INDIAN COMPANIES ACT, 1956

Most Important Features of a Company (Indian Companies Act, 1956)

Following are the broad features of a company:

1. Incorporated Association:

Company is an incorporated association of persons created by the law of the country. In India companies are formed and registered under the Companies Act 1956. Incorporation of a company requires registration of formal documents with the Registrar of Companies.

Memorandum of Association is the important document which contains the fundamental conditions and purposes for which a company is formed. In fact, a company does not have its existence beyond its memorandum of association. The other important document is the Articles of Association which lay down the rules and regulations for governance of the company.

The ‘Registration Certificate’ or the ‘Certificate of Incorporation, grants a legal entity to a company enabling it to discharge functions such as entering into contract, purchasing, owning and holding of properties. A company may be held liable for breach of law. It can sue and be sued in its name.

2. Independent Legal Entity:

A company has a legal entity distinct and separate from its constituent members (shareholders). It is an autonomous body, self-controlling and self-governing. It can hold and deal with any type of property of which it is the owner, in any way it likes. It can enter into contracts, open a bank account in its own name, sue and be sued by its members as well as outsiders.

The rights and obligations of a company are distinct from its constituent members. “Shareholders are not, in the eyes of the law, part owners of the undertaking. The undertaking is something different from the totality of the shareholders.” Shareholders cannot be held liable for the wrongs or misdeeds of the company.

A company has a nationality, domicile and residence but cannot ask for the enforcement of those fundamental rights which are exclusively available to national citizens. The nationality of the company, however, does not depend upon the nationality of its shareholders.

A company can enter into partnership with one or more individuals or another company. It can buy shares or debentures of another company. A company can form other companies by subscribing to their Memorandum of Association.

A director of a company can be the office bearer of the trade union of the workers of the same company. A shareholder, if qualified as a chartered accountant, can be the auditor of the same company.

A director or a managing director cannot be held personality liable for the payment of arrears of taxes or salaries of employees due by the company. A company can sue for libel or slander effecting its business reputation.

A company can be held liable for criminal acts. It can be held liable for breach of law and can be made to pay fine. However, no imprisonment of a company is possible. It can be charged with conspiracy to defraud or may be convicted of making use of false documents with intent to deceive. It can also be held liable for torts committed by its employees in the course of their employment.

On account of this independent corporate existence the creditors of a company are creditors of the company alone and their remedy lies against the company and its property only and not against any of its members. Law recognizes the existence of the company quite irrespective of the motives, intentions, scheme or conduct of the individual shareholders.

The principle of separate legal entity of the company was judicially recognized by the House of Lords in 1867 in the case of Oakes v. Turquand and Hording (1867). It was then held that since an incorporated company has a legal personality distinct from that of its members, a creditor of such a company has remedy only against the company and not against an individual shareholder.

Thus, a creditor of an incorporated company has remedy only against the company for his debts and not any of the members of whom it is composed. The position was further

clarified by the House of Lords in the famous case of Salomon v. Salomon & Co. Ltd.(1897) The facts of the case are as follows:

Mr. Salomon was the owner of a prosperous shoe business. He floated a company 'Salomon & Co. Ltd.' with only seven shareholders – himself, his wife, daughter and four sons. The newly formed company purchased the sole proprietorship business of Mr. Salomon for £ 40,000.

The purchase consideration was paid by the company by allotment of £ 20,000 shares and £ 10,000 debentures and the balance in cash to Mr. Salomon. The debentures carried a floating charge on the assets of the company.

The company went into liquidation within a year due to trade depression. On winding up, assets of the company were running short of its liabilities by £11,000. The unsecured creditors of the company contended that the company, though incorporated under the Act, had never an independent existence; it was in fact Salomon under the name of a company.

On this ground, the creditors claimed priority for the payment of their debts over the debenture-holders (Mr. Salomon). Debentures had a floating charge on the assets of the company.

The plea of the unsecured creditors that Mr. Salomon and Salomon & Co. are one and the same was not accepted by the court. It was held that the existence of a company is quite independent and distinct from its members. Shareholders may also be the creditors of the company. Court recognized the separate and independent personality of the company.

"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 before, the same persons are managers, and the same hands receive the profits, the company is not in law their agent or trustee.

There is nothing in the Act requiring that the subscribers to the Memorandum should be independent for unconnected, or that they or any of them should take a substantial interest in the undertaking, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of the company."

The concept of separate corporate entity was again confirmed in the case of Lee v. Lee's Air Farming Ltd. (1961).

Lee formed a company for the purpose of carrying on his own business of aerial top-dressing. He was the beneficial owner of the shares and also the sole "governing director" of the company.

He also got himself appointed as the chief pilot of the company and under statutory obligations caused the company to insure him against liability to pay compensation under the Workmen's compensation Act.

He was killed in a flying accident. In a suit by his widow for compensation, the Privy Council held that Lee and his company were distinct legal entities which had entered into contractual relationships under which he became, qua chief pilot, a servant of the company.

In his capacity of governing director, he could, on behalf of the company, give himself orders, in his other capacity of pilot, and hence the relationship between himself as pilot, and the company was that of a servant and master. In effect the magic of corporate personality enabled him to be a master and servant at the same time and to get all the advantages of both—and of limited liability.'

The Indian Courts have also unequivocally upheld the independent legal entity of a company in various cases, a few of which are cited below:

Re. Kondoli Tea Co. Ltd. (1886):

Some persons owned a tea estate. They transferred it to a company. They claimed exemption from ad valorem (according to value) duty on the ground that it is simply a transfer from them to themselves under a different name.

The court did not accept this contention and observed, "The Company was a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of property, as the shareholders had been totally different persons."

Abdul Haq v. Das Mai (1910):

Abdul Haq was an employee in a company. He had not been paid his salary for several months. He sued Das Mai, a director of the company for recovery of the amount of salary due to him. It was held that he would not succeed, because “the remedy lies against the company and not against the directors or members of the company.

The liability of an individual member is not increased by the fact that he is the sole person beneficially interested in the property of the company and that the other members have become members merely for the purpose of enabling the company to become incorporated and posses only a nominal interest in its property or hold it in trust for him.

The concept of independent corporate entity may under certain circumstances be disregarded. This is explained later in the book while explaining the circumstances under which the corporate veil may be pierced, or lifted up.

3. Separate Property:

The corporate property is clearly distinguished from the members’ property and members have no direct proprietary rights to the company’s property but merely their ‘shares’. Change in the constitution of the company’s membership will not cause any realization or slitting of its property.

Company cannot be the property of the person who owns all the shares in the company, nor can it be considered to be his agent. No member can either individually or jointly claim any ownership rights in the assets of company during its existence or on its winding up.

“No shareholder has any right to any item of property owned by the company, for he has no legal or equitable interests therein.” A member cannot have any insurable interest in the property of the company. The leading case is:

Macaura v. Northern Assurance Co. Ltd. (1925):

Mr. Macaura was the holder of nearly all the shares, except one, of a timber company. He was also the substantial creditor. He insured the company’s timber in his own name.

The timber was destroyed by fire. It was held that the insurance company was not liable to compensate as Macaura had no insurable interest in the property which belonged to the company only.

4. Perpetual Existence:

A company has a perpetual, succession. It has no allotted span of life. The mode of incorporation and dissolution of a company and the right of the members to transfer shares freely guarantee the continuity of the existence of the company quite independent of the life of the members. The existence of a company can be terminated only by law.

Being an artificial person, it cannot die irrespective of the fact that its members, even the founders or subscribers to the Memorandum, may die or go out of it. Moreover, in spite of the changes in the membership of the company, it can perform its contracts and enter into future agreements. Thus, members may come and go but the company can go on forever.

5. Common Seal:

Though a company has an artificial personality, it acts through human beings, who are called as directors. They act as agents to the company but not to its members. All the acts of the company are authorized by its “common seal”. The “common seal” is the official signature of the company. A document not bearing the common seal of the company will not be binding on the company.

6. Separation of Ownership and Management:

A company is owned (de facto) by a number of shareholders which is too large a body to manage the affairs of the company. Shareholders set the objectives of the company and appoint their representatives or agents (known as directors) to manage the affairs of the company on their behalf to pursue their objectives.

The directors, in turn, hire professional managers (executives) to run the day-to-day operations of the company under their supervision and control. This striking feature of separation of ownership and management has raised many issues which give rise to evolution of corporate governance as the focal point of modern corporations.

7. Limited Liability:

The liability of shareholders of a company is different from the liability of the company. Shareholders generally have limited liability- limited to the extent of unpaid value of shares held up. Shareholders have no obligation to the company once they have paid full amount on the shares held by them. In cases of losses, shareholders are not called upon to make good the losses.

Creditors cannot claim from the personal wealth of the shareholders. In the case of a guarantee company, the members are liable to contribute a specified agreed sum to the assets of the company in the event of the company being wound up.

8. Transferability of Shares:

One can sell one’s share of ownership rights to an interested buyer as the shares of a company are transferable. While in case of public companies shares are freely transferable which is provided by the law, there are some restrictions in the transferability of shares of private companies. In fact transferability of shares and limited liability are the enabling factors for the tremendous rise of companies all over the world.

Legal aspects

Formation of a company

The procedure or formation of a company may be divided into four stages;

1. Promotion
2. Incorporation
3. Raising of capital
4. Commencement of business

I. Promotion

It is the first stage in the formation of a company.

In this stage the idea of carrying on a business is conceived by a person or a group of persons called promoters. They make detailed investigation about the workability of the idea, amt of capital required, operating expense etc etc..

Before a company an be formed, there must be some persons who have an intention to form a company and who take the necessary steps to carry that intention into operation. Such persons are called promoters.

The promoter is the person who brings a company into existence.

II. Incorporation

A company is said to be incorporated when it is registered with the registrar under the companies act. The certificate of incorporation is the birth certificate of the company. A company comes into existence from the date mentioned in the certificate.

Procedure for registration

The promoter has to first decide the proposed form of company as whether it is to be a public company or a private company.

They may form the company with limited liability , unlimited liability or limited by guarantee.

They have to decide the name of the company agreeable and desirable to all. For eg if the name proposed is identical with or closely resembles the name of an existing company , it is undesirable.

For getting registration an application has to be made to the registrar. The application shall be accompanied by the following **documents:**

1. Memorandum of association
2. Articles of association
3. A statement of nominal capital
4. A notice of address of the registered office of the company.
5. A list of directors and their consent to a act signed by them
6. A declaration that all the requirements of the act have been complied with. Such declaration shall be signed by an advocate of high court or supreme court or a chartered accountant who is engaged in the formation of company

Certificate of incorporation

If the registrar is satisfied that all the requirements of the act have been complied with he shall register the company and issue a certificate of incorporation.

Conclusive proof

Once a company is registered incorporation cannot be challenged subsequently. The certificate of incorporation is a conclusive evidence of the fact that-

1. all the requirements of the act have been complied with.
2. company is duly registered.
3. company came into existence on the date of certificate.

Advantages of incorporation

1. Transferability of shares
2. Separate legal entity
3. Perpetual succession
4. Common seal
5. Separate property
6. Capacity to sue

III. Raising of capital

After incorporation a company can raise capital by issuing shares. A private company cannot issue shares to public.

In case of public company a copy of prospectus is filed with the registrar and it will be issued to the public. Those who are intended in purchasing share are required to send their application money to company's banker.

On the last date fixed for the receipt of application if the company has received application equal to minimum subscription the directors will start with allotment of shares.

IV. Commencement of business

A private company may commence its business immediately after incorporation.
But a public company cannot commence business immediately after incorporation but it has to obtain a certificate of commencement from the registrar.

MEMORANDUM OF ASSOCIATION

Memorandum of association for a company is like the constitutional law for a country. It is the document which contains the rules regarding constitution and activities of the company. It is a fundamental charter of the company.

It defines the extent of powers of the company, beyond that it cannot go. It is a document filed at the time of incorporation.

It is a public document ie any interested public can get a copy on payment of prescribed fees.

Contents of memorandum

1. Name clause
2. Registered office clause
3. Object clause
4. Liability clause
5. Capital clause
6. Association clause or subscription clause.

1. Name clause

The first clause of memorandum requires a company to state its name
Rules:-Should not adopt identical with or resembles that of an existing company. Ltd for public company and Pvt Ltd for private company. Should not use a name prohibited by the Name and Emblems Act.

2. Registered office clause

The memorandum must specify the state in which the registered office of the company is to be situated.

3. Object clause

This is the most important clause of the memorandum of association. It defines the object of the company and the extent of its powers. The object of the company must be state very clearly and a company cannot do anything beyond object clause. The objects of the company shall not be illegal or against public policy.

4. Liability clause

This clause state the nature of liability of members.

5. Capital clause

This clause contains the total amount of capital with which the company is registered. This capital is known as authorized capital or nominal capital or registered capital.

6. Association clause or subscription clause

The memorandum concludes with subscription clause. The memorandum must be subscribed by at least 7 persons in case of public company and 2 in case of private company. Each subscriber must sign the document and write the number of shares taken by him.

ALTERATION OF MEMORANDUM

The alteration of the memorandum is possible only by strictly following the procedure laid down in the Act

1. Alteration of a name clause

The name of a company can be changed by passing a special resolution and with approval of central govt. If a company is registered with a name which is in the opinion of central govt is identical with or too closely resemble to the name of an existing company, it can be changed by passing an ordinary resolution but with the approval of central govt .

2. Alteration of registered office clause

If the shift of office is within local limits, ie from one place to another place in the same city , town or village that can be done by giving a notice of change to registrar.

If the shift is outside local limits, a special resolution has to be passed.

If the shift is from the jurisdiction of one registrar to another's the special resolution should be confirmed by the regional director of the state. (new sec 17 A Amendment Act 2000)

3. Alteration of object clause

•The alteration of object clause is subject to so many restrictions. A company may change its objects for the following purposes;

1. To carry business more economically or more efficiently.
2. To attain its main purposes by new or improved means.
3. To enlarge or change local area of operation
4. To restrict or abandon any of its objects specified in the memorandum.
5. To amalgamate the company with any other company.
6. To sell or dispose of the whole or any part of the undertaking of the company.

–A special resolution and approval of company law board is necessary for alteration.

4. Alteration of liability clause

Liability clause cannot be altered so as to make the liability of members unlimited.

5. Alteration of capital clause

Alteration can be made to
1.To increase share capital
2.To convert fully paid share to stock
3.Cancellation of shares etc

Doctrine of ultra vires

Memorandum contains the rules regarding constitution and activities of the company. It is a fundamental charter of the company. It defines the extent of powers of the company, beyond that it cannot go.
A co can act and function within the limits of memorandum. Any act which is beyond the memorandum is ultra vires the company. Such acts are void .
Ultra means beyond and vires means powers. So ultra vires means 'beyond powers'.
The purpose of this doctrine is to helps the shareholders , creditors and every third person dealing with the company to ensure that their investment are not diverted to unauthorized objects.

ARTICLES OF ASSOCIATION

Articles of association are the internal regulations of the company and are for the benefit of shareholders. These are the rules and regulation relating to the internal management of a company. The article define the mode and form on which the business of the company is to be carried on.

Reference:

Advocate: Annapurani Venkatesan