons (two in the case of a private company and one in the case of



One Person Company) in the presence of at least one witness, who will attest the signatures. The particulars about the signatories to the memorandum as well as the witness, as to their address, description, occupation etc., must also be entered.

**It is to be noted that a company being a legal person can through its agent, subscribe to the memorandum. However, a minor cannot be a signatory to the memorandum as he is not competent to contract. The guardian of a minor, who subscribes to the memorandum on his behalf, will be deemed to have subscribed in his personal capacity.**

The above clauses of the Memorandum are called compulsory clauses, or "Conditions". In addition to these a memorandum may contain other provisions, for example rights attached to various classes of shares.

The Memorandum of Association of a company cannot contain anything contrary to the provisions of the Companies Act. If it does, the same shall be devoid of any legal effect. Similarly, all other documents of the company must comply with the provisions of the Memorandum.



## 8. DOCTRINE OF ULTRA VIRES

**Doctrine of ultra vires:** The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "*ultra vires*" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers in their nature are limited.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act, thus far and no further. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is ultra vires the company, you cannot enforce it against the company.

**Example 7:** If you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by

means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company, then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company. Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

The leading case through which this doctrine was enunciated is that of ***Ashbury Railway Carriage and Iron Company Limited v. Riche-(1875)***.

The facts of the case are:

The main objects of a company were:

- (a) To make, sell or lend on hire, railway carriages and wagons;
- (b) To carry on the business of mechanical engineers and general contractors.
- (c) To purchase, lease, sell and work mines.
- (d) To purchase and sell as merchants or agents, coal, timber, metals etc.

The directors of the company entered into a contract with Riche, for financing the construction of a railway line in Belgium, and the company further ratified this act of the directors by passing a special resolution. The company however, repudiated the contract as being ultra-vires. And Riche brought an action for damages for breach of contract. His contention was that the contract was well within the meaning of the word general contractors and hence within its powers. Moreover, it had been ratified by a majority of shareholders. However, it was held by the Court that the contract was null and void. It said that the terms general contractors was associated with mechanical engineers, i.e. it had to be read in connection with the company's main business. If, the term general contractor's was not so interpreted, it would authorize the making of contracts of any kind and every description, for example, marine and fire insurance.

***An ultra vires contract can never be made binding on the company. It cannot become "Intravires" by reasons of estoppel, acquiescence, lapse of time, delay or ratification.***

**The whole position regarding the doctrine of ultra vires can be summed up as:**

- (i) When an act is performed, which though legal in itself, is not authorized by the object clause of the memorandum, or by the statute, it is said to be ultravires the company, and hence null and void.
- (ii) An act which is ultravires, the company cannot be ratified even by the unanimous consent of all the shareholders.
- (iii) An act which is ultravires the directors, but intravires the company can be ratified by the members of the company through a resolution passed at a general meeting.
- (iv) If an act is ultravires the Articles, it can be ratified by altering the Articles by a Special Resolution at a general meeting.

**However, the disadvantages of this doctrine outweigh its main advantage, namely to provide protection to the shareholders and creditors.** Although it may be useful to members in restraining the activities of the directors, **it is only a nuisance in so far as it prevents the company from changing its activities in a direction which is agreed by all.** Again, the purpose of doctrine of ultravires has been defeated as now the object clause can be easily altered, by passing just a special resolution of the shareholders.



## 9. ARTICLES OF ASSOCIATION

The articles of association of a company are its rules and regulations, which are framed to manage its internal affairs. Just as the memorandum contains the fundamental conditions upon which the company is allowed to be incorporated, so also the articles are the internal regulations of the company (***Guinness vs. Land Corporation of Ireland***). These general functions of the articles have been aptly summed up by Lord Cairns in ***Ashbury Carriage Co. vs. Riche*** as follows: "The articles play a part subsidiary to memorandum of association. They accept the memorandum as the charter of incorporation, and so accepting it the articles proceed to define the duties, the rights and powers of the governing body as between themselves and the company and the mode and form in which the business of the company is to be carried on, and the mode and form in which changes in the internal regulation of the company may from time to time be made."

The document containing the articles of association of a company (the Magna Carta) is a business document; hence it has to be construed strictly. It regulates domestic management of a company and creates certain rights and obligations between the members and the company [***S.S. Rajkumar vs. Perfect Castings (P) Ltd.***].

The articles of association are in fact the bye-laws of the company according to which director and other officers are required to perform their functions as regards the management of the

company, its accounts and audit. It is important therefore that the auditor should study them and, while doing so he should note the provisions therein in respect of relevant matters.

**Section 5 of the Companies Act, 2013 seeks to provide the contents and model of articles of association. The section lays** the following law-

- (1) **Contains regulations:** The articles of a company shall contain the regulations for management of the company.
- (2) **Inclusion of matters:** The articles shall also contain such matters, as are prescribed under the rules. However, a company may also include such additional matters in its articles as may be considered necessary for its management.
- (3) **Contain provisions for entrenchment:** The articles may contain provisions for entrenchment (to protect something) to the effect that specified provisions of the articles may be altered only if conditions or procedures as that are more restrictive than those applicable in the case of a special resolution, are met or complied with.
- (4) **Manner of inclusion of the entrenchment provision:** The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.
- (5) **Notice to the registrar of the entrenchment provision:** Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.
- (6) **Forms of articles:** The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.
- (7) **Model articles:** A company may adopt all or any of the regulations contained in the model articles applicable to such company.
- (8) **Company registered after the commencement of this Act:** In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

**The following are the key differences between the Memorandum of Association vs. Articles of Association:**

1. **Objectives:** Memorandum of Association defines and delimits the objectives of the company whereas the Articles of association lays down the rules and regulations for

the internal management of the company. Articles determine how the objectives of the company are to be achieved.

2. **Relationship:** Memorandum defines the relationship of the company with the outside world and Articles define the relationship between the company and its members.
3. **Alteration:** Memorandum of association can be altered only under certain circumstances and in the manner provided for in the Act. In most cases permission of the Regional Director, or the Tribunal is required. The articles can be altered simply by passing a special resolution.
4. **Ultra Vires:** Acts done by the company beyond the scope of the memorandum are ultra-vires and void. These cannot be ratified even by the unanimous consent of all the shareholders. The acts ultra-vires the articles can be ratified by a special resolution of the shareholders, provided they are not beyond the provisions of the memorandum.



## 10. DOCTRINE OF INDOOR MANAGEMENT

**Doctrine of Constructive Notice:** Section 399 of the Companies Act, 2013 provides that any person can inspect by electronic means any document kept by the Registrar, or make a record of the same, or get a copy or extracts of any document, including certificate of incorporation of any company, on payment of prescribed fees.

The memorandum and articles of association of a company when registered with Registrar of Companies, become public documents, and they are available for inspection to any person, on the payment of a nominal fees. In other words, Section 399 confers the right of inspection to all. It is therefore, the duty of every person dealing with a company to inspect its documents and make sure that his contract is in conformity with their provisions but whether a person reads them or not, it will be presumed that he knows the contents of the documents. This kind of presumed/implied notice is called constructive notice.

### By constructive notice is meant:

- (i) Whether a person reads the documents or not, he is presumed to have knowledge of the contents of the documents. He is not only presumed to have read the documents but also understood them in their true perspective, and
- (ii) Every person dealing with the company not only has the constructive notice of the memorandum and articles, but also of all the other related documents, such as Special Resolutions etc., which are required to be registered with the Registrar.

Thus, if a person enters into a contract which is beyond the powers of the company as defined in the memorandum, or outside the authority of directors as per memorandum or articles, he cannot acquire any rights under the contract against the company.

**Doctrine of Indoor Management:** The Doctrine of Indoor Management is the exception to the doctrine of constructive notice. The aforesaid doctrine of constructive notice ***does in no sense mean that outsiders are deemed to have notice of the internal affairs of the company.*** For instance, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed. This can be explained with the help of a landmark case ***The Royal British Bank vs. Turquand.*** This is the doctrine of indoor management popularly known as ***Turquand Rule.***

***FACTS of the Royal British Bank vs. Turquand***

Mr. Turquand was the official manager (liquidator) of the insolvent Cameron's Coalbrook Steam, Coal and Swansea and Loughor Railway Company. It was incorporated under the Joint Stock Companies Act, 1844. The company had given a bond for £ 2,000 to the Royal British Bank, which secured the company's drawings on its current account. The bond was under the company's seal, signed by two directors and the secretary. When the company was sued, it alleged that under its registered deed of settlement (the articles of association), directors only had power to borrow up to an amount authorized by a company resolution. A resolution had been passed but not specifying how much the directors could borrow.

**Held, it was decided** that the bond was valid, so the Royal British Bank could enforce the terms. He said the bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed. Articles of association were registered with Companies House, so there was constructive notice. But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable. The bond was valid because there was no requirement to look into the company's internal workings. This is the indoor management rule, that the company's indoor affairs are the company's problem.

**Exceptions to the doctrine of Indoor Management:** Thus, you will notice that the aforementioned rule of Indoor Management is important to persons dealing with a company through its directors or other persons. They are entitled to assume that the acts of the directors or other officers of the company are validly performed, if they are within the scope of their apparent authority. So long as an act is valid under the articles, if done in a particular manner, an outsider dealing with the company is entitled to assume that it has been done in the manner required.

The above-mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

- (a) **Actual or constructive knowledge of irregularity:** The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

In **Howard vs. Patent Ivory Manufacturing Co.** where the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

Likewise, in **Morris v Kansseen**, a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

- (b) **Suspicion of Irregularity:** The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

The protection of the "Turquand Rule" is also not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. Suspicion should arise, for example, from the fact that an officer is purporting to act in matter, which is apparently outside the scope of his authority. Where, for example, as in the case of **Anand Bihari Lal vs. Dinshaw & Co.** the plaintiff accepted a transfer of a company's property from its accountant, the transfer was held void. The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property.

Similarly, in the case of **Haughton & Co. v. Nothard, Lowe & Wills Ltd.** where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said that it was something so unusual "that the plaintiff were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it." Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf."

- (c) **Forgery:** The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

Forgery may in circumstances exclude the '**Turquand Rule**'. The only clear illustration is found in the **Ruben v Great Fingall Consolidated**. In this case the plaintiff was the transferee of a share certificate issued under the seal of the defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.

The plaintiff contended that whether the signature were genuine or forged was apart of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

## SUMMARY

### Company

- ♦ An artificial person created under the Companies Act, 2013 with distinct characteristics of separate legal entity and perpetual succession.
- ♦ The capital of the company is divided into transferable shares and shareholders called as members because their name is entered into the Register of members.
- ♦ The member of the company generally has limited liability upto the extent of unpaid nominal value of shares held by him.

### Corporate veil theory

- ♦ *Saloman vs. Saloman & Co. Ltd.* laid that company is a juristic person different and separate from its members.
- ♦ Under certain situations the courts may lift the corporate veil/ veil of incorporation and thus disregard the separate legal entity of the company. This is called lifting the corporate veil.

### Incorporation of company

- ♦ A company is said to come into existence only after its registration and issue of Certificate of Incorporation.
- ♦ The company to be incorporated must be validly constituted and be an association for a lawful purpose. After all the formalities are compiled and the Registrar is satisfied, the company is registered under the Act.
- ♦ On registration the Registrar shall issue a Certificate of Incorporation to the company.
- ♦ To provide an integrated process of incorporation, the MCA has introduced SPICe for simplifying the filing of forms.

### Effect of registration

- ♦ From the date of incorporation the company becomes a legal person by the name contained in the Memorandum and capable of exercising all the functions of an incorporated company.



- ♦ The issue of Certificate of Incorporation is considered as conclusive evidence as to compliance of all the legal formalities in respect of registration of company.

### Capital

- ♦ **Nominal or authorized share capital:** Authorized by memorandum to be the maximum amount of share capital
- ♦ **Issued share capital:** That part of authorized capital which is offered by the company for subscription.
- ♦ **Subscribed share capital:** Such part of the capital which is for the time being subscribed by the members of a company.
- ♦ **Called up capital:** Such part of the capital that has been called for payment.
- ♦ **Paid up capital:** It is the total amount paid or credited as paid up on shares issued.  
Paid up capital = Called up capital – calls in arrears.

### Share Capital

- ♦ **Equity share capital:** with reference to any company limited by shares, means all share capital which is not preference share capital.
- ♦ **Preference share capital:** with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to— payment of dividend and repayment.

### Memorandum of Association

- ♦ It is known as charter of the company.
- ♦ It is fundamental document of a company containing the fundamental conditions upon which a company is to be incorporated.
- ♦ It lays object and scope of activities and limitations on the power of a company beyond which the company cannot go.
- ♦ Any act done or contracts made by a company which are beyond the express or implied scope of its memorandum, are said to be null and void. This is termed as doctrine of ultra vires.
- ♦ The conditions and the provisions of the memorandum can be altered to the extent and in the manner provided by the Act which allows alterations by special resolution and confirmation by Central Government/Registrar of Companies.

### Article of Association

- ♦ Document containing rules, regulations or bye-laws of a company.
- ♦ It lays down the form in which the business of the company is to be carried on.

- ◆ It also lays down the powers of directors and officers of the company and thus forming the basis of a contract between the company and the members and between the members Inter se (among themselves).
- ◆ Every company have an absolute power to alter its Articles of Association by a special resolution subject to the provisions of the Act and conditions of the memorandum of the company.

### Doctrine of Constructive Notice

- ◆ As memorandum and article is a public document so it is considered that every person dealing with the company is deemed to have notice of the contents of memorandum and articles of the company.
- ◆ It is presumed that person have not only read these documents but have also understood their proper meaning.

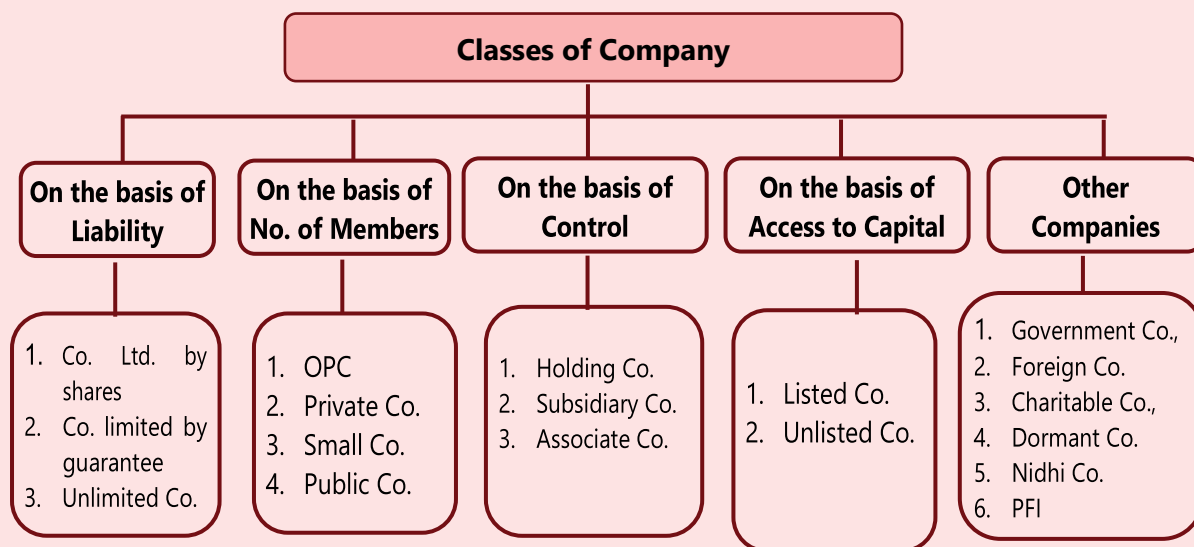
### Doctrine of Indoor Management/ Turquand Rule

- ◆ This is an exception to doctrine of Constructive Notice.
- ◆ This protects the outsiders against the company, who acts in good faith.
- ◆ It says that person who deals with the company are not bound to enquire into the regularity of the internal procedure of the company. They assume that everything is done in accordance with the procedure laid down in the article of the company and thus not affecting adversely the rights of the dealing parties in any way by irregularity of the internal procedure.

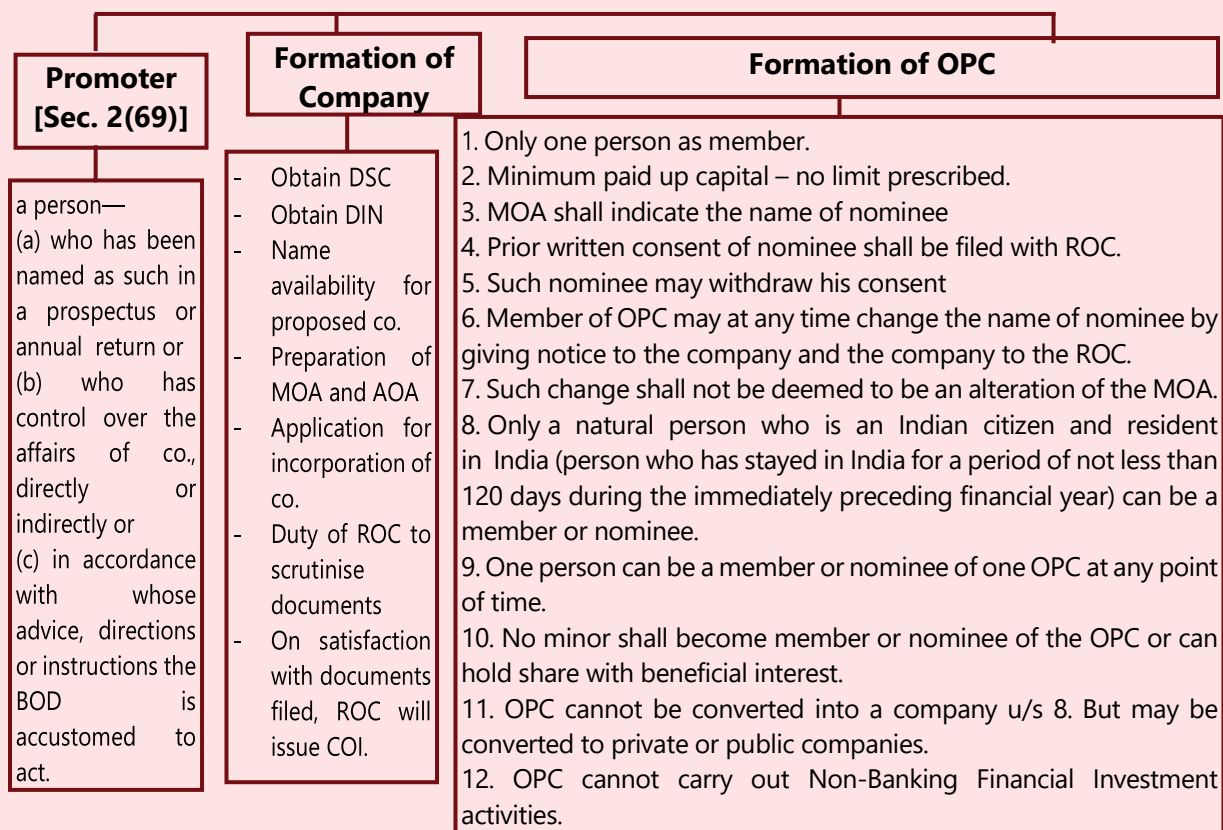
## COMPANIES ACT, 2013

### Company – Definition, Characteristics & Corporate Veil

<p><b><u>Section 2(20)</u></b>  <b>Company</b> means a company incorporated under this Act or under any previous company law.  <b><u>Chief Justice Marshall</u></b>  A company is an artificial being, invisible, intangible and existing only in the contemplation of law.  <b><u>Professor Haney</u></b>  Company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.</p>	<p><b><u>Characteristics</u></b></p> <ol style="list-style-type: none"> <li>1. Separate Legal Entity</li> <li>2. Perpetual Succession</li> <li>3. Limited Liability of members</li> <li>4. Common Seal - official signature of co.</li> <li>5. Artificial Legal Person</li> </ol>	<p><b><u>Corporate Veil</u></b>  Means the company is identified separately from the members of the company.  <b><u>Lifting Of Corporate Veil</u></b>  Means ignoring legal entity of the company. Following are the circumstances-  a) Trading with Enemy  b) Protection of Revenue  c) To avoid a legal obligation  d) Formation of subsidiaries to act as agent  e) Prevention of Fraud or Improper Conduct</p>
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### Mode of Registration / Incorporation of Company



### Share & Share Capital Company

#### Classification

- (a) **Authorized capital**- Capital authorized by MOA to be maximum capital of company.  
 (b) **Issued capital**: Capital issued for subscription;  
 (c) **Subscribed capital**- Capital subscribed by members of company  
 (d) **Called up capital**- Capital called for payment.  
 (e) **Paid up share capital**- Aggregate amount of money credited as paid on shares issued not including any other amount received in respect of such shares.

#### Shares [Section 2(84)]

**Share**- means a share in the share capital of a company and includes stock.

**Numbering of shares**- Every share in a company having a share capital shall be distinguished by its distinctive number.

**Shares are a movable property** transferable in the manner provided by the articles of the company.

#### Kinds of share capital

- (i) **Equity share capital** —  
 (1) with voting rights; or  
 (2) with differential rights as to dividend, voting or otherwise in accordance with prescribed rules;  
 (ii) **“Preference share capital”**, part of the issued share capital of the company which carries or would carry a preferential right with respect to—  
 (a) **payment of dividend**, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and  
 (b) **repayment**, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up.

### Memorandum of Association

MOA of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act

#### Object of registering MOA

1. It contains objects of Co.
2. It shows co.'s powers.
3. Every person dealing with company is presumed to have knowledge of MOA.
4. Shareholders know for what his money is used

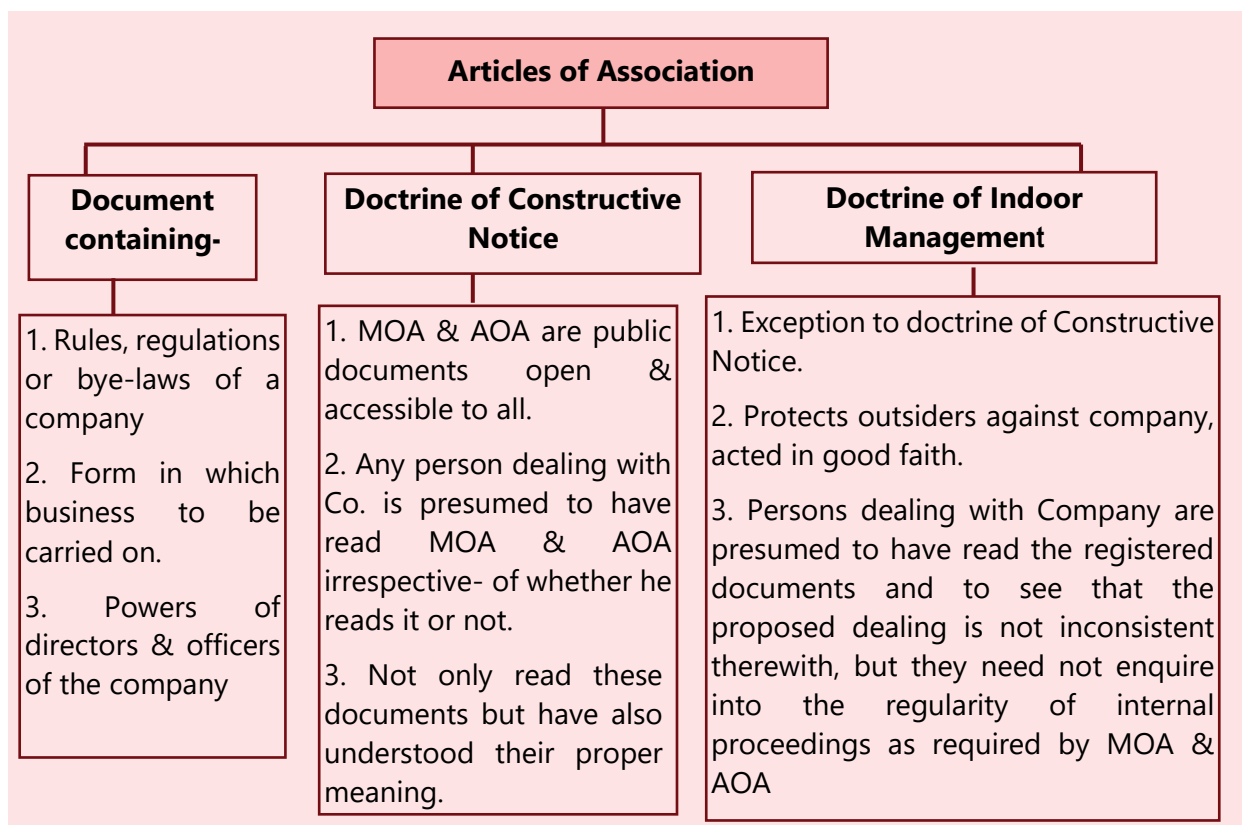
#### Contents of MOA

1. Name Clause
2. Registered Office Clause
3. Object Clause
4. Liability Clause
5. Capital Clause (Authorised Capital)
6. Nomination Clause (OPC)

#### Doctrine of Ultravires

**Ultra means 'beyond' Vires means 'powers'**

1. When an act beyond object clause of MOA is ultravires the company and null and void.
2. Ultravires act cannot be ratified even by unanimous consent of all the shareholders.
3. Act ultravires the directors, but Intravires Company, shareholders may ratify it.
4. Act ultravires the AOA, can be ratified by altering AOA.



## TEST YOUR KNOWLEDGE

### Multiple Choice Questions

1. *Maximum number of members under a private company as provided under the Companies Act, 2013.*
  - (a) 50
  - (b) 150
  - (c) 200
  - (d) No limit
2. *Document that regulates the management of internal affairs of a company are-*
  - (a) Memorandum of Association
  - (b) Prospectus
  - (c) Articles of Association
  - (d) Certificate of incorporation

3. *Under the Companies Act, 2013, "Significant influence" constitutes how much % of total share capital or of business decisions under an agreement?*
  - (a) *At least 2%*
  - (b) *At least 2.5%*
  - (c) *At least 10%*
  - (d) *At least 20%*
4. *A Private Company which is subsidiary of a Public Company is treated as-*
  - (a) *Public Company*
  - (b) *Private Company*
  - (c) *Holding Company*
  - (d) *Dormant Company*
5. *Which one of the following is not the content of the Memorandum of Association?*
  - (a) *Name clause*
  - (b) *Registered office clause*
  - (c) *Objects clause*
  - (d) *Board of Directors clause.*
6. *An Act is said to be ultra vires a company when it is beyond the powers.*
  - (a) *Of the Company*
  - (b) *Of the Directors*
  - (c) *Of the Directors but not the company*
  - (d) *Conferred on the company by the Articles of Association.*
7. *Turquand Rule is related to:*
  - (a) *Doctrine of ultra vires*
  - (b) *Doctrine of constructive notice*
  - (c) *Doctrine of indoor management*
  - (d) *Doctrine of subrogation*
8. *The minimum number of members in a private company and public company are*
  - (a) *Three and Seven respectively*
  - (b) *Two and seven respectively*

- (c) *Two and nine respectively*
  - (d) *None of the above*
9. *Only a natural person who is an Indian citizen and who has stayed in India for a period of at least \_\_\_\_ days during the immediately preceding financial year shall be eligible to incorporate an OPC.*
- (a) *180 days*
  - (b) *181 days*
  - (c) *120 days*
  - (d) *183 days*
10. *XYZ Limited is having 15% share capital held by X Limited and 50% held by Central Government and 10% held by State Government and 25% held by other people then that company will be \_\_\_\_\_ .*
- (a) *Government Company*
  - (b) *Private Company*
  - (c) *Public Company*
  - (d) *Dormant company*
11. *The Doctrine of indoor management is a protection that is available to:*
- (a) *Shareholders*
  - (b) *Outsiders who deal with the company*
  - (c) *Board of Directors*
  - (d) *Creditors*
12. *The doctrine which advocates the fact that company cannot act beyond the scope of its memorandum of association is:*
- (a) *Doctrine of constructive notice*
  - (b) *Doctrine of indoor management*
  - (c) *Doctrine of ultra vires*
  - (d) *Doctrine of intra vires*

### Descriptive Questions

1. *What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital.*
2. *Can a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt?*
3. *Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company?*
4. *Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 2013. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'.*
5. *A, an assessee, had large income in the form of dividend and interest. In order to reduce his tax liability, he formed four private limited company and transferred his investments to them in exchange of their shares. The income earned by the companies was taken back by him as pretended loan. Can A be regarded as separate from the private limited company he formed?*
6. *Sound Syndicate Ltd., a public company, its articles of association empowers the managing agents to borrow both short and long term loans on behalf of the company, Mr. Liddle, the director of the company, approached Easy Finance Ltd., a non banking finance company for a loan of ₹ 25,00,000 in name of the company.*

*The Lender agreed and provided the above said loan. Later on, Sound Syndicate Ltd. refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and the lender should have enquired about the same prior providing such loan hence company not liable to pay such loan.*

*Analyse the above situation in terms of the provisions of Doctrine of Indoor Management under the Companies Act, 2013 and examine whether the contention of Sound Syndicate Ltd. is correct or not?*
7. *Examine the following whether they are correct or incorrect along with reasons:*
  - (a) *A company being an artificial person cannot own property and cannot sue or be sued.*
  - (b) *A private limited company must have a minimum of two members, while a public limited company must have at least seven members.*
8. *Mike Limited is incorporated in India having Liaison office at Singapore. Explain in detail meaning of Foreign Company and analysis on whether Mike Limited would be called as*



*Foreign Company as it established a Liaison office at Singapore as per the provisions of the Companies Act, 2013?*

9. *ABC Limited has allotted equity shares with voting rights to XYZ Limited worth ₹ 15 Crores during the Financial Year 2023-24. After that the total Paid-up Equity Share Capital of ABC Limited is ₹ 100 Crores.*

*Define the Meaning of Associate Company and comment on whether ABC Limited and XYZ Limited would be called Associate Company as per the provisions of the Companies Act, 2013?*

## ANSWERS/HINTS

### Answers to MCQs

1.	(c)	2.	(c)	3.	(d)	4.	(a)	5.	(d)	6.	(a)
7.	(c)	8.	(b)	9.	(c)	10.	(a)	11.	(b)	12.	(c)

### Answer to Descriptive Questions

1. **Company limited by guarantee:** Section 2(21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited upto a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

#### **Similarities and dis-similarities between the Guarantee Company and the Company having share capital:**

The common features between a 'guarantee company' and 'share company' are legal personality and limited liability. In the latter case, the member's liability is limited by the amount remaining unpaid on the share, which each member holds. Both of them have to state in their memorandum that the members' liability is limited.

However, the point of distinction between these two types of companies is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in the latter case, they may be called upon to do so at any time, either during the company's life-time or during its winding up.

2. Yes, a non-profit organization can be registered as a company under the Companies Act, 2013 by following the provisions of section 8 of the Companies Act, 2013. Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to
- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.
  - Such company intends to apply its profit in
  - promoting its objects and
  - prohibiting the payment of any dividend to its members.

The Central Government has the power to issue license for registering a section 8 company.

- (i) Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.
  - (ii) The registrar shall on application register such person or association of persons as a company under this section.
  - (iii) On registration the company shall enjoy same privileges and obligations as of a limited company.
3. **Doctrine of ultra vires:** The meaning of the term ultra vires is simply "beyond (their) powers". The legal phrase "ultra vires" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [**Ashbury Railway Company Ltd. vs. Riche**]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter

into a transaction which is ultra vires the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is ultra vires the company. As the lender remains the owner, he can take back the property in specie. If the ultra vires loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is ultra vires the company being void, cannot be ratified by the shareholders of the company. Sometimes, act which is ultra vires can be regularised by ratifying it subsequently. For instance, if the act is ultra vires the power of the directors, the shareholders can ratify it; if it is ultra vires the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

4. **Doctrine of Indoor Management (the Companies Act, 2013):** According to the “doctrine of indoor management” the outsiders, dealing with the company though are supposed to have satisfied themselves regarding the competence of the company to enter into the proposed contracts are also entitled to assume that as far as the internal compliance to procedures and regulations by the company is concerned, everything has been done properly. They are bound to examine the registered documents of the company and ensure that the proposed dealing is not inconsistent therewith, but they are not bound to do more. They are fully entitled to presume regularity and compliance by the company with the internal procedures as required by the Memorandum and the Articles. This doctrine is a limitation of the doctrine of “constructive notice” and popularly known as the rule laid down in the celebrated case of **Royal British Bank v. Turquand**. Thus, the doctrine of indoor management aims to protect outsiders against the company.

The above mentioned doctrine of Indoor Management or Turquand Rule has limitations of its own. That is to say, it is inapplicable to the following cases, namely:

- (a) **Actual or constructive knowledge of irregularity:** The rule does not protect any person when the person dealing with the company has notice, whether actual or constructive, of the irregularity.

In **Howard vs. Patent Ivory Manufacturing Co.** where the directors could not defend the issue of debentures to themselves because they should have known

that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained.

Likewise, in ***Morris v Kansseen***, a director could not defend an allotment of shares to him as he participated in the meeting, which made the allotment. His appointment as a director also fell through because none of the directors appointed him was validly in office.

- (b) **Suspicion of Irregularity:** The doctrine in no way, rewards those who behave negligently. Where the person dealing with the company is put upon an inquiry, for example, where the transaction is unusual or not in the ordinary course of business, it is the duty of the outsider to make the necessary enquiry.

The protection of the "Turquand Rule" is also not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. Suspicion should arise, for example, from the fact that an officer is purporting to act in matter, which is apparently outside the scope of his authority. Where, for example, as in the case of ***Anand Bihari Lal vs. Dinshaw & Co.*** the plaintiff accepted a transfer of a company's property from its accountant, the transfer was held void. The plaintiff could not have supposed, in absence of a power of attorney that the accountant had authority to effect transfer of the company's property.

Similarly, in the case of ***Haughton & Co. v. Nothard, Lowe & Wills Ltd.*** where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt to other, the court said that it was something so unusual "that the plaintiff were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it." Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf."

- (c) **Forgery:** The doctrine of indoor management applies only to irregularities which might otherwise affect a transaction but it cannot apply to forgery which must be regarded as nullity.

Forgery may in circumstances exclude the 'Turquand Rule'. The only clear illustration is found in the ***Ruben v Great Fingall Consolidated***. In this case the plaintiff was the transferee of a share certificate issued under the seal of the

defendant's company. The company's secretary, who had affixed the seal of the company and forged the signature of the two directors, issued the certificate.

The plaintiff contended that whether the signature were genuine or forged was apart of the internal management, and therefore, the company should be estopped from denying genuineness of the document. But it was held, that the rule has never been extended to cover such a complete forgery.

5. The House of Lords in *Salomon Vs Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company. But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate façade and hold the persons in control of the management of its affairs liable for the acts of the company. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assessee.

In *Dinshaw Maneckjee Petit* case it was held that the company was not a genuine company at all but merely the assessee himself disguised that the legal entity of a limited company. The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan. The court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.

In the instant case, the four private limited companies were formed by A, the assessee, purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assessee himself. Therefore, the whole idea of Mr. A was simply to split his income into four parts with a view to evade tax. No other business was done by the company.

Hence, A cannot be regarded as separate from the private limited companies he formed.

## 6. Doctrine of Indoor Management

According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

Thus,

1. What happens internal to a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but do not know the information he/she is not privy to.
2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

In the given question, Easy Finance Ltd. being external to the company, need not enquire whether the necessary resolution was passed properly. Even if the company claim that no resolution authorizing the loan was passed, the company is bound to pay the loan to Easy Finance Ltd.

**7. (a) A company being an artificial person cannot own property and cannot sue or be sued**

**Incorrect:** A company is an artificial person as it is created by a process other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual.

Further, the company being a separate legal entity can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. It can sue and be sued in its own name. It can do everything which any natural person can do except be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.

**(b) A private limited company must have a minimum of two members, while a public limited company must have at least seven members.**

**Correct:** Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the

requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a private company.

**8. Foreign Company [Section 2(42) of the Companies Act, 2013]:** It means any company or body corporate incorporated outside India which—

- (i) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (ii) conducts any business activity in India in any other manner.

Since Mike Limited is a company incorporated in India, hence, it cannot be called as a foreign company. Even though, Liaison Office was officially established at Singapore, it would not be called as a foreign company as per the provisions of the Companies Act, 2013.

**9.** As per Section 2(6) of the Companies Act, 2013, an Associate Company in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

The term “significant influence” means control of at least 20% of total voting power, or control of or participation in business decisions under an agreement.

In the given case, ABC Ltd. has allotted equity shares with voting rights to XYZ Limited of ₹ 15 crore, which is less than requisite control of 20% of total share capital (i.e. ₹ 100 crore) to have a significant influence of XYZ Ltd. Since the said requirement is not complied therefore ABC Ltd. and XYZ Ltd. are not associate companies as per the Companies Act, 2013.

