

UNIT 1 JOINT STOCK COMPANY

Meaning- Kinds Of Companies- Formation-Incorporation-Memorandum Of Association - Contents And Alteration - Doctrine Of Ultra Vires - Articles Of Association- Contents - Distinction Between The Two - Doctrine Of Indoor Management-Prospectus-Contents - Prospectus-Statements Of Lieu Of Prospectus.

COMPANY MEANING

A company means an association of individual formed for some common purpose. But it is a voluntary association of persons. It has capital divisible into parts, known as shares, an artificial person created by a process of law and it has a perpetual succession and a common seal.

Definition

According to **Prof. Lindley**, company is defined as, “An association of many persons who contribute money or money’s worth to a common stock, and employ it in some common trade or business (i.e., for a common purpose), and who share the profit or loss (as the case may be) arising therefore. The common stock so contributed is denoted in money and it the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted”.

Characteristics of a Company

1. Separate Legal Entity

A company formed and registered under the companies act is a distinct legal entity. It is a creation of law and is sometimes called artificial person having invisible and intangible. It is a fiction of law with legal, but no natural or physical existence.

Case of Salomon Vs Salomon Co Ltd: S Sold his boots business to a newly formed company for \$30, 000. His wife, one daughter and four sons took up one share of \$ 1 each. S took 23, 000 shares of \$ 1 each and \$ 10, 000 debentures in the company. The debentures gave S a chargeover the assets of the company as the consideration for the transfer of the business. Subsequently when the company was wound up, its assets were found to be worth \$6, 000 and its liabilities amounted to \$ 17, 000 of which \$ 10, 000 were due to S (secured by debentures) and \$ 7, 000 due to unsecured creditors.

The unsecured creditors claimed that S and the company were one and the same person and that the company was a mere agent for S and hence they should be paid in priority to S. Held, the company was, in the eyes of the law, a separate person independent from S and was not his agent. S, though virtually the holder of all the shares in the company, was also a secured creditor and was entitled to repayment in priority to the unsecured creditors.

2. Perpetual Succession

A company is an artificial person, as such it never dies. Its life does not depend on the life of its members. It may not be affected by insolvency, mental disorder or retirement of its

members. It is created by law and can be put an end to only by the process of law. Even the earthquake, flood or hydrogen bomb cannot destroy it. It continues to exist even if all its human members are dead. Unlike a natural person a company never dies. It is an entity with a perpetual succession. Its existence is not affected by the death, lunacy and insolvency of its members.

3. Limited Liability

In a company limited by shares, the liability of members is limited to the unpaid value of the shares. If the face value of a share in a company is Rs.10 and a member has already paid Rs.7 per share, he can be called upto to pay not more than Rs.3 per share during the lifetime of the company.

In a company limited by guarantee, the liability of members is limited to such amount as the members may undertake to contribute to the assets of the company in the event of its being wound up.

4. Common seal

A company is a juristic person with a perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal acts as the official signature of the company. Every company must have a seal with its name engraved on it.

5. Transferability of shares

The capital of a company is divided into parts, called shares. These shares are, subject to certain conditions, freely transferable so that no shareholder is permanently or necessarily wedded to the company. When the joint stock companies were established, the great object was that the shares should be capable of being easily transferred.

6. Capacity to sue and be sued

A company can sue and be sued in its corporate name. It may also inflict or suffer wrongs. It can in fact do or have done to it most of the things which may be done by or to a human being. On incorporation, a company acquires separate and independent legal personality. As a legal person, it can sue and be sued in its name.

7. Separate Property

A company, as already observed, is a legal person distinct from its members. It is therefore capable of owing, enjoying and disposing of property in its own name. Although, the capital and assets of the company are contributed by its shareholders, they are not the private and joint owners of the property of the company. The property of the company is not the property of the shareholders; it is the property of the company.

LIFTING THE CORPORATE VEIL

A company is a legal person distinct from its members. This principle may be referred to as 'the veil of incorporation'. The effect of this principle is that there is a veil between the company and its members i.e., the company has a corporate personality which is distinct from its members.

But over a period, the abuses of this corporate personality became apparent. Thus it became necessary for the court to break through or lift the corporate veil or crack the shell of corporate

personality and look at the persons behind the company who are the real beneficiaries of the corporate fiction.

The corporate veil is lifted in the following cases;

- Determination of the character
- Where company is a mere cloak or sham
- Where the company is acting as an agent of the shareholders
- Protection of revenue

Statutory exception

1. Number of members below statutory minimum

Sec.45, if a company carries on business for more than 6 months after the number of its members has been reduced below 7 in case of a public company or 2 in case of private company, every person who knows this fact and is a member during the time that the company so carries on business after the six months, is severally liable for the whole of the debts of the company contracted during that time, i.e., after six months. It may be noted that in such a case the continuing members (i.e., those who continue to be members after six months).

- a. Can be sued and not those who have withdrawn from the membership;
- b. Shall be liable only if they are aware of the fact of the member falling below the statutory minimum.

2. Failure to refund application money

Sec.69 (5), the directors of a company are jointly and severally liable to repay the application money with interest if the company fails to refund the application money of those applicants who have not been allotted shares, within 130 days of the date of issue of the prospectus.

3. Misdescription of company's name

Sec.147 (4) where an officer or agent of a company does any act or enters into a contract without fully or properly mentioning the company's name and the address of its registered office, he shall be personally liable. Thus where a bill of exchange, hundi or promissory note is signed by an officer of a company or any other person on its behalf, without mentioning this fact that he

is signing on behalf of the company; he is personally liable to the holder of the instrument unless the company has already paid the amount.

4. Fraudulent Trading

Sometimes in the course of the winding up of a company it may appear that some business of the company has been carried on with intent to defraud creditors of the company, or any other person or for any fraudulent purpose. In such a case, the court may declare that any persons who were knowingly parties to the carrying on of the business in this way are personally liable without any limitations of liability for all or any of the debts or other liabilities of the company as the court may direct. The court may do so on the application of the official liquidator, or the liquidator or any creditor or contributory of the company.

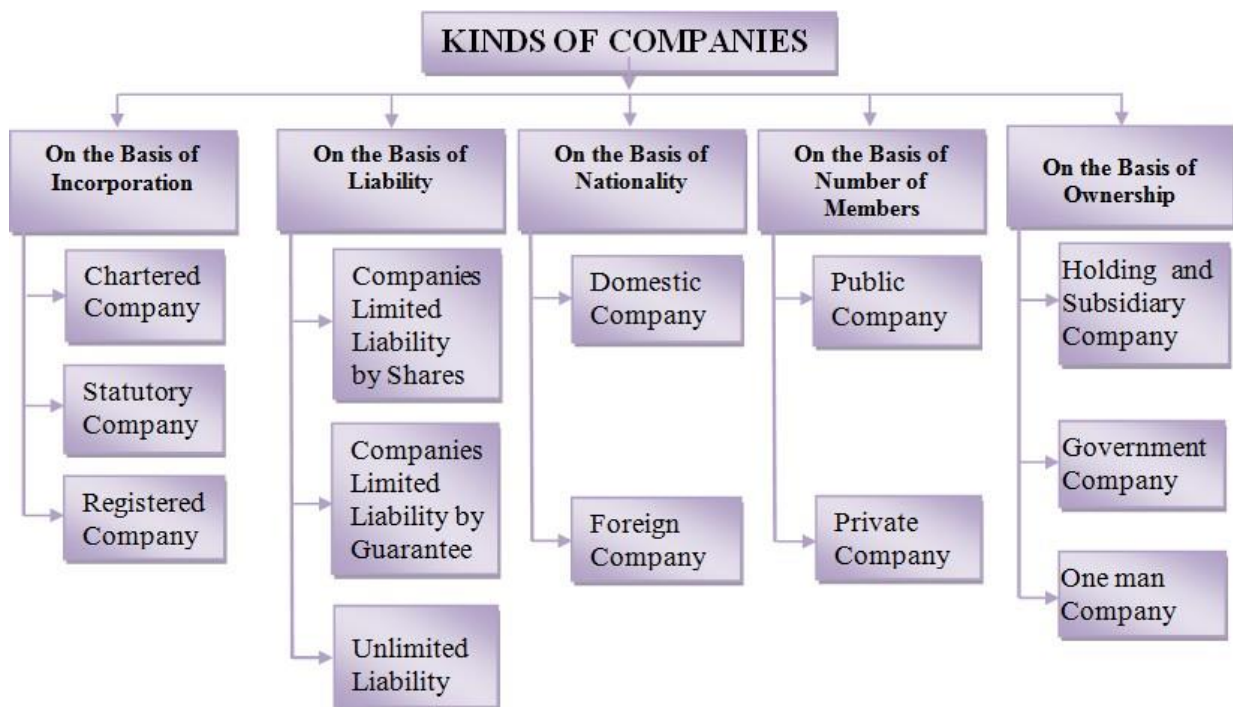
5. Holding and Subsidiary Companies

In the eyes of the law, the holding company and its subsidiaries (for definition of holding and subsidiary companies) are separate legal entities. But in the following two cases, a subsidiary company may lose its separate identity to a certain extent:

- i) Where at the end of its financial year, a company has subsidiaries, it must lay before its members in general meeting not only its own accounts, but also a set of group accounts showing the profit or loss earned or suffered by the holding company and its subsidiaries collectively and their collective state of affairs at the end of the year.
- ii) The court may, on the facts of a case, treat a subsidiary company as merely a branch or department of one large undertaking owned by the holding company.

KINDS OF COMPANIES

Joint Stock Companies can be classified on the basis of corporation, nature of liability, extent of public interest, ownership, nationality etc. let us examine briefly the different kinds of companies.



I. On the Basis of Incorporation

Any company is to be incorporated under an Act. The provision of the particular Act under which it is established governs its working. Companies of this kind are of three types. They are;

a. Statutory Companies

These are the companies which are created by a special act of the Parliament or State Legislature, e.g., the Reserve Bank of India, the State bank of India, the Life Insurance Corporation, etc. these are mostly concerned with public utilities, e.g., railways, tramways, electricity companies and enterprises of national importance.

b. Registered Companies

Companies which are registered under the Companies Act, 1956, or were registered under any of the earlier companies Acts are called registered companies. A vast majority of companies we come across belong to this category. Tata Motors Limited, Reliance Telecommunication Limited, EID Parry Limited, etc belong to this category.

c. Chartered Companies

Companies established as a result of a charter granted by the King or Queen of a country is known as chartered companies. The charter issued, governs their functioning. In other words, The Crown, in the exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. **Example** – Bank of England, East India Company, etc.

II. On the Basis of Liability

On the basis of the extent of liabilities of the shareholders such companies are divided into three categories.

a. Companies Limited by Share

Where the liability of the members of a company is limited to the amount unpaid on the shares such a company is known as a company limited by shares. If the shares are fully paid, the liability of the members holding such shares is nil.

b. Companies Limited by Guarantee

In a company limited by guarantee the liability of a shareholder is limited to the amount he has voluntarily undertaken to contribute to meet any deficiency at the time of its winding up. Such a company may or may not have a share capital. If it has a share capital a member's liability is limited to the amount remaining unpaid on his share plus the amount guaranteed by him. This type of company is started with the object of promoting science, arts, sports, charity, etc. it is clear that its objective is not profit earning. It gets subscription from its members and donations and endowments from philanthropists.

c. Unlimited Liability

A company without limited liability is known as an unlimited liability. In case of such a company, every member is liable for the debts of the company, as in an ordinary partnership, in proportion to his interest in the company. In other words, their liability extends to their private properties also in the event of winding up. Unlimited companies are almost non-existent.

III. On the Basis of Nationality

They are of two types viz., domestic companies and foreign companies.

a. Domestic Company

Companies registered under the Companies Act, 1956, or under earlier Acts are considered domestic companies.

b. Foreign Company

Foreign company means a company incorporated outside India but having a place of business in India. It has to furnish to the authorities the full address of the registered or principal office of the company or a list of its directors or names and addresses of the residents in India authorized to receive notices, documents, etc.

IV. On the Basis of Number of Members

a. Private Company

A private company means a company which by its articles

- i. restricts the rights to transfer its shares
- ii. Limits the number of its members minimum 2 and maximum number of members fifty (excluding the employees)
- iii. Prohibits any invitation to the public to subscribe for any shares or debentures of the company. The name of the company must end with the words 'private limited'.

b. Public Company

The public is invited to subscribe to the shares of the company usually by issuing a prospectus. Shares are easily transferable. A public company must have at least 7 persons to form and no maximum limit as to its number of shareholders or members. The name must end with the word 'limited'.

V. On the Basis of Control / Ownership

a. Holding Company and Subsidiary Company

A company is known as the holding company of another company if it has control over that other company. A company becomes a holding company of another

- i) if it can appoint or remove all or majority of the directors of the latter company or
- ii) if it holds more than 50% of the equity share capital of the latter or
- iii) if it can exercise more than 50% of the total voting power of the latter.

A company is known as a Subsidiary of another company when control is exercised by the latter (called holding company). Over the former called a subsidiary company.

b. Government Companies

A Government company is one in which not less than 51% of the paid up capital is held by the Central Government or by any one or more State Governments or partly by the Central Governments and partly by one or more State Governments. Examples: Bharath Heavy Electricals Limited, Steel Authority of India Limited, etc.

A subsidiary of a Government company is also treated as a Government company. A Government company also enjoys a separate corporate existence. It should not be identified with the Government and its employees are not Government employees.

c. One man company

These are companies in which one man holds virtually the whole of the share capital with a few extra members holding the remainder who may be his relations or nominees.

DISTINCTION BETWEEN PUBLIC COMPANY AND PRIVATE COMPANY

S. No.	PUBLIC COMPANY	PRIVATE COMPANY
1.	Minimum No. of Members: 7 persons	2 persons
2.	Maximum No. of Members: No limits	Not more than fifty members excluding past and present employees
3.	Name of the Company: The company name must be ended with 'Limited'.	'Private Limited' must be added at the end of the name.
4.	Article of Association: Can have its own Articles or can adopt Table A of the Companies Act, 1956.	Prepare own AOA.
5.	Commencement of Business: Shall not commence business unless granted the certificate of commencement of business	Commence business as soon as it is incorporated
6.	Invitation to public: May invite public to subscribe to its share/debentures by issuing prospectus	Cannot extend such invitation to the public
7.	Transferability of shares: No restriction on transfer of shares	Restrict the right of members to transfer the shares by its articles
8.	Qualification Shares: The directors should acquire the prescribed qualification shares	Need not acquire qualification shares
9.	Quorum: Minimum number of members should be present in a meeting is five	Two number of members should be present in a meeting
10.	Issue of Prospectus: A public limited company can issue prospectus	A private company is prohibited from issuing prospectus
11.	Issue of subsequent shares: Public company's new shares are offered first to the existing shareholders	Rights issue does not arise
12.	Issue of share warrants: It can issue share warrants	A private company cannot issue share warrant
13.	Number of directors: At least three directors	At least two directors
14.	Statutory meetings: Compulsory	No such obligations
15.	Managerial remuneration: Cannot exceed 11% of the net profit	No such restriction

DISTINCTION BETWEEN PARTNERSHIP FIRM AND JOINT STOCK COMPANY

S. No.	BASIS OF DIFFERENCE	PARTNERSHIP FIRM	JOINT STOCK COMPANY
1.	The Acts	Partnership firm is governed by the Indian Partnership Act, 1932	Companies are governed mainly by the provisions of the Companies Act, 1956
2.	Registration	Registration is optional	Registration is compulsory
3.	Number of members	Minimum of 2 persons and Maximum number is restricted to 10 in the case of Banking business and to 20 in other types of businesses	Minimum number of members Public – 7 persons Private – 2 persons Maximum number of members Public – unlimited Private – 50 excluding members or employees
4.	Legal status	No separate legal existence	It is an artificial person created by law
5.	Liability	Liability of a partner is joint, several and unlimited	Limited to the unpaid amount of shares held
6.	Transfer of shares	A partner cannot transfer his interest in the firm without the consent of all other partners	Shares are fully transferable
7.	Management	Management of a firm is carried on by all or by any of them acting for all	Board of directors elected by the members carry out the management
8.	Stability	A partnership firm is not stable, it can be affected by death, insanity or insolvency of any one or all its partners	A company is stable as it is totally unaffected by any such contingencies
9.	Procedural complexities	Both for formation and dissolution, the procedures are simple	Both the formation and winding up are subject to many legal formalities
10.	Financial resources	The capital contribution as well as the finance that can be raised tend to be limited	The scope for mobilizing larger resources is very wide
11.	Membership	In a partnership only individuals can become its members	In a company, an institution can also become a member by purchasing its shares

12.	Nature	Partnership is the relation between persons who have agreed to share the profits or losses of a business	A company is an artificial person
13.	Mutual relationship of the members	In the partnership, each partner is an agent of the others	The members of the company are not its agents or representatives
14.	Audit	Audit of accounts is not except uncertain circumstances	It is essential for every company to get its accounts annually audited by chartered accountant
15.	Dissolution	Partnership can be mutually dissolved at time	Legal formalities for winding up are many

PROMOTION AND FORMATION OF COMPANY

PROMOTION OF COMPANY

The term, 'promotion' refers to the process by which the idea of forming a company takes a definite shape resulting in its incorporation. It is in fact the first stage in the formation of company.

PROMOTER

It is the promoter who gets the idea of starting a company and undertakes all the preliminary work necessary for its formation. In other words, the promoter of a company is a person who does the necessary preliminary work incidental to the formation of the company.

Definition

Palmer explains the significance of the term promoter in the following words. "A Promoter starts a scheme of forming a company, gets together the Board of Directors, retains bankers and solicitors, prepares or gets prepared memorandum and articles of association, provides the preliminary expenses, drafts the prospectus; in a word undertakes to form a company with reference to a given project and takes the necessary steps to get it going".

Functions of a promoter

1. He settles the company's name and ascertains that it will be accepted by the Registrar of Companies.
2. He also settles the details of the company's Memorandum and Articles, the nomination of directors, solicitors, bankers, brokers, auditors and secretary and the registered office of the company.
3. He arranges for the printing of the Memorandum and Articles, the registration of the company, the issue of prospectus, if a public issue is necessary.

Duties of promoters

- Involved in business activities
- Instruct the solicitors to prepare necessary documents
- Secure the services of directors
- Provide registration fees
- Arranging for advertisement, circulation of prospectus, investment of capital.

Remuneration of Promoters

A promoter has no right to get compensation from the company for his services in promoting the company unless there is a contract to that effect. But in practice, a promoter takes remuneration for his services in one of the following ways;

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

Any remuneration paid to the promoters must be disclosed in the prospectus, if it is paid within the preceding 2 years from the date of the prospectus.

INCORPORATION / FORMATION OF COMPANY

For registering the company with the registrar of companies, the promoter has to initiate a number of steps as outlined below;

1. Approval for the proposed name

A company can choose any name but it should not closely resemble the name of an existing company. Hence the promoter has to get the approval from the registrar for the proposed name of the company.

2. Filing of Documents

The promoter has to get prepared the following documents and file them with the registrar of companies of the State in which the registered office of the company is situated.

i) Memorandum of Association

This document which is of fundamental importance defines the scope of activities of the company. It should contain the name, the place where the registered office is situated, authorized capital and the objects of the business. It should be printed and duly stamped, signed and witnessed. A minimum of two persons in the case of a private limited company and seven in the case of a public limited company must sign the document.

ii) Article of Association

This contains the regulations connected with the internal management of the company. This document must also be duly stamped and signed by the signatories to the

memorandum and witnessed.

iii) Original letter of approval

Original letter of approval of name be obtained from the Registrar and be filed.

iv) A list of directors

A list of directors who have consented to be its directors must be filed.

v) Written consent to act as directors

The directors have to give their consent in writing to act as its directors. They should also undertake to take the necessary qualification shares and pay for them.

vi) Notice of the address of the registered office

vii) Statutory declaration

A declaration stating that all the requirements of law relating to registration have been complied with is to be filed. This declaration must be given by an Advocate of the Supreme Court or High Court, or by a Chartered Accountant who is engaged in the formation of the company or by a person named in the Articles as a director or secretary of the company.

- viii) The registrar will scrutinize all the documents and if he finds them in order, he will issue the certificate of incorporation

This certificate is a conclusive evidence of the fact that the company has been duly registered. A private limited company can commence business on getting the certificate of incorporation, but a public company has to take some more steps for getting another certificate known as certificate for commencement of business.

3. Issue of Prospectus

The Board of directors should arrange for drafting a prospectus when it wants to approach the public for securing capital. A prospectus contains all essential points which would induce the investing public to apply for shares in the company. A copy of the prospectus must be delivered to the Registrar before issuing to the public.

4. Minimum Subscription

A company can proceed to allot shares only if minimum subscription specified in the prospectus has been collected in cash.

5. Statement in Lieu of Prospectus

Where the promoters raise the entire capital through private arrangement, there is no need to issue a prospectus. However, a statement in lieu of prospectus, the contents of which are similar to a prospectus, must be prepared and filed with the Registrar at least three days before allotment.

6. Filing of further documents

The following documents are also to be filed with the Registrar;

- i) A declaration that the minimum subscription stated in the prospectus has been collected in cash
- ii) A declaration stating that each director has paid in cash for the application and

- allotment on the shares taken up by them
- iii) A declaration that no money has become refundable to applicants because of its failure to obtain permission for shares or debentures to be dealt in on any recognized stock exchange
 - iv) A statutory declaration by the secretary or one of its directors stating that the above requirements have been complied with.

If the Registrar is satisfied that these documents are in order, he will issue a certificate entitling the company to commence business. It is only on getting this certificate; a public limited company can start its business.

Certificate of Incorporation

On registration, the Registrar will issue a certificate of incorporation whereby he certifies that the company is incorporated. For the date of incorporation mentioned in the certificate, the company becomes a legal person separate from its shareholders and secures a perpetual succession. Hence it is the birth certificate of the company.

Certificate of commencement of business

A private company may commence its business immediately on incorporation but a public company cannot commence business immediately after incorporation, unless it has obtained a certificate of commencement of business from the Registrar.

MEMORANDUM OF ASSOCIATION (MOA)

MOA is one of the core documents, which has to be filed with the Registrar of companies at the time of incorporation of a company. It is a document, which sets out the constitution of the company and is really the fundamental conditions upon which alone the company is allowed to be incorporated.

In other words, it contains the fundamental conditions upon which alone the company is allowed to be incorporated. It defines the activities the company is permitted to undertake. Any act done which is outside the scope outlined in its memorandum is ultra vires (beyond the power of) the company and is not binding on it.

Contents of Memorandum

1. Name Clause

A company may be registered with any name it likes. But a name, which in the opinion of the Central Government is undesirable, and in particular which is identical or which too nearly resembles the name of an existing company shall register no company. Every public company must write the word 'limited' after its name and every private company must write the word 'private limited' after its name.

Rules regarding name

- i) undesirable name to be avoided
- ii) identical name to be avoided
- iii) injunction if identical name adopted
- iv) limited or private limited as the last word or words
- v) prohibition of use of certain names
- vi) restriction on use of certain key words as part of name

2. Registered Office Clause

This clause states the name of the state where the registered office of the company is to situate. The registered office clause is important for two reasons. First, it ascertains the domicile and nationality of a company. Second, it is place where various registers relating to the company must be kept and to which all communications and notice must be sent.

3. Object Clause

The object clause is the most important clause in the memorandum of association of a company. It is not merely a record of what is contemplated by the subscribers. But it serves a two-fold purpose; 1) it gives an idea to the prospective shareholders the purpose for which their money will be utilized; 2) it enables the persons dealing with the company to ascertain its powers.

4. Liability Clause

This clause states that the liability of the members of the company is limited. In the case of a company limited by shares, the members are liable only to the amount unpaid on the shares taken by him. In the case of a company limited by guarantee, the members are liable to the amount undertaken to be contributed by them to the assets of the company in the event of its being wound up.

5. Capital Clause

The memorandum of a company limited by shares must state the authorized or nominal share capital, the different kinds of shares, and the nominal value of each share. The chief point to consider in regard to this clause is what funds are necessary to set the business going or, if it is proposed by an existing concern, what sum is needed to pay its price and what, in addition, is wanted to keep the business going.

6. Association Clause or Subscription Clause

This clause provides that those who have agreed to subscribe to the memorandum must signify their willingness to associate and form a company. The memorandum has to be signed by each subscriber in the presence of at least one witness who must attest the signature. Each subscriber must write opposite his name the number of shares he shall take.

Alteration of Memorandum of Association

For the purpose of alteration, the provisions of the Memorandum can be divided into two categories;

- i) The provisions which must be included in the memorandum, these are called

‘conditions’. These cannot be altered except in the mode, and to the extent, for which express provision is made in the companies act, 1956.

- ii) Other provisions. Such provisions including those relating to the appointment of managing director or manager may be altered in the same manner as the articles of the company i.e., by a special resolution unless otherwise provided by the companies act, 1956.

Alteration of Memorandum

1. Change of name

By Special Resolution

A company may change its name by a special resolution and with approval of the Central Government signified in writing in case of deletion or addition of the word “private” on the conversion of a public company into a private company or vice versa.

By ordinary Resolution

If a company registered by a name which, in the opinion of the Central Government, is identical with or too nearly resembles, the company may change its name by ordinary resolution with the previous approval of the Central Government within 12 months.

The company has to get fresh certificate of incorporation.

Secretary procedure for change of name

- a. He should make an application with fees of Rs.500 by means of DD or a treasury challan to know the availability of the changed name.
- b. Once the Registrar informs the changed name availability, the Board meeting should decide to convene a general meeting to pass a special resolution.
- c. Copy of special resolution signed by the chairman should be filed with the registrar with 30 days of passing the resolution.
- d. A copy of the notice should be send to the recognized stock exchange if it is listed companies.
- e. 6 copies of the altered memorandum of association should send to the stock exchange.
- f. Apply to the registrar for a fresh certificate of incorporation

2. Change of registered office

- a. Change Of Registered Office From One Place To Another Place In The Same City, Town Or Village
 - With the confirmation of the Regional Director of the Zone the change of place of its registered office can be done. This change has to be informed within 30 days to the Registrar with supportive documents.
- b. Change Of Registered Office From One State To Another
 - The company has to pass special resolution and with the previous approval from the Central Government.
 - Copy of special resolution signed by the chairman should be filed with the registrar with 30 days of passing the resolution.

- A copy of the notice should be send to the recognized stock exchange if it is listed companies.
- 6 copies of the altered memorandum of association should send to the stock exchange.

3. Alteration of Objects

Object clause is the most important clause in the MOA. It can be altered by passing special resolution so as to enable it –

- To carry on its business more economically or more efficiently
- To attain its main purpose by new or improved means
- To enlarge or change the local area of its operation
- To carry on some business which under existing circumstances may conveniently or advantageously be combined with the objects specified in the memorandum
- To restrict or abandon any of the objects specified in the memorandum
- To sell or dispose of the whole, or any of the undertaking
- To amalgamate with any other company or body of persons.

The altered copy along with minutes should be send within 30 from the date of filing of such documents.

4. Change in liability clause

A company limited by shares or guarantee cannot change the Memorandum so as to impose any additional liability on the members or to compel them to buy additional shares of the company unless all the members agree in writing to such change either before or after the change.

5. Change in capital clause

Change in the capital clause which may involve increase, reduction or reorganization of capital, will be done by passing ordinary or special resolution as required by the circumstances.

DOCTRINE OF ULTRA VIRES

An act ultra vires the company - A company has the power to do all such things as are –

1. Authorized to be done by the companies act,
2. Essential to the attainment of its objects specified in the memorandum,
3. Reasonable and fairly incidental to its objects.

A company has power to carry out the objects set out in the memorandum and also everything which is reasonably necessary to enable it to carry out those objects. Any activities not expressly authorized by the memorandum are ultra vires to the company. Otherwise, the term ultra vires means that the doing of the act is beyond the legal power and authority of the company. If an act is ultra vires the company i.e., it is outside the scope of the company's objects, it is wholly void and inoperative and will not be binding on the company. Even the whole body of shareholders cannot ratify it.

ARTICLES OF ASSOCIATION

‘Articles’ means the Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act. The articles of association are the rules and regulations of a company framed for the purpose of internal management of its affairs. The articles are framed for carrying out the aims and objects of the Memorandum of Association.

Contents of Articles of Association

1. Adoption of preliminary contracts
2. number and value of shares
3. allotment of shares
4. calls on shares
5. lien on shares
6. transfer and transmission of shares
7. forfeiture of shares
8. alternation of shares
9. shares certificate
10. conversion of shares into stock
11. voting rights and proxies
12. meetings
13. directors, their appointment etc
14. borrowing powers
15. accounts and audit
16. dividends and reserves
17. winding up
18. issue of redeemable preference shares, if any

In the case of companies with the liability limited by guarantee, the articles must also state the number of members with which the company is to be registered. It must also state the extent of liability in the event of winding up. In the case of a private company the articles must also contain the following provisions;

- a. restricting the right to transfer shares, if any
- b. limiting the number of its members to 50 excluding the past and present employee members
- c. prohibiting any invitation to the public to subscribe for any shares in or debentures of the company.
- d. prohibiting any acceptance of deposits from the persons other than the directors, members or their relatives.

MEMORANDUM AND ARTICLES – DISTINCTION

1. Content and Scope

MOA is the charter of the company and defines the scope of its activities. AOA of the company is a document, which regulates the internal management of the company.

2. Relationship between company, members and outsiders

MOA defines the relationship of the company with the outside world, whereas AOA deals with the right of the members of the company intense and also establishes the relationship of the company with the members.

3. Alteration

MOA cannot be altered except in the manner and to the extent provided by the Act, whereas the AOA being only the bylaws of the company can be altered by a special resolution.

4. Supremacy

Memorandum is a supreme document of the company, whereas articles are subordinate to the memorandum.

5. Ultra-vires Acts

A company cannot depart from the provision contained in the memorandum, and if it does, it would be ultra-vires the company, anything done against the provisions of Articles, but which is ultra-vires the Memorandum, can be ratified.

DOCTRINE OF CONSTRUCTIVE NOTICE

The Memorandum and Articles of association of every company are required to be registered with the registrar of companies. On registration they become public documents and are open for public inspection on payment. Everyone dealing with the company, whether a shareholder or an outsider, is presumed to have read the two documents. This deemed knowledge of the two documents their contents is known as the constructive notice memorandum and articles.

DOCTRINE OF INDOOR MANAGEMENT

The outsiders dealing with the company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regular done. They are presumed to have read these documents and to see that the proposed dealing is not inconsistent therewith, but they are bound to do more; they need not inquire into regularity of the internal proceedings as required by the memorandum and the articles. They can presume that all is being done regularly. This limitation of the doctrine of constructive notice is known as the “doctrine of indoor management”.

EXCEPTIONS

1. Knowledge of Irregularity

Where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he can't claim the benefit under the rule of indoor management.

Example: Howard V. Patent Ivory Company. The directors of a company could borrow any amount up to \$ 1, 000 without the approval of the shareholders in general meetings. But for any amount beyond \$ 1, 000 they had to obtain the consent of the shareholders in the General Manager.

The directors themselves lent to the company an amount in excess of the borrowing powers of the company without the consent of the shareholders in General manager. Hence the company was liable to them only for \$ 1, 000.

2. Negligence

Where a person dealing with a company could discover the irregularity if he had made proper inquiries he can't claim the benefit of the rule of indoor management.

Example: Anand Bihari Lal V. Dinshaw and Company, In this case accepted of a company property its accountants. Held, the transfer was void as such as transaction was apparently beyond the scope of the accounting authority.

3. Forgery

The indoor management does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgery committed by its officers.

4. Acts outside the scope of apparent authority

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

PROSPECTUS

Sec.2 (36) defines "Any documents described as a prospectus and include any notice circular, advertisement or documents inviting deposits from the public or inviting offer from the public for the purchase of any shares in or debentures of a body corporate.

Formalities in issuing a prospectus

- Every company is issued by or on behalf of a company must be dated; this date is regarded as a date of its publication
- It should be signed by every director \ agent delivered to registrar on or before the date of application
- The prospectus issued to the public should mention copy of prospectus along with specified with document filed with registrar.
- Authorized form securities exchange board of India
- A prospectus must contain the necessary information to enable the public to decide whether or not to subscribe for its shares.

Contents of a prospectus

1. General Information

- Name and address of registered office of the company
- Details of letter of intent \ industrial license
- Name of stock exchange where listed

- Date of opening, closing of the issue
- Name, address of lead manager, bankers to the issue, brokers to the issue
- Underwriting arrangement

2. Capital Structure of the company

- Authorized, issued, subscribed, paid up capital of the company should be mentioned
- Size of the issue

3. Details of the issues

- Object of the issues
- Tax benefits available to the company
- Rights of the information holders AND Terms of payment
- Authority for the issues and details of resolution passed for the issues

4. Details about the company management

- History, main objects, present business of the company
- Subsidiaries of the company
- Promoters and their background
- Name, address occupation of manager, managing director's relationship with the company

5. Details about the Project

- Cost of the project and means of financing
- Location of the project
- Plant & machinery for the projects
- Infrastructure facilities for raw materials
- Expected date of trial production and commercial production
- Schedule of implementation of the projects

6. Financial Information

- A report from the auditors on profit and losses of the company
- Asset and liabilities of the company
- Rate of dividend paid by the company

7. Statutory and other Information

- Minimum subscription as laid down in the SEBI guidelines
- Underwriting Commission and brokerage
- Fees payable to the lead manager
- Date of listing on stock exchanges

8. Other Information

- In respect of any issue made by the company and other listed companies under

the same management, the following details;

- Name of the company, year of issue, types of issue, amount of issue and date of completion of the projects
- Procedure and time schedule for allotment and issue of certificates
- Management perception of risk factors
- Procedure for making application and availability of forms, prospectus and mode of payment
- Changes in directors and auditors in the last 3 years.

Liability for Misstatements in Prospectus

A. Civil Liability

A person who has been induced to subscribe for shares in a company on the strength of misstatement or omission in the prospectus may have a remedy either against the company or against the promoters or directors.

Remedies against the company

a. Recession of contract

Where a person has purchased the shares of a company on the faith of a prospectus which contained misleading, but no necessarily fraudulent statement, he can seek rescission of the contract.

b. Claim for damages

The shareholders have to return the shares to the company and the claim the money with interest from the company.

Remedies against the directors \ promoters

Any person who has purchase shares \ debentures on the faith of the prospectus containing untrue statement may sue directors, promoters and experts

a. Damages for deceit \ fraud

Any persons induced to invest in the company by fraudulent statement in a prospectus can sue the company and persons responsible for damages. The share should be first surrendered to the company before the company is sued for damages.

b. Compensation

The above persons shall be liable to compensation to every person who subscribes for any shares \ debentures for any loss or damages sustained by him by reason of any untrue statement included therein.

B. Criminal Liability

Every person who authorizes the issue of prospectus shall be punishable for untrue statements with imprisonment for a term which may extend to 2 years or with fine extend up to Rs.50, 000.

References

1. P.M.S.Abdul Gaffoor and S. Thothadri, Company Law, Vijay Nichole Imprints Private Limited, 2e(2016).
2. V.Balachandran and S. Thothadri, Legal Aspects of Business, Tata Mc Graw Hill Education Private Limited, (2012).
3. P.Saravanel S.Sumathi, Legal Systems in Business, Himalaya Publishing House,(2011).

Question Bank

PART- A

1. Define Company.
2. Define Corporate Veil.
3. Tell about Statutory Company
4. Describe about Foreign company.
5. Apply the duties of promoters for organization.
6. Express Certification of Incorporation.
7. Recognize Doctrine of Ultra Vires.
8. Record about Doctrine of Indoor Management.
9. Interpret the Statement in lieu of prospectus.
10. Record about Doctrine of Indoor Management.

PART- B

1. State the circumstances under which Corporate veil could be lifted.
2. Discriminate private limited company and public limited company.
3. Categorize the different kinds of companies.
4. Explain how companies are formed in India.
5. Discuss about promoter and his functions.
6. Explain the essential characteristics of registered company.
7. Differentiate joint stock company and partnership firm on various basis.
8. What is meant by Memorandum of Association? Describe the contents Memorandum of Association.
9. Explain Articles of Association and explain the contents of the Articles of Association.
10. Define Prospectus. Reiterate the contents of prospectus.