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FORMING A COMPANY

A company is an artificial entity created by law for the purpose of carrying on any object such as business, sports, research, charity, etc. However, most companies are formed for the purpose of conducting business. The process of forming a company can be divided into four distinct stages: (*i*) promotion; (*ii*) registration or incorporation; (*iii*) capital subscription; and (*iv*) commencement of business.

As regards a private company, it needs to go through the first two stages only. As soon as it receives the certificate of incorporation, it can commence business. This is so because it cannot invite the public to subscribe to its shares and must arrange to raise the capital privately. But a public company, having a share capital, has to go through all four stages mentioned above and only then will it be entitled to commence its business. We shall now discuss each of these four stages.

PROMOTION

This is the first stage in the formation of a company. *Gerstenberg* in his book, *Financial Organisation and Management of Business,* has defined "promotion" as, "the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom." First of all the idea of carrying on a business which can be profitably undertaken is conceived either by a person or by a group of persons who are called promoters. After conceiving the idea, the promoters make detailed investigations to find out the weaknesses and strong points of the idea, to determine the amount of capital required and to estimate the operating expenses and probable income. When the promoter is satisfied that the idea, as originally conceived, can be put into practice profitably, he takes the necessary steps for assembling the proposition. These steps include securing the cooperation of the required number of persons who will associate themselves with the project and act as the first directors of the company to be floated, securing the necessary patents, acquisition of a

suitable site for the factory, arrangements for machinery and equipment, tentative arrangements for personnel and so on.

After assembling the proposition, the promoters prepare a detailed financial plan showing therein total cost of the project, sources of finance, etc. They must also decide at this stage whether the company to be formed is to be a private company or a public company. The minimum number of members required to form a company is seven in the case of a public company and two in the case of a private company. They must also arrange in advance the success of the company floatation by finalising contracts with the underwriters and the Issue Houses. Finally, they should get prepared necessary documents such as memorandum of association, articles of association, the prospectus and arrange for their publication. These documents are prepared with the help of a legal experts and the promoters have to see that the particular requirements of the Act are incorporated therein.

PROMOTERS

Though the Act nowhere defines the term "promoter", a number of judicial decisions have attempted to explain it. The best definition comes from L.J.Browen who says that, "it is not term of law but of business, usefully summing up in a single commercial word, a number of business operations, familiar to the commercial world by which a company is brought into existence."[1]

Lord Blackburn has beatifully stated that, "it is a short and convenient way of designating those who set in motion the machinery by which the Act enables them to create an incorporated company."[2]

Justice Cockburn defines a promoter as, "one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose."[3]

So long as the work of formation continues, those who carry on that work retain the character of promoters. However, if the board of directors is formed and it undertakes the remaining work respecting company formation, the promoters' functions come to an end.[4]

Not everybody connected with the formation of a company can be called a promoter. Thus professional advisers, legal as well as others, are not promoters. Similarly when those engaged in starting a new enterprise,

[1]*Whaley Bridge Calico Printing Co. v. Green* (1880) 5 Q.B.D. 109.
[2]*Erlanger v. New Sombrero Phosphate Co.* (1878) 3 A.C. 1218.
[3]*Twycross v. Grant* (1877) 2 C.P.D. 469.
[4]*Ibid.*

consult experts to advise them of the full facts with regard to the proposed enterprise and its future prospects (*e.g.* valuers, surveyors, engineers etc.) they cannot be called promoters.

A person may also not be regarded as a promoter if his signature appears at the foot of the memorandum or if he had initially subscribed for some shares. Even the fact that money paid by him against shares was utilised in the expenses of the formation of the company, would not make him a promoter.[5] Individuals do not become promoters because they buy property, subsequently sold by them to a company at a profit, even though the consideration consists of shares in the same company. But where certain persons buy property with a view to selling it later to a company to be formed by them, such persons will be regarded as promoters from the moment they took first step to carry out that object.[6]

Legal Position of Promoters

Not an agent or trustee. The legal position of a promoter is somewhat peculiar. He is not a trustee for the company because there is no company yet in existence. For the same reason, he cannot be the company's agent either.

Fiduciary position of a promoter. The correct way to describe his legal position is that he stands in a fiduciary position towards the company about to be formed. Lord Blackburn observed in this connection: "Those who accept and use such extensive powers are not entitled to disregard the interest of the corporation altogether. They must make a reasonable use of the powers which they accept from the legislature; and consequently they do stand, with regard to that corporation when formed in what is commonly called a fiduciary relation to some extent."[7]

Fiduciary duties of a promoter. Two important results follow from the fiduciary postion of promoters: (*a*) A promoter cannot be allowed to make any secret profits. If it is found that in any particular transaction of the company, the promoter has obtained a secret profit for himself, he will be bound to refund the same to the company; (*b*) He is not allowed to derive a profit from the sale of his own property unless all the material facts are disclosed. If a promoter contracts to sell the company a property without making a full disclosure, and the property was acquired by him at a time when he stood in a fiduciary position towards the company, the company may either rescind the sale or affirm the contract and recover the profit made from it by the promoters.

[5]*G. Tiruvengadachariar v. Valu Muaoliar* (1838) I.L.R. Mad. 192.
[6]*Gluckstein v. Barnes* (1900) A.C. 240.
[7]*Erlanger v. New Sombrero Phosphate Co.* (1878) 3 A.C. 1218.

It is thus clear that it is not the profit made by promoter which the law forbids but the non-disclosure of it. A promoter who sells his property to a company formed by him is not precluded from making a profit provided a full disclosure is made by him to the company.

It is worth noting here the facts of *Erlanger v. New Sombrero Phosphate Co.*[8]

A syndicate of which E was the head, purchased an island containing phosphate mines. A company was formed to purchase propery from him and he also named some fictitious persons as its directors. The property was later sold to the company by a contract between the company and a nominee of the Syndicate at a price which was twice the price paid by E for its original purchase. The purchase agreement was approved at the meeting of shareholders, but no material facts were disclosed. Later on when the company went into liquidation, the liquidator filed a suit against E to recover the profits made by him in the said transaction. E tried to defend it on the ground that the directors had full knowledge regarding the sale. But his plea was rejected by the court and it was held that as there had been no disclosure by the promoters of the profits they were making, the company was entitled to rescind the contract and recover the purchase money from E and other members of the Syndicate.

The disclosure may be made either (*a*) to an independent board of directors; or (*b*) directly to prospective shareholders by means of prospectus or articles.

In relation to disclosure it must be kept in mind that the promoters must make a full disclosure. A half disclosure is sometimes worse than none. Thus in *Gluckstein v. Barnes,* a syndicate was formed to purchase a property called "Olympia" with a view to reselling it to a company. The syndicate first bought charges on the property at a discount and made a profit of £20,000. The syndicate afterwards bought the property, on which it held charges for £1,40,000 with a view to re-selling it to a company to be formed by it. The syndicate then sold the property to "Olympia Ltd.", a company formed by it for £1,80,000. In the prospectus that was issued, the syndicate disclosed the profit of £40,000 and not the former one of £20,000. It was held that the trustees ought to have disclosed the profit of £ 20,000, that they had not disclosed it and that they were bound to pay it to the company.[9]

Consequences of non-disclosure. It has already been observed that where promoters do not make disclosures of material facts while selling their property to the company, the sale may be set aside at the instance

[8](1878) 3 A.C. 1218.
[9](1900) A.C. 240.

of the company. If, however, rescission has become impossible, the company is entitled to claim damages from the promoters and the measure of such damages is the profit made by the promoters upon the purchase and resale of the property.[10]

Liability of Promoters

As we have already seen, the promoter is liable to account to the company for all secret profits made by him without full disclosure to the company. The company can also sue for rescission of the contract of sale by the promoter of the company, where the promoter has not disclosed his interest therein.

Besides, Section 62(1) holds the promoter of a company liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement included in it. However, Section 62 also provides certain grounds on which a promoter can avoid his liability.

Similarly Section 63 provides for criminal liability for misstatements in the prospectus and a promoter may also become liable under this section.

Section 56 lays down matters to be stated and reports to be set out in prospectus. A promoter may also be held liable by shareholders for non-compliance of this section.

He may also be sued for damages in an action for deceit under the general law in case of fraudulent mistatement in the prospectus.

A promoter is also liable to be publicly examined by the court as to his conduct and dealings, where an order has been made for winding up the company by court and the Official Liquidator has made a report to the court starting that in his opinion a fraud has been committed by the promoter in the promotion or formation of the company or in relation to the company since its formation. (Sec. 478)

Similarly he may be held liable to compensate the company if he has misapplied or retained or become liable or accountable for any money or property of the company, or has been guilty of any misfeasance or breach of trust in relation to the company. (Sec. 543)

Remuneration of Promoters

A promoter is not entitled to recover any remuneration for his services from the company unless the company, after its incorporation, enters into a contract with him for this purpose. It may be noted that he has no claim against the company for remuneration even if it may have been settled

[10] *Re Leeds and Hanley Theatres of Varieties Ltd.* (1902) 2 Ch. 809.

previously. The inability of a company to contract before its incorporation makes it impossible for promoters to obtain contractual rights to remuneration for their services. In some cases, articles of the company provide for the directors paying a specified sum to promoters for their services but this does not give the latter any contractual right to sue the company. It is simply an authority vested in directors.[11] Even if there is a clause in their articles authorising the directors to pay the expenses, the latter are not justified in paying out money without due inquiry.[12]

The remuneration may be paid in any of the following ways: (*a*) a commission may be paid to the promoter on the purchase price of the business or property taken over by the company through him; (*b*) the company may grant him a lump sum either in cash or in the form of shares; (*c*) he may purchase the business or other property and sell the same to the company at an inflated price. He must make a disclosure to this effect; (*d*) he may take a commission at a fixed rate on shares sold; or (*e*) promoters may take on option to subscribe within a fixed period for a certain portion of the company's unissued shares at par. This is a valuable option if the shares are likely to hit a premium.

Whatever be the nature of a remuneration or benefit, it must be disclosed in the prospectus if paid within the proceeding two years from the date of the prospectus.

PRELIMINARY CONTRACTS OR PRE-INCORPORATION CONTRACTS

Preliminary contracts are contracts made on behalf of a company yet to be incorporated. Such contracts are generally entered into by promoters to acquire some property or right for and on behalf of the company to be formed. The promoters enter into the preliminary contracts with third parties, generally as agents or trustees of the company. Such contracts are not legally binding on the company because two consenting parties are necessary to a contract, whereas the company, before incorporation, is a non-entity.[13] Even a company cannot ratify such contracts after incorporation because, for valid retification, the principal must have been in existence at the time when the promoters entered into such contracts.

Company not bound by preliminary contracts. A company is not bound by preliminary contracts even if it takes benefits of work done on its behalf. It can be well illustrated by the case of *Re English and Colonial*

[11]*ReRotherham Alum, Etc., Co.* (1883) 25 Ch. D. 103.
[12]*Re Englefied Collery Co.* (1877-78) 8 Ch. D. 388.
[13]5*Kelner v. Baxter* (1866) L.R. 2 C.P. 174.

Produce Ltd.[14]

A solicitor of a company about to be formed prepared memorandum and articles of association on the instructions of persons who ultimately became directors of the company. He also paid the necessary registration fees. The company went into liquidation and he claimed the fees and expenses. It was held that the company was not bound to pay the fees and expenses to the solicitor and therefore it could not be sued in law for those expenses, much as it was not in existence at the time when the expenses were incurred. Similarly, the company cannot enforce such contracts made before incorporation by the promoters.

In *Natal Land Co. v. Pauline Colliery Syndicate,*[15] the company agreed with C, and agent of syndicate about to be formed, to grant to the syndicate the lease of coal mine. The syndicate was subsequently registered, and the lease refused. It was held that the syndicate was not entitled to a specific performance of the said contract against the company, there being no binding contract between the company and the syndicate.

This means that as regards preliminary contracts, the company, when formed, can neither be bound by such a contract nor has it any right to sue a third party into fulfilling it.

Promoter's liability for preliminary contracts. It has already been made clear that the company is neither bound by, nor can have the benefit of, a pre-incorporation contract. It is the promoter who remains personally liable for a pre-incorporation contract. This is because where a contract is made on behalf of a company known to both the parties to be non-existent, the contract is deemed to have been entered into personally by the promoters and they will be held personally liable for such contract. In order to relieve the promoter from the above liability, the company may adopt such contracts by entering into fresh contracts with third parties on the same terms and conditions as given in preliminary contracts entered into by promoters for and on behalf of the company yet to be formed. Only then is there a contract between the company and the vendor.

Even the fact that the adoption of the preliminary contract is made one of the objects of the company in its memorandum or articles, or that the company has passed a special resolution to adopt it, will not create a contract between the company and the vendor.[16]

Similarly if a company acts on the basis of contract made before its formation under the mistaken belief that the contract is binding on it, it is no evidence of a new contract and it does not bind the company.[17]

[14](1906) 2 Ch. 435.

[15](1904) A.C. 120.

[16]*North Sydney Investment Co. v. Higgins* (1899) A.C. 263.

[17]*Re Northumber land Avenue Hotel Co.* (1886) 33 Ch. D. 16.

But in *Howard v. Patent Ivory Co.,* where the promoters had made a contract for purchase of property for the company to be formed and the contract of sale was carried into effect by the conveyance of property and by issue of debentures which was to be the consideration, it was held to be an evidence of a fresh contract between the company and vendor and the company could not repudiate the contract.[18]

In order to be on the safe side promoters generally include a clause in the preliminary contracts stating that if the company makes a contract in terms of the preliminary contract, his liability shall cease; if one the other hand, the company does not do so within a certain time, either party shall have a right to rescind it.

Specific performance of preliminary contracts. However, the principles enunciated and illustrated above have really had no application in our country in view of the provisions of Specific Relief Act, 1963. Section 17 and 19 of this Act lay down that where the promoters of a company have, before its incorporation, entered into contracts for the purpose of the company and such contracts are warranted by terms of incorporation, specific performance may be obtained by or enforced against the company if the company has accepted the contract after its incorporation and has communicated such acceptance to the other party.

The term "contracts for the purposes of the company" used above refers to such contracts as are necessary for the incorporation and working of the company, for instance, contracts for the preparation and printing of the memorandum and articles of association or contracts for the supply of necessary raw materials or machinery for the functioning of the company. However, for such a contract to be enforceable, it is necessary that the company has accepted the contract after its incorporation and has communicated such acceptance to the other party.

Preliminary contracts and provisional contracts. Any contract made by a public company after incorporation but before the date on which it is entitled to commence business shall be provisional only and shall not be binding on the company until the certificate of commencement of business is obtained. Such provisional contracts become binding automatically on the issue of the certificate of commencement of business. [See. 149(4)]

This means that there are three situations in the case of a public company in which contracts are made on its behalf:

(*i*) Contracts made before its incorporation--preliminary or pre-incorporation contracts.

(*ii*) Contracts made after incorporation of a public company but

[18](1888) 38 Ch. D. 156.

before obtaining the certificate of commencement of business-provisional contracts.

(*iii*) Contracts made by a public company after obtaining the certificate of commencement of business are legally binding on the company.

It may be noted here that a private company can commence business immediately after obtaining the certificate of incorporation. Therefore, contracts which are made before incorporation of a private company are known as preliminary or pre-incorporation contracts. But a private company becomes legally bound by all such contracts which are made after its incorporation. Hence, there is no need for provisional contracts in the case of a private company.

REGISTRATION OR INCORPORATION

This is the second stage of formation of the company. In this stage the company is registered with the Registrar of Companies under the Companies Act. Section 12 provides that for forming a public company at least seven persons and for forming a private company at least two persons are required. These persons will subscribe their names to the memorandum of association and will also comply with the requirements of the Companies Act in respect of registration to form and incorporate a company, with or without limited liability. Accordingly, the company formed under this section may be (*a*) a company limited by shares; (*b*) a company limited by guarantee; or (*c*) an unlimited company.

However, before registration the promoters must take the following steps:

(*i*) they must obtain the approval of the proposed name from the Registrar of Companies. To take approval of the name, an application has to be made in the prescribed form. The application should be filed with the prescribed fee and it will be better for promoters to select and send 3 or 4 names in order of preference;

(*ii*) they must have necessary documents prepared and printed;

(*iii*) they must obtain the licence under the Industries (Development and Regulation) Act, 1961, if it is required in case of the business to be started by the company; and

(*iv*) they must prepare preliminary contracts and a prospectus or statement in lieu of a prospectus.

Filing Documents with the Registrar

The following documents are to be filed with the Registrar of Companies of the State in which the registered office of the company is to be

situated, along with an application for registration and necessary fees:

(1) The memorandum of association of the company, which shall be printed, divided into paragraphs and signed by each subscriber who shall add his address, description and occupation in the presence of at least one witness who shall attest his signature. [Sec. 33(1)(a)]

(2) The articles of association of the company, if any, which shall also be duly signed by subscribers of the memorandum of association. A public company limited by shares may not have its own articles and, in that case, Table A, the model set of articles, shall be applicable but this fact must be specified on the memorandum. However, all other companies must prepare their articles which shall be filed with the Registrar along with the memorandum. [Sec. 33(1)(b)]

(3) The agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole-time director or manager. [Sec. 33(1)(c)]

It may be noted here that the above clause has been inserted by the Companies (Amendment Act), 1988.

(4) Notice of address of the registered office of the company must be given to the Registrar within 30 days of incorporation if it cannot be filed at the time of registration. (Sec. 146)

(5) A list of persons who have given their consent to act as directors of the company must be filed with the Registrar.

(6) The written consent of every proposed director signed by him, along with a written undertaking to take up and pay for qualification shares, if any, must be filed with the Registrar. This is, however, not necessary for companies other than public companies limited by shares. [Sec. 266(1)(5)]

(7) A declaration that all the requirements of this Act in respect of registration have been complied with. The declaration can be made by any of the following: (*a*) an advocate of the Supreme Court or a High Court; (*b*) an attorney or a pleader entitled to appear before a High Court; (*c*) a secretary or chartered accountant in whole-time practice in India, who is engaged in the formation of a company; or (*d*) a person named in the articles as a director, manager or secretary of the company. [Sec. 33(2)]

Registration of company. The Registrar will examine the documents. He may, however, accept the declaration as sufficient evidence of compliance with the Act. If he is satisfied that all requirements of the Act in respect of registration have been complied with, he will register the company and place its name in the Register of Companies. A certificate of incorporation will be issued whereby the Registrar whall certify under his hand that the company is incorporated and, in the case of a limited

company, that the company is limited. [Sec. 34(1)]

If the requirements of registration have been complied with, the Registrar has no power to refuse registration.[19] But if the Registrar improperly refuses to register the company, he may be compelled to register the company by an order of the court.[20]

Where the documents are refused registration, the fee paid at the time of filing of documents with the Registrar is not refundable.[21]

Effect of registration. From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum. It becomes capable of exercising all the functions of an incorporated company having perpetual succession and a common seal. [Sec. 34(2)]

Conclusiveness of Certificate of Incorporation

The certificate of incorporation is the birth certificate of a company. The company comes into existence from the date mentioned in the certificate of incorporation and the date appearing on it is conclusive, even if wrong. This is illustrated by the decision in *Jubilee Cotton Mills Ltd. v. Lewis.*[22] In this case, the necessary documents were delivered to the Registrar for registration on 6th January. Two days later, the Registrar issued the certificate of incorporation but dated it 6th January instead of 8th January, the day on which the certificate was issued. On 6th January, some shares were allotted to Lewis. The question arose whether the allotment made before the certificate was actually issued was void. It was held that the certificate of incorporation is conclusive evidence of all that it contains. The company comes into existence from the date mentioned in the certificate, even if wrong. Therefore, in law the company was formed on 6th January and allotment of shares was valid.

Not only does the certificate created the company, the certificate is conclusive for all purposes. Section 35 lays down that a certificate of incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto and that the company is duly registered under this Act.

Thus, where the memorandum was materially altered after the signatures of the subscribers but before registration, and the company was

[19]*Princess of Reuss v. Bos.*, (1871) L.R. 5 H.L. 176.

[20]*R. v. Registrar of Companies, Ex. p. Bowen* (1914) 3 K.B. 1161.

[21]*Ratanshi Panchan Tank v. Registrar of Companies,* A.I.R. (1971) Ker. 1.

[22](1924) A.C. 958.

registered by the Registrar and the certificate of incorporation issued, it was held that the certificate is conclusive and no court has power to annul it. "When once the certificate of incorporation is given, nothing is to be inquired into as to the regularity of the prior proceedings."[23]

Where even five subscribers to the memorandum were minors, it was held that though the Registrar should not have issued the certificate, it was conclusive for all purposes.[24]

Similarly, where the objects of the company are illegal but it has obtained a certificate of incorporation, the certificate would prevent any doubt from being raised as to the legal personality of the company, but the certificate would not validate the illegal objects.[25]

Once the company is created, it cannot be got rid off except by resorting to provisions of the Act which provide for the winding up of companies. The certificate of incorporation, even if it is irregular, cannot be cancelled.[26]

CAPITAL SUBSCRIPTION

It has already been pointed out that a private company can commence business immediately on receipt of the certificate of incorporation. But a public company cannot commence business unless it obtains another certificate called 'the certificate of commencement of business' from the Registrar of Companies. For this purpose, a public company has to go through 'capital subscription stage' and 'commencement of business stage'.

Making necessary arrangements for raising capital . In the capital subscription stage, the company makes necessary arrangements for raising the capital of the company. It may noted here that after the incorporation of a company, the affairs of the company are taken over by the directors. Usually, the promoters are the first directors of the company. In order to make necessary arrangements for raising the capital of the company, a meeting of the board of directors will be convened to deal with the following business:

(*a*) Appointment of secretary and fixing the terms and condition of his appointment. Usually, the appointment of *pro tem* secretary appointed by the promoters at promotion stage is confirmed.

(*b*) Appointment of bankers, brokers, solicitors and auditors.

[23]*Peel's Case* (1867) L.R. 2 Ch. App. 674.
[24]*Moosa v. Ebrahim* 40 Cal. 1 (P.C.)
[25]*Bowman v. Secular Society Ltd.* (1917) A.C. 406.
[26]*Princess of Reuss v. Bos.* (1871) L.R. 5 H.L. 176.

(*c*) Adoption of preliminary contracts entered by the promoters on behalf of the company in the pre-incorporation stage.

(*d*) Adoption of underwriting contracts in order to secure minimum subscription.

(*e*) Adoption of the draft 'prospectus' or 'statement in lieu of prospectus'.

(*f*) Appointment of managing director or manager and other responsible officers of the company.

(*g*) Approval of the design of the common seal of the company and authorising the custody thereof.

(*h*) Listing of shares on the stock exchange.

It may be noted here that the new comprehensive guidelines issued by the Securities and Exchange Board of India (SEBI), have scrapped the need for prior approval for raising capital from the Controller of Capital Issues with the repeal of the Capital Issues (Control) Act, 1947. (*Text of the Guidelines issued by the Securities Exchange Board of India (SEBI) is given in the Appendix at the end of the book*).

Inviting public subscription. Where the directors of public company wish to invite the public to subscribe for its shares, they will file a copy of the prospectus with the Registrar of Companies. On the advertised date the prospectus will be issued to the public. No prospectus can be issued unless a copy of it has been filed with the Registrar. Prospective investors can obtain a copy of the prospectus either from the company's registered office or its bankers. Investors are required to forward their applications for shares along with application money to the company's bankers mentioned in the prospectus. The bankers will then forward all applications to the company and the directors will consider the allotment of shares. If the subscribed capital is at least equal to the minimum subscription as disclosed in the prospectus, the directors will allot shares to the applicants. Allotment letters will be sent to those applicants who have been allotted shares in the company whereas letters of regret will be sent to those who have been refused. A return as to allotment is filed with Registrar. In due course of time, a register of members will be prepared and share certificates will be issued to shareholders in exchange of letters of allotment. If the company does not receive applications, which can cover the minimum subscription within 120 days of the issue of prospectus, no allotment can be made and all moneys received will be refunded.

Arranging capital privately. Sometimes a public company may decide not to approach the general public for selling its shares as it may be in a position to obtain the required capital privately. In this situation the

company will file a statement in lieu of prospectus with the Registrar at least three days before the allotment of shares. It need not issue a prospectus. It may also be noted that the contents of a prospectus and a statement in lieu of a prospectus are more or less the same. (Sec. 70)

COMMENCEMENT OF BUSINESS

A private company can commence business immediately after obtaining certificate of incorporation. But a public company cannot commence business until it receives the certificate of commencement of business.

Companies issuing prospectus. A company which has issued a prospectus inviting the public to subscribe for its shares cannot commence any business or exercise any borrowing powers unless, (*a*) shares payable in cash have been allotted to an amount not less than the minimum subscription; (*b*) every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others; (*c*) no money is liable to be repaid to the applicants for failure to apply for, or to obtain, the permission for the shares or debentures to be dealt in on any recognised stock exchange; and (*d*) a declaration duly verified by one of the directors or the secretary that the above requirements have been complied with is filed with the Registrar. If the company has not appointed a secretary, it can get the declaration signed by a secretary in whole-time practice. [Sec. 149(1)]

Companies not issuing prospectus. Where a company with a share capital has not issued a prospectus inviting the public to subscribe for its shares, it shall not commence any business or exercise any borrowing power, unless (*a*) a statement in lieu of a prospectus is filed with the Registrar: (*b*) every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others; (*c*) a declaration duly verifed by one of the directors or the secretary that above requirements have been complied with is filed with the Registrar. If the company has not appointed a secretary, it can get the declaration signed by a secretary in whole-time practice. [Sec. 149(2)]

When the company fulfils the above conditions, the Registrar shall certify that it is entitled to commence business and that the certificate shall be conclusive evidence that the company is so entitled. [Sec. 149(3)]

Provisional contracts. Any contract made by a public company after incorporation but before the date on which it is entitled to commence business shall be provisional only and shall not be binding on the company until the certificate is obtained. [Sec. 149(4)]

Thus where the goods are supplied to the company which never

becomes entitled to commence business, no one can sue the company for the price of goods supplied to it.[27]

Failure to commence business. It may also be noted that the court has the power to wind up a company, if it does not commence its business within a year of its incorporation. [Sec. 433(3)]

QUESTIONS

1. Explain the different steps to be taken to float a public limited company from its inception to the commencement of business.

2. How is a joint stock company incorporated? Mention the documents which are filed with the Registrar in that connection.

[*Delhi. B. Com. (Hons.) 1971*]

3. Describe the documents necessary for a company to be incorporated and to function under the Companies Act 1956.

4. Explain the steps to be taken and procedures to be followed for the incorporation of a limited company. [*C.A. (Final), Nov., 1978*]

5. Discuss the essential steps towards the incorporation of a company.

[*Kerala, B. Com. 1974*]

6. Explain the procedure for incorporation of a company and briefly describe the various documents that are to be filed with the Registrar of Companies at the time of incorporation. [*Allahabad, B. Com. (Part II), 1978*]

7. "A promoter is not a trustee or an agent of the company but he stands in a fiduciary position towards it." Comment. [*Delhi, B. Com. (Hons.), 1975, 1969*]

8. (*a*) What is the legal position of the promoters of a company?

(*b*) "The validity of a certificate of incorporation cannot be disputed on any ground whatsoever." Comment. [*Delhi, B. Com. (Hons.), 1977*]

9. Who is company promoter? Discuss the work of a company promoter and his relationship with the company. What are the rights and liabilities of the promoter and how is he remunerated by the company for his work?

[*Agra, M. Com., 1959*]

10. State the legal position of pre-incorporation contracts. Can a company ratify such contracts? [*Delhi, B. Com. (Hons.), 1979*]

11. Distinguish between preliminary and provisional contracts.

[*Delhi, B. Com. (Hons.), 1979*]

12. Any contract made by a company before the date at which it is entitled to commence business shall be provisional only. Explain.

[*Delhi, B. Com. (Hons.), 1985*]

13. State the present position of law relating to commencement of business by a newly incorporated company and commencement of a new business by an existing company. [*Company Secretary (Final), April 1974*]

[27]*Re "Otto" Electrical Manufacturing Co.*, (1906) 2 Ch. 390.

PRACTICAL PROBLEMS

1. *A*, on the instructions of promoters of a company, prepared Memorandum of Association and Articles of Association, paid the registration fees and got the company incorporated. *A* claims his cost and charges from the company. The company refused to pay. Will *A* succeeded?

[*Delhi, B. Com. (Hons.), 1972*]

2. The Memorandum of Association and the Articles of Association of a company were delivered to the Registrar on 10 June for registration. On 15 June, the Registrar issued the Certificate of Incorporation but dated 10 June. The company made allotment of its share on 12 June. The allotment is challenged on the ground that it was mode before the actual date of incorporation. Is the allotment of shares valid? [*Delhi, B. Com. (Hons.), 1973*]

3. *A*, a furniture dealer, entered into a contract with the company for the furnishing of the offices of the company. The company went into liquidation before it could obtain certificate of commencement of business. Can *A* prove in the winding up for the price of the furniture supplied to the company?

[*Delhi, B. Com. (Hons.), 1974, 1990*]

4. The promoters of a company, incorporated on 1 July 1973 had entered into a contract with *X* on 1 April 1973 for supply of goods when the company came into existence. The company, however, does not want to proceed with the contract. Discuss the correctness or otherwise of the company's action.

[*C.A.(Final), May 1974*]

5. The memorandum of association of a public company was signed by two adult persons and the other five signatories to the memorandum were minors. The Registrar, however, registered the company and issued under his hand certificate of incorporation. Can the certificate of incorporation be challenged?

6. After signatures and before registration a proposed memorandum of association had been altered without the authority of the subscribers so materially and the alteration entirely neutralised and annihilated the original execution and signature of the document. The Registrar, however, registered the company and issued under his hand a certificate of incorporation. The subscribers objected that they had never signed the memorandum of association with which the company was registered and the provisions of the Act had not been compiled with. Discuss.

7. The memorandum of association of a company, was presented to the Registrar of the Companies for registration and the Registrar issued the certificate of incorporation. The company, after complying with all the prescribed legal formalities, started a business according to the objects clause which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Discuss.

5

MEMORANDUM OF ASSOCIATION

MEANING AND IMPORTANCE

A company's memorandum of association is of supreme importance. The first step in the formation of a company is to prepare a memorandum of association because no company can be formed or registered under the Companies Act without it. It is the charter of the company. "It contains fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors and the outside public as well of the shareholders."[1] It sets out the constitution of the company and provides the foundation on which the company is built. It lays down the objects and scope of activities of the company and also defines the relationship of the company with the outside world. Its importance can be gauged by the fact that it contains rules regarding the capital structure of the company, the liability of its members and its scope of activiries. "Its purpose is to enable shareholders, creditors and those who deal with the company to know what is its permitted range of enterprise."[2]

It may be noted here that a memorandum not only defines the powers of the company but also confines them. Nothing beyond the powers as defined by the memorandum, shall be attempted by the company. If this is done, it shall be considered *ultra vires.* It was rightly pointed out in *Ashbury Railway Carriage & Co. v. Riche*[3] that, "the memorandum is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit."

Purpose of memorandum. The purpose of a memorandum is two-fold. In the first place, it gives protection to shareholders who learn from it the purposes to which their money can be applied. In the second place, it

[1]*Guinness v. Land Corporation of Ireland* (1882) 22 Ch. D. 359.

[2]*Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd.* (1931), A.C. 677.

[3](1875) L.R. 7H.L. 653, 671.

gives protection to persons who deal with the company and who can infer from it the extent of the company's powers. They can know with certainty as to what the objects of the company are and as to whether the contractual relation to which they contemplate entering with the company is within the corporate objects of the company.[4]

Unalterable charter to some extent. Memorandum of association is a fundamental document of the company. Being the very basis of the company, it is not allowed to be altered by the company every now and then in the interests of its members, creditors and the outside public dealing with it. The unalterable character of the memorandum is recognised by Section 16 of the Companies Act, 1956. It lays down that a company shall not alter the conditions mentioned in its memorandum except in cases and in the manner and to the extent provided in the Act in Sections 17-19. That is why the memorandum is regarded as an unalterable charter of a company.

Form of memorandum. Section 14 of the Act lays down that the memorandum shall be according to the prescribed form or as near to it as the circumstances admit. These prescribed forms, as given in Schedule I of the Act, are as follows:

Table B for memorandum of a company limited by shares.

Table C for memorandum of a company limited by guarantee and not having a share capital.

Table D for memorandum of a company limited by guarantee and having share capital.

Table E for memorandum of an unlimited company.

Printing and signing of memorandum. The memorandum shall be (*a*) printed; (*b*) divided into paragraphs numbered consecutively; and (*c*) signed by each subscriber (who shall add his address, description and occupation, if any), in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any. (Sec. 15)

CONTENTS OF MEMORANDUM

Section 13 of the Companies Act lays down that the memorandum of association of every company shall contain the following clauses:

(1) **Name Clause.** In this clause the name of the company, with "Limited" as the last word of the name in the case of a public company and "Private Limited" as the last words in the case of a private company, must be stated. It may be noted here that a company has a seperate legai

[4]*Cotman v. Broughman* (1918) A.C. 514.

entity and is recognised by its name.

Licence to drop the word 'Limited.' Where it is proved to the satisfaction of the Central Government that an association is (*a*) about to be formed as a limited company for promoting commerce, art, science, religion, charity or any other useful object, and (*b*) intends to apply its profits, and other income in promoting its objects and prohinbits the payment of any dividend to its members, it may direct that the association be registered as a company with limited liability, without the addition to its name of the word "Limited" or the words "Private Limited." (Sec. 25)

Undesirable names to be avoided. Ordinarily, a company is free to adopt any name it likes. But the name should not be one which, in the opinion of the Central Government, is undesirable. A name which is identical with or which closely resembles the name of an existing company may be considered undesirable by the Central Government. (Sec. 20)

Generally, no company can trade with a name identical or similar to that of an already existing company, so as to deceive the prospective customers of one into trading with the other.[5]

When a company has been registered under a name that resembles the name of an existing company, the existing company can apply for an injunction restraining the new company from the use of such a name. It may be noted here that since a company is recognised by its name, which becomes a part of its business reputation, it would be injured if a new company were to adopt it.

Before the court grants an injunction restraining the new company from using the name, it must be shown that resemblance between the two names is such as is calculated to deceive or mislead. In *Society of Motor Manufacturers and Traders Ltd. v. Motor Manufacturers and Traders Mutual Assurance Co. Ltd.,* where a company was incorporated to conduct the business of motor vehicle assurance under a name somewhat similar to that of a motor dealers' trade protection association, the court refused an injunction to the association because the difference between the activities of the company and the association precluded any possibility of confusion.[6]

In *Ewing v. Buttercup Margarine Co.,*[7] *Ewing* was carrying on business under the name of *Buttercup Dairy Company* as a wholesale and retail provision merchant. A new company, *Buttercup Margarine Co.,* was formed with the object of manufacturing and selling margarine i

[5]*Tussaud v. Tussaud* (1890) W.N. 78.
[6](1925) 1 Ch. 675.
[7](1917) 2 Ch. 1.

wholesale. *Ewing* applied to the court for restraining the new company from using the name, contending that it was calculated to deceive and that people were likely to be confused into thinking of both companies as one or closely related. The court granted an injunction.

The court, however, will not grant an injunction to prevent the use of a purely descriptive word with a definite meaning and in common use. In *Aerators Ltd. v. Tollitt,*[8] the business of the plaintiff was the sale of apparatus by which small quantities of liquids could be aerated. The defendant proposed to register a company to be called *Automatic Aerators Limited,* the object of which was to work patents in respect of aeration of liquids in large quantities. The court did not grant the injunction as both companies had different patents and apparatus although the main object of both was to manufacture apparatus for the instantaneous automatic aeration of liquids.

Certain names prohibited by statute. A company cannot adopt a name which attracts the provisions of the Emblems and Name (Prevention of Improper Use) Act, 1950. This Act prohibits the use of the name and emblems of the United Nations and the World Health Organisation, the official seal and emblems of the Central and State Governments, the Indian national flag, the name and pictorial representation of Mahatma Gandhi and the Prime Minister of India.

Publication of name. Every company shall paint or affix its name and the address of its registered office outside every office or place in which the business of the company is conducted [Sec. 147(1)(a)]. Similarly every company shall have its name engraved in legible characters on its seal. [Sec. 147(1)(b)]

Every company shall have its name and the address of the registered office mentioned in legible characters on all its business letters, bill heads, letter paper, all notices and other official publications, all negotiable instruments issued or endorsed by the company and on all other orders, receipts, invoices and letters of credit. [Sec. 147(1)(c)]

(2) Registered office clause. This clause states the name of the State in which the registered office of the company will be situated. But the full address of the registered office must be communicated to the Registrar within 30 days of incorporation or from the date it commences business, whichever is earlier. All communications and notices to the company shall be addressed to its registered office. (Sec. 146)

The situation of registered office determines its domicile and all important books and statutory registers shall be kept at its registered office.

[8](1902) 2 Ch. 319.

(3) **Objects clause.** This is the most important clause in the memorandum. It defines the sphere of the company's activities, the aims that its formation seeks to achieve and the kind of activities or business that it proposes to conduct. A company cannot conduct any business foreign to its objects clause. If anything unauthorised by the objects clause is undertaken, it is considered *ultra vires* and hence not binding on the company.

Why objects? The objects clause of the memorandum gives protection to shareholders who learn from it the purposes for which their money can be applied. It ensures them that their money will not be risked in any business other than that for which they have been asked to invest. Similarly, it also protects individuals who deal with the company and who can infer from it the extent of the company's powers. The creditors of the company who are to receive repayment of their moneys from the assets of the company feel secure if they know that the funds of the company will not be utilised for any object not mentioned in the objects clause.

Choice of company's objects. Subscribers to the memorandum may choose any object or objects for the proposed company. However, they must keep in mind certain points while drafting the objects clause of the memorandun.

(1) The objects should not include anything illegal or against the general law of the country. For instance, the general law of the country prohibits gambling and thus no company can be formed for this purpose.

(2) They should not include anything in contravention of the Act itself. For example, a clause in the memorandum providing that the company can buy its own shares is invalid, as the Act prohibits purchase of its own shares by the company.

(3) They should not include anything which is against public policy, for instance, trading with alien enemies.

Construction of Objects Clause

As a result of the Companies (Amendment) Act, 1965, Section 13 lays down that in the case of a company in existence before this amendment, the objects clause of the memorandum should simply state the objects of the company. But in the case of a company formed after such amendment, the objects clause must be divided into two groups.

(*i*) *Main Objects.* This group will cover the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.

(*ii*) *Other Objects.* This group will cover any objects not included in the above group. In case of companies (other than trading corporations) whose objects are not confined to one State, the objects clauses should

also mention the names of the States to whose territories the objects of the company shall extend.

Ancillary or incidental objects. An act of the company can be covered under "ancillary or incidental to the main object" if it is helpful in the attainment of the latter.

It may be further noted that the objects clause generally includes such words as "to do all such things as are incidental or ancillary to the attainment of the main objects." These words do not increase the area of the company's powers as defined by the preceding clause of the memorandum. These words should be construed as being limited to the doing of such things as are legitimately necessary to the attainment of the objects previously specified. The following instances provide ample illustration of this:

Where a company expended money on scientific research, while its main object was the business of chemical manufacturing, it was held that the act was conducive to attainment of the main object of the company and therefore very much within its powers.[9]

Similarly, where the main object of the company was to supply boats for ferry and it used the boats, when not required for the ferry, in excursion, this was also held to be very much within the powers of the company as it was incidental to its main objects.[10]

However, an act of the company does not become incidental or ancillary merely because it is to the benefit of the comapny but is not any way helpful or essential to the attainment of its main object. Accordingly, the council having a statutory power to work tramways was restrained from running omnibuses in connection with the tramways. The court held that the council could not undertake the omnibus business as it was in no way incidental to the business of working tramways, however beneficial it might prove to the original business.[11]

(4) Liability clause. This clause states the nature of the liability of members. The memorandum of a company limited by shares or by guarantee shall state that the liability is limited. This means that in the case of a company limited by shares, the member's liability is limited to the face value of shares or so much thereof as remains unpaid and if his shares are fully paid-up his liability is nil. [Sec.13(2)]

However, Section 45 provides that where a company has carried on business with fewer members than the statutory minimum for more than six months, every member who is aware of this fact is serverally liable for

[9]*Evans v. Brunner, Mond & Co.* (1921) 1 Ch. 359.
[10]*Forest v. Manchester etc. Rly, Co.* (1861) 30 Beav. 40.
[11]*London County Council v. Attorney General* (1902) A.C. 165.

the entire debts of the company contracted after a period of six months and may be severally sued therefore. His liability becomes unlimited.

Further, in the case of a company limited by guarantee, this clause shall state the amount which every member undertakes to contribute to the assets of the company in the event of its being wound up. [Sec. 13(3)]

It may be noted here that the liability clause is entirely omitted from the memorandum in an unlimited company.

In a limited company, the memorandum may provide that the liability of the directors or of any director or manager shall be unlimited. (Sec. 322)

(5) Capital clause. This clause states the amount of share capital with which the company is proposed to be registered and the division thereof into shares of fixed amount. This is known as the authorised or nominal capital of the company. The stamp duty and registration fee are payable on authorised or nominal capital. A company cannot issue more shares than are authorised for the time being by the memorandum. The Act does not lay down any rules for fixing the authorised capital of the company but it should be sufficiently high considering the immediate needs of the business and possible expansion in the near futue. It is not essential to mention here the rights attached to different classes of shares which may be provided for in the article. This clause is to be omitted in the case of companies with unlimited liability and the companies limited by guarantee having no share capital.

(6) Association or subscription clause. In this clause the subscribers declare that they desire to be formed into a company and agree to take shares stated against their names. No subscriber will take less than one share. The memorandum has to be subscribed to by at least seven persons in the case of a public company and by at least two persons in the case of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall add his address, description and occupation, if any. This clause generally runs in this form: "We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the memorandum of association and we respectively agree to take the number of shares in the capital of the company, set opposite of our respective names."

After registration, no subscriber to the memorandum can withdraw his subscription on any ground.[12]

Further, the subscribers of the memorandum appoint the first directors of the company. If they do not appoint any, the subscribers

[12]*Re Metal Constituents Co. (Lord Lugan's Case)* 1 Ch. 707.

themselves become the directors by the very fact of incorporation. They shall hold office until the directors are elected in the first annual general meeting of the company. (Sec. 254)

ALTERATION OF THE MEMORANDUM

A company shall not alter the conditions contained in its memorandum except in the cases, in the mode, and to the extent for which express provision is made in this Act. [Sec. 16(1)]

The conditions contained in the memorandum can be altered as below:

(1) **Change of name.** *By special resolution.* A company may change its name by special resolution and with the approval of the Central Government signified in writing. However, no such approval shall be required where the only change in the name of the company is the addition thereto or the deletion therefrom, of the word "Private", consequent on the conversion of a public company into a private company or of a private company into a public company. (Sec. 21)

By ordinary resolution. If through inadvertence or otherwise, a company is registered by a name which, in the opinion of the Central Government, is identical with or too nearly resembles the name of an existing company, it may change its name by an ordinary resolution and with the previous approval of the Central Government signified in writing. [Sec. 22(1)(a)]

In such a case the Central Government can also direct a company within twelve months of registration to change its name. The company must change its name by passing an ordinary resolution and with the approval of the Central Government, within a period of three months from the date of the direction or such longer period as the Central Government may sanction. [Sec. 22(1)(b)]

Registration of change of name. With in 30 days of passing of the resolution, a copy of the same shall be filed with the Registrar. A copy of the order of the Central Government's approval shall also be filed with the Registrar within 3 months of the order. The Registrar shall enter the new name in the Register of Companies in place of the former name and shall issue a fresh certificate of incorporation with the necessary alterations. The change of name shall be complete and effective only on the issue of such certificate. The Registrar shall also make the necessary alteration in the company's memorandum of association. (Sec. 23)

The change of name shall not affect any right or obligations of the company or render defective any legal proceedings by or against it. (Sec. 23)

(2) **Change of objects clause.** The objects clause can doubtless be altered, but the alteration is subject to a number of restrictions. These restrictions are intended to protect the interests of the shareholders and creditors of the company. Section 17 of the Companies Act lays down the procedural and substantive limits on the power of alteration to the objects clause. The idea is that a company is incorporated for the conditions contained in the memorandum and it should not be allowed to make alteration of the objects clause a routine affair.

Substantive Limits

Section 17(1) provides that a company may change its objects clause in so far as it is necessary for any of the following purposes:

(1) *To conduct its business more economically or efficiently.* Under this clause there is only very limited scope for amendment because the business which the company is to conduct must be the same as before. The change pertains only to the mode of conducting the business enabling the company to do so more economically and efficiently.

In *Re Scientific Poultry Breeders' Association Ltd.*[13] the main object of the company was to encourage and improve the breeding of poultry. Its memorandum also prohibited payment of remuneration to or division of profits among the members of the governing body. When the business and membership of the company increased, it was found that members of the governing body were unable to give proper attention to the management of its affairs unless some remuneration was paid to them. It passed a special resolution for payment of equitable remuneration to the members of the governing body. When the petition was presented to the court for sanction, it was held that the alteration did not affect the main object of the company and would enable it to carry on its business more economically or efficiently.

(2) *To attain its main purpose by new or improved means.* In this case the emphasis is on attainment of the main objects of the company. The latter is permitted to alter the means of conducting its business, enabling it to take advantage of new scientific discoveries and inventions.

(3) *To enlarge or change the local area of its operations.* In this clause also the business of the company remains the same, the only change is in the areas of its operation. In *Indian Mechnical Gold Extracting Co.*[14] the memorandum confined the area of its operations to India. The company passed a special resolution deleting the words "in India" from the memorandum so as to enlarge its area of operation. The court confirmed

[13](1933) Ch. 227.
[14](1891) 3 Ch. 538.

the alteration on the ground that it would enable the company to enlarge its area of operations. The court also directed that the company should change its name in such a manner that it did not give the impression that its business operations were confined only to India.

(4) *To carry on some business which under the existing circumstances may conveniently or advantageously be combined with the business of the company.* This clause gives very wide powers to the company to alter its objects clause. A company may take up any new business which can conveniently or advantageously be combined with the existing business of the company at the date of the proposed alteration.

In *Parent Tyre Co.*[15] it was held that the additional business which a company, by alteration of its memorandum, may carry on may be wholly different from and bear no relation to its existing business, provided it is capable of being conveniently and advantageously combined with it. Moreover it should not be destructive or inconsistent with the existing business. Whether a business is such or not is for the company's shareholders and managers to judge. In this case a tyre company was authorised to conduct the general business of bankers and financiers. The company in this case had never manufactured tyres as it had always been a holding company. All its funds were invested in *Dunlop Rubber Co. Ltd.*, and it wished to spread its investment risks over a wider range of securities.

Similarly, a company which was formed for generating power was allowed to make alteration in its objects clause under this condition so as to enable it to carry on cold storage and other allied business.[16]

But a company which was formed for carrying on distillery business and other allied objects to that business was not permitted to undertake cinema business as the new business could not conveniently or advantageously be combined with the existing business of the company.[17]

In *Re Cyclist Touring Club*,[18] a company was incorporated to protect and promote the interests of pedal cyclists on public roads. The company passed a special resolution so as to include all vehicles including motors. The court disallowed the alteration as it was inconsistent with the objects of the company because cyclists had to be protected against danger from motorists. The court held that the company would find itself in the impossible position of having to protect one class of members from another.

(5) *To restrict or abandon any of the objects specified in the*

[15](1923) 2 Ch. 222.

[16]*Re Ambala Electric Supply Co. Ltd.* (1963) Comp. Cas. 585.

[17]*Punjab Distillery Industries Ltd. v. Registrar of Companies* (1963) Comp. Cas. 811.

[18](1907) 1 Ch. 269.

memorandum.

(6) *To sell or dispose the whole or any part of the undertaking.*

(7) *To amalgamate with any other company or body of persons.*

Procedural Limits

The following procedure must be followed for altering the objects clause:

(i) Special resolution. A special resolution authorising the alteration must be passed at a general meeting of the company. (Sec. 17)

It is worth noting here that the Companies (Amendment) Act, 1996 has dispensed with the requirement of seeking the confirmation of the Company Law Board for alteration of the objects clause.

(ii) Registration of alteration. A copy of the special resolution authorising the alteration together with a copy of the altered memorandum shall be filed with the Registrar within one month from the date of such resolution. The Registrar shall register the same and certify the registration within one month. Alteration takes effect when it is so registered. (Sec. 18)

(3) Change of location of the registered office. The procedure for changing the company's registered office may be studied under the following heads:

(a) *Change within the same city.* If a company intends to change the location of its registered office from one place to another within the same city, town or village, all that is required is a resolution of the board of directors and the notice to be given to the Registrar within 30 days of the change. [Sec. 146(2)]

(b) *Change from one city to another city in the same State.* If a company intends to shift its registered office from one city, town or village to another within the same State, a special resolution should be passed at a meeting of the shareholders and a copy of the said resolution is to be filed with the Registrar within 30 days of the passing of the resolution. Notice of the new location must be given to the Registrar within 30 days of the shifting of the office. [Sec. 146(2)]

(c) *Change from one State to another.* A company can shift its registered office from one State to another only for meeting out any of the purposes (substantive limits) discussed above under Section 17 (1). Besides, the following procedure shall be followed for effecting the change:

(i) *Special resolution.* A special resolution authorising the alteration must be passed by the company and a copy thereof should be filed with the Registrar within 30 days of the passing of the resolution.

(ii) *Confirmation by Company Law Board.* The alteration must be confirmed by the Company Law Board. Before confirming the alteration, the Board shall consider the objections of persons whose interests will, in the opinion of the Board, be affected by the alteration. After considering the above factors, the

Company Law Board may make an order confirming the alteration on such terms and conditions as it thinks fit. It has the discretion even to refuse to confirm the alteration. (Sec. 17)

In this connection it is important to note that the Orissa High Court held that the State in which the registered office of the company is situated could oppose the shifting of the registered office to places outside that State on the ground of loss of revenue and employment opportunities.[19]

But the Calcutta High Court has dissented from the above decision and taken a contrary view. It has held that State has no right to oppose the shifting of registered office from one State to another on the ground of loss of revenue. It was pointed out that the consideration of loss of revenue is not only irrelevant, but if it is accepted it would deprive the company of the statutory power conferred on it by Section 17. The State may, however, object as a creditor in respect of arrears of revenue due to it.[20] The Bombay High Court also took a similar view.[21]

(iii) *Registration of alteration.* Where the alteration involves a transfer of the registered office from one State to another, a certified copy of the order of the Company Law Board together with a printed copy of the altered memorandum shall be filed with the Registrar of each State with three months from the date of the order. The Registrars shall register the same and certify the registration within one month of the date of the filing of such documents. The Registrar of the State from which such office is transferred shall send to the Registrar of the other State all documents relating to the company registered, recorded or filed in his office. (Sec. 18)

If no registration is made within three months with the Registrar, all proceedings connected with the alteration become void. However, if the Company Law Board is satisfied it may extend time for registering the alteration by one month. (Sec. 19)

(iv) *Notice of new location to Registrar.* Notice of new location must be given to the Registrar with 30 days of the shifting of the office. [Sec. 146 (2)]

(4) Change of liability clause. *No increase in members' liability.* No change can be made in this clause so as to make the liability of members

[19] *Orient Paper Mills Ltd. v. The State A.I.R.*, (1957) Orissa 232: *In Re Orissa Chemical and Distilleries Pvt. Ltd.*, A.I.R. (1961) Orissa 62.

[20] *In re Mackinnon Mackenizie & Co. Pvt. Ltd.*, (1967) 1 Comp. L.J. 200; *Rank Film distributors of India Ltd., v. The Registrar of Companies* A.I.R. 1969 Cal. 32.

[21] *Minerva Mills v. Government of Maharashtra* (1975) 45 Comp. Cas 1.

unlimited. Section 38 provides that the liability of the members or any class of members cannot, by altering thememorandum or articles, be made to take more shares or to pay more for the shares already taken, unless he agrees to do so in writing either before or after the alteration. But a company which is a club or an association can alter its memorandum or articles even if the alteration requires the members to pay recurring or periodical subscriptions or charges at a high rate, without the written consent of the members.

Making directors liability unlimited. A limited company, if authorised by its articles, may alter the memorandum by a special resolution so as to render unlimited the liability of its directors or anyone director or manager. Any person holding the office of director or manager before the alteration shall not be bound by this alteration until the expiry of his present term or unless he has accorded his consent in writing to this effect. (Sec. 323)

Registration of an unlimited company as a limited company. Section 32 provides that a company registered as unlimited may register under this Act as a limited company. The registration of an unlimited company as a limited company under this section shall not affect any debts, liabilities, obligations or contracts incurred or entered into by the company before such registration.

(5) **Changes in the capital clause.** Changes in the capital clause of the memorandum are discussed later in the chapter on 'Share Capital' under the following headings; (*a*) alteration of capital under Section 94; (*b*) reduction of capital; (*c*) reserve liability; (*d*) variation of the rights of shareholders; and (*e*) reorganisation of capital.

DOCTRINE OF ULTRA VIRES

A company is incorporated for some specified objects, stated in its memorandum of association. It cannot do anything outside the powers specified in its memorandum.

Consequently any act done or any contract made by the company which goes beyond the memorandum or which is not expressly or implicitly warranted by it, is *ultra vires* the company. The result is that such an act or contract is wholly void and will not be binding upon the company. It cannot be ratified even by the unanimous vote of all the members of the company.

The doctrine of *ultra vires* is best illustrated in *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche.*[22] A company had been formed, and its object clause was as follows: "To make and sell, or lend on hire, the

[22](1875) L.R. 7H.L. 653.

railway carriages and wagons and all kinds of railway plant, fittings, machinery and rolling stock and to carry on the business of mechanical engineers and general contractors." The company entered into a contract with Messrs. Riche for financing the construction of a railway line in Belgium. Later, the company repudiated the contract on the ground that it was *ultra vires.* Riche brought action against the company for breach of contract and claimed damages. His contention was that the contract was within the powers of the company as it was covered under the general contractor's business. Moreover, it had been ratified by a majority of shareholders.

The contract was held to be *ultra vires* the company by the House of Lords and hence it was null and void. Lord Cairns, L.C., observed: "The term 'general contractors' must be taken to indicate the making generally, of such contracts as are connected with the business of mechanical engineers. If the term 'general contractors' is not so interpreted, it would authorise the making of contracts of any and every description, such as, for instance, of fire and marine insurance and the memorandum, in place of specifying the particular kind of business would therefore, be altogether unmeaning. Hence the contract was entirely beyond the objects in the memorandum of association. If so, it was thereby placed beyond the powers of the company make the contract. If the company could not make it, much less could it be ratified. If every shareholder of the company had been in the room and had said 'That is a contract which we desire to make, and which we authorise the directors to make,' the case could not have stood in any different position from that in which it stands now. The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by Act of Parliament, they were prohibited from doing."

In *Attorney General v. The Great Eastern Railway,*[23] the courts interpreted the rule in a liberal spirit and agreed that the company could do everything incidental to the attainment of its main objects unless it was expressly prohibited.

It may be noted further that incidental objects are not to be treated as separate objects, complete in themselves. They are to be treated as incidental to the company's specified objects and to be used only for the purpose of carrying out those objects.

Main objects Rule of Construction. We find that the principle of *ultra vires* confines the actions of the company to its objects clause. In order to avoid such hardships companies started including every conceivable kind of business in their memorandum. But this defeated the very purpose of the objects clause. A special rule of construction has in some cases been

[23](1880) 5A.C. 476.

applied where the objects clause includes a long list of businesses which the company may undertake. The court identifies one business which appears to be the main business of the company and all other businesses are considered merely ancillary to the main object. This is known as the main objects rule of construction. It is best illustrated in the case of *Re German Date Coffee Co.*[24]

In this case the company was formed for working a German patent which would be granted for manufacturing coffee from dates. The company was also to obtain other patents for improvements on and extensions of the said invention. The German patent was not granted to the company. The latter purchased a Swedish patent and the company started making and selling coffee from dates. On a petition of two shareholders, the court held that as the main object of the company had become impossible, it was just and equitable to wind it up.

Acts held to be intra vires. The following illustrations are helpful in understanding the application of the doctrine of *intra vires:* (*i*) where a company bound to supply boats for ferry employed the boats when not required, for excursions, this was held to be *intra vires,*[25] (*ii*) where a hotel company temporarily let part of its premises not required for its business, this was held to be *ultra vires,*[26] (*iii*) where a company expended money on scientific research, when the main object of the company was the business of chemical manufactures, this was held to be *intra vires.*[27]

Acts held to be ultra vires. But in the following cases, the transactions were held to be *ultra vires:* (*i*) where a railway company undertook to secure capital for, and guarantee profits to, another company about to run steam boats in connection with the line, however beneficial it may be to the railway company, this was held to be *ultra vires,*[28] (*ii*) where a railway company was working coal mines and selling coal at a profit, this was considered *ultra vires,*[29] and (*iii*) where the council having a statutory power to work tramways, proposed to run omnibuses in connection with the tramways, however beneficial it might prove the original business, it was considered *ultra vires.*[30]

Acts ultra vires the directors or articles but intra vires the company. There may be certain acts which are *intra vires* the company but which are *ultra vires* the directors or *ultra vires* the articles. If an act is *ultra vires* the

[24](1882) 20 Ch. D. 169.
[25]*Forrest v. Manchester etc. Rail Co.* (1861), 20 Beav, 40.
[26]*Simpson v. Westminster Palace Hotel Co.* (1860) 8 H.C.L. 712.
[27]*Evans v. Brunner, Mond & Co.* (1921) 1 Ch. 359.
[28]*Colman v. E.C. Rly. 1* (1846) 10 Beav. 1.
[29]*Attorney General v. G.N. Railway Co.* (1860) 1 Dr. & Sm. 154.
[30]*London County Council v. Attorney General* (1902) A.C. 165.

director but *ultra vires* the company, it can be ratified by the shareholders in the general meeting, and thus the company is bound by it. Similarly, if an act is *ultra vires* the articles, it can be ratified by altering the articles through a special resolution. It may be noted here that a company can change its articles with retrospective effect.[31]

Effect of Ultra Vires Transactions

(1) **Injuction.** A company is created for the objects stated in its memorandum. Individuals who buy shares in the company are entitled to believe that their money will not be risked in any business not stated in the company's memorandum. Hence, whenever a company has cmmitted an *ultra vires* act or is likely to do so, any member of the company may restrain it by getting an injuction against it.

(2) **Personal liability of directors for ultra vires payments.** The directors must see to it that the funds of the company are used for carrying on the authorised business as stated in its memorandum. If a director makes an *ultra vires* payment, he can be compelled to make good the funds used.[32] But the directors who refunded the money could get indemnity as against the person who received the payment with the knowledge that payment to him was *ultra vires.*[33]

(3) **Liability for breach of warranty of authority.** Directors entering into *ultra vires* may be liable to the third party for breach of warranty of authority. It may be noted here that directors are the agents of a company and should act within its powers. The company cannot give directors any authority for *ultra vires* acts, since it itself does not have any authority for them. If they induce an outsider to enter into a contract with the company in a matter in which the latter does not have power to act, they will be liable to the third party for his loss, provided the third party does not know that they have no authority to enter into a particular contract. In *Weeks v. Propert*[34] a railway company invited applications for a loan on debentures. At the time of inviting the applications the company had already exhausted the limit of £60,000 which it was authorised to borrow by its memorandum. On the basis of this advertisement, the plaintiff offered a loan of £500 which was accepted bt the directors and a debenture was issued to him. The laon was held to be *ultra vires* and void and therefore was not binding on the company. The directors were held personally liable for breach of warranty of authority as by inserting the advertisement, they had warranted that they had the power to borrow, a

[31]*Allen v. Gold Reefs of West Africa Ltd.* (1900) 1 Ch. 656.
[32]*Rc Sharpe* (1892) 1 Ch. 154.
[33]*Russell v. Wakefield Water Works Co.* (1975) L.R. 20 Eq. 474.
[34](1873) L.R. 8 C.P. 427.

power that they did not in fact possess.

In order to make the directors personally liable, it must be established that their act amounts to an implied misrepresentation of facts and not of law.

(4) **Ultra vires acquired property.** If the funds of the company have been spent *ultra vires* in purchasing some property, its right over the property will be protected. Thus, in a case where a company's telephone wires were cut and it had no power in the memorandum to put up the wires, it was held entitled to recover damages for the injury.[35]

(5) **Ultra vires contracts.** A contract which is *ultra vires* the company will have no legal effect. It is absolutely void. Such contracts are not binding upon the company and it can neither sue nor be sued on them. An *ultra vires* contract cannot become *intra vires* by reason of estoppel, lapse of time, acquiescence of delay or ratification. The reason is that every person who deals with the company is expected to know its powers and if he enters into a contract that is inconsistent with them, he does so at his own risk.

Exceptions. However, the claim of the aggrieved party shall lie in the following cases even though the act of the company is *ultra vires:*

(*i*) If the company takes an *ultra vires* loan and uses it to pay off the lawful debts of the company then the second creditor (lender) steps into to the shoes of paid-off creditor and to that extent will have the right to recover his loan from the company.[36] But he cannot claim any right to any securities held by the original creditor.[37]

(*ii*) If the property handed over to the company by virtue of an *ultra vires* contract exists in specie or if it can be traced, the person handing it over can reclaim it.[38]

(*iii*) If money is lent by a company that does not have the power to lend it, it can be recovered because the debtor will be estopped from taking the plea that the company had no power to lend.[39]

(6) **Ultra vires torts.** A company will be liable for any tort of its employees if (*a*) the tort is committed in pursuance of its stated objects; and (*b*) it is committed by employees within the course of their employment.

A company will not be liable for any torts committed outside its objects. For example, one company had power under its memorandum to

[35]*National Telephone Co. v. Constables of St. Peter Port* (1900) A.C. 317.
[36]*Neath Building Society v. Luce* (1889) 43 Ch. D. 158.
[37]*Re Wrexham Rly. Co.* (1889)1 Ch. 440.
[38]*Sinclair v. Boroughman* (1914) A.C. 398.
[39]*Re Coltman* (1818) 19 Ch. D. 64.

run tramways. It started operating omnibuses which was outside the object clause of its memorandum. A driver of one such bus negligently injured a person, who sued the company for damages. It was held that the company could not be held liable for damages because, having no existence outside the memorandum, it could not have appointed the driver.

QUESTIONS

1. Comment briefly on the following:

(*a*) The memorandum is a charter of the company.

(*b*) The memorandum of association of a company defines as well as confines its objects.

(*c*) A company's object clause is of fundamental importance not only to members but also to non-members. [*Delhi, B. Com. (Hons.), 1979*]

2. "The memorandum of association is the charter of a company and defines the limitations of the powers of the company."

[*Company Secretary, Inter, June 1977*]

3. Discuss how the different clauses of the memorandum of association of a company may be altered quoting relevant case law.

[*Company Secretary (Final), April, 1974*]

4. What is a memorandum of association of a company and what are its contents? Can the memorandum be amended? How the registered office clause can be amended? [*Allahabad, B. Com. (Part I) 1975*]

5. Explain the restrictions imposed upon the adopting of a name by a company and examine the ways in which the name of a company may be altered.

[*I.C.W.A., Dec. 1976*]

6. For what purposes can a company alter the objects clause in its memorandum and situation of registered office from one State to another in India? What is the procedure to be followed for such alteration?

[*Company Secretary (Inter), Oct., 1975*]

7. Mention the clauses that memorandum must contain. Explain the necessity of setting out clearly the "objects" in the memorandum. To what extent may a company lawfully undertake business and perform acts not expressly set out in the objects clause? [*Delhi B. Com. (Hons.), 1985*]

8. What are the requirements for alteration of the objects clause in the memorandum of association with special reference to the Companies (Amendment) Act, 1974? [*C.A. (Inter) Nov. 1978*]

9. Explain the doctrine of *ultra vires* in relation to the companies and describe the liability of a company and its agents for *ultra vires.*

[*Delhi B. Com., (Hons.) 1977*]

10. What do you understand by the 'doctrine of *ultra vires*'? To what extent has this doctrine protected the interests of the company, the shareholders and the outsiders dealing with the company? [*Delhi, M.Com., 1977*]

11. Explain the doctrine of *ultra vires.* What are the effects of *ultra vires*

transactions? Can a company ratify such transactions?

[*Delhi, M. Com., 1973, 1974*]

12. Write an explanatory note on the doctrine of *ultra vires* and state the liabilities of a company and its agents for *ultra vires* acts.

[*Company Secretary, (Inter) April 1975*]

13. "Acts *ultra vires* the company can be made binding upon the company by a unanimous vote of all the members of the company." Comment.

[*Delhi, B. Com. (Hons.) 1974*]

14. "As memorandum of associations are drafted the doctrine of *ultra vires* is illusory protection to the shareholders and pitfall for third parties". Discuss the doctrine of *ultra vires* in the light of the above observation.

[*Delhi B. Com., (Hons.) 1975*]

PRACTICAL PROBLEMS

1. *AB* Limited was registered with the Registrar of Companies, Calcutta on 15 January 1975. The Registrar of Companies, Bombay also registered on 15th May 1975 a company with the same name. On coming to know of this, the first registered company wants to prevent the company subsequently registered from continuing with the same name. Advise suitably. [*C.A. (Final) Nov. 1975*]

2. The plaintiff carried on business under the name of Buttercup Dairy Company as a retail and wholesale provision merchant in Maharashtra and the defendant was incorporated with its registered office at Calcutta with the main object of manufacturing and selling margarine under the name "Buttercup Margarine Co. Ltd." after ascertaining that there was no similar name on the Company Register. What relief, if any, can the plaintiff get?

[*C.A. (Final) Nov. 1078*]

3. Directors of a public limited company accepted a bill of exchange on behalf of the company, But the word "Limited" was omitted from the name of the company at the time of acceptance. Who can be held liable for the payment of the bill?

4. A bill of exchange was draw upon a limited company in its proper name. The bill was accepted by two directors of the company. However, the work "limited" did not appear in acceptance because the rubber stamp by which the words of acceptance were impressed was larger than the paper of the bill. On the company's failure to pay the bill, can the directors be held liable thereon?

5. The memorandum of association of a company formed to improve and encourage the breeding of poultry contained a provision that no remuneration should be paid to the members of the governing body of the company. But the company owing to increase in the business passed a special resolution providing for equitable remuneration to such members for the service rendered. Can this alteration of the memorandum be confirmed? If so, state why and by whom?

[*C.A. (Inter) Nov. 1977*]

6. The objects of the defendant company, as stated in the memorandum of association, were 'to make, sell or lend on hire, railway carriages and wagons, and all kinds of railway plants, fitting, machinery and rolling stock'. The company

entered into a contract for the purchase of a deal for constructing a new railway line in Australia. A shareholder of the company filed suit for setting aside the contract since it was outside the scope of the objects clause of the company. But the company defended the suit under the plea that the generaal body of shareholders has ratified the action taken by its directors. How would you decide? Give reasons.

7. A company carrying on business in jute is empowered by the objects clause of its memorandum of association to do any other business not connected with jute. By a special resolution passed unanimously the company resolved to alter the objects clause to include the power to carry on additional business in rubber. The Registrar of Companies opposed the company's application to the Court for confirmation of the alteration on the ground that the business sought to be added was entirely new and also alien to the existing business and that it could not be profitably, conveniently or advangeously combined with the existing business. Will the Registrar's contention prevail? Discuss. *[C.A. (Final) May 1977]*

8. A company altered its memorandum of association, as prescribed by law, and the alteration was also confirmed by the Court. A certified copy of the order of the Court was filed 4 months after the order was passed by the Court. Discuss if the Registrar can register the alteration. *[C.A., May, 1966]*