

CHAPTER II

DISCLOSURE THROUGH REGISTRATION OF CONSTITUTION - MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

Every outsider dealing with a company is deemed to have noticed^{of}_L the contents of the Memorandum and Articles of Association of a company, which on registration assume the character of public documents.¹ The office of Registrar of Companies is a public office as such the Memorandum and Articles of Association are open and accessible to all. It is the duty of every person dealing with the company to inspect these documents and see that it is within the powers of the company to enter into such contracts. If he does not inspect them, under the doctrine of constructive notice, he is deemed to have knowledge of the contents of these documents.

Lord Hatherly while acknowledging the importance of registration of these documents observed that "But whether he actually reads them or not, it will be presumed that he has read them ... Every joint stock company has its Memorandum and Articles of Association ... open to all who are minded to have any dealings whatsoever with the company and those who so deal with them must be affected with notice of all that is contained in these documents".² The consequence of not

referring these documents may prove to be fatal to the transaction, particularly when act done turns out to be beyond the power of the company or articles of Association. The case of Kotla Venkataswamy v. Ram Murthi³ amply illustrate this point. In this case the Articles of Association contained a clause that all deeds and documents of the company shall be signed by the Managing Director, the Secretary and a working director on behalf of the company. A deed of mortgage was signed by the Secretary and working director only. Held, the deed was invalid notwithstanding that the plaintiff acted in good faith and money was applied for the purposes of the company."

From the above, it becomes clear that outsiders dealing with the company is bound to inspect Memorandum and Articles of Association. This right of inspection is conferred by Section 610 of the Act. Clause (a) of Sub-section (1) of Section 610 provides that "save as otherwise provided elsewhere in this Act, any person may inspect any documents kept by the Registrar in accordance with the rules made under the Destruction of Records Act, 1917, being documents filed or registered by him in pursuance of this Act, or making a record of any fact required or authorised to be recorded or registered in pursuance of this Act, on payment for each inspection, of a fee of one rupee", and Clause (b) confers a right to have copy or extract of such documents.

The importance of these documents lays in the fact that they are admissible in evidence as public documents because they are documents preserved for public use.⁴

In general all information filed with the Registrar are available for public inspection and to have copies. But this right is not an absolute right. It has following exceptions:

(a) As per provision ~~610~~ (a) of Sub-Section (1) of Section 610, ~~610~~, without the consent of the Central Government certain documents delivered with prospectus in pursuance of sub-clause (i) of clause (b) of Sub-section (1) of Section 610 are not available for inspection except during the fourteen days beginning with the date of prospectus.

(b) Only members and existing creditors or their agents are entitled to have access to the full statement of affairs filed by a receiver or manager. Others have to content with only the summary of it.

As regards inspection and copies of documents maintained by the company itself there are wide divergences. If the information merely duplicates that in the Registrar Office, it is normally available on at least equally favourable terms. Thus Registers of members, directors and secretary are open to inspection by members without fee and by others on payment of fees. In case of register of charges free search is extended

to any creditor. The registers which have to be maintained only by company can be searched on similar terms, this applies to the registers of debenture holders or director's share-holdings etc. But only members are entitled to inspection and copies of the minutes of general meeting, while the books are open only for inspection by the directors. Members can also obtain from their company copies of the Memorandum and Articles of Association with all amendments and registrable resolutions, but no one can demand them from the company notwithstanding that they are available for inspection from the Registrar Office. No statutory right has been given to the outsiders, but they can of course, refuse to have dealing with the company unless copies are supplied.

From the above, it may be said that the right of outsiders to pry into the indoor management of a company is severally limited and the rule in *Royal British Bank v. Turquand* is, of course, a corollary of this, since the limitation on their rights is normally coupled with a corresponding freedom from any obligation to investigate. Even the right of members are restricted for they do not have access to the books and records as partners in a partnership firm have.

It was held⁵ that beneficiary could not compel the trustee, who was a director, to produce the company's books and papers for their inspection.

It may be noted that in U.S.A. the partnership analogy was followed so that shareholders are entitled to inspect the books except to the extent to which this right is curtailed.

(1) The Company's Constitution - Memorandum of Association :

The preparation and registration of Company's constitution is laid down as one of the conditions precedent for the formation of a company. As per section 33 for the purpose of formation of a company, the promoters must prepare and file Memorandum and Articles of Association (henceforth referred as M.A. & A.A.) of the proposed company with the Registrar of Companies of the State in which the registered office of the company is to be situated. These documents can only be altered as per the provisions of the Act and copy of the altered M.A. & A.A. must also be filed with the Registrar.

(1-A) Meaning of the Memorandum of Association :

The M.A. is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed.⁶

In another case⁷ it was held that M.A. has two fold objects :

The first is, that the intending corporator, who contemplates the investment of his capital shall know within what field it is to be put at risk.

The second is that any one who deal with the company shall know, without reasonable doubt, whether the contractual relation into which he contemplates entering with the company is one relating to a matter, within its corporate objects.

Yet in another case⁸ it was held that " the Memorandum of Association contains the fundamental conditions upon which alone the company is allowed to be incorporated. The conditions introduced for the benefit of the shareholders and also of creditors and outside public as well. One of the function of the M.A. is to disclose to the investors, the permitting range of company's activities and to the outsiders, the areas of operation of the company.

(1-B) Contents :

Looking to the importance of the M.A. from the point of view of disclosure, certain matters are required to be disclosed in it. In this connection Section 13 of the Act, provides that M.A. of a company shall contain following clauses :

- (i) Name clause,
- (ii) Situation clause,
- (iii) Objects clause,
- (iv) Liability clause,
- (v) Capital clause, and
- (vi) Association clause.

(I) NAME CLAUSE :

The first clause of the M.A. states the name of the company. The name of the company establishes its identity and is the symbol of its existence.⁹ The promoters of a company are given free hand in the selection of the name of the new company. However, Section 20 (1) of the Act, lays down very important limitation in the choice of the name. According to the provisions of the section a company cannot be registered by a name which in the opinion of the Central Government, is undesirable. Broadly speaking a name is undesirable if it is too similar to the name of another existing company. The implication of this rule is that once a company is registered with a particular name, that company acquires monopoly of that name, and it can restrain other company from using its name. It was held¹⁰ that " a company by registering its name gains a monopoly of the use of that name since no other company can be registered under a name identical with or so nearly resembling it as to be calculated to deceive. In another case¹¹ it was held that name becomes intangible property of the company and a suit for passing off may lie.

Further, as per Section 147 (1) (a) the name of every company together with the address of its registered office is required to be painted or affixed outside the premises wherever it's business is carried on, in a conspicuous position, in letters easily legible. It is also to be engraven on the official seal of the company

And as per Clause (c) of Sub-section (1), it also requires to be mentioned on all letters, negotiable instruments, orders, receipts and other documents written and executed by or on behalf of the company.

The failure to comply with the provisions of the section is not only punishable but also makes the officer or person concerned personally liable.¹² The relief provided by Section 633 of the Act is also not applicable to such case.¹³

From the juristic point of view, a company is a legal person distinct from its members.¹⁴ The effect of this principle is that there is a veil between the company and its members. The Courts in general consider themselves bound by this principle, but sometime the court may disregard the corporate entity, one of this instance is misdiscription of the name of the company.¹⁵

Further the name of the company, with 'limited' as the last word of the name in case of a public limited company and with 'Private Limited' as the last words of the name in the case of a private company must be mentioned.

The objects of the provisions of Section 20 is to the protect the investors, creditors and particularly persons dealing with the company from deceit or fraud which might be committed by a company having similar or identical name.¹⁶

The object of the provisions of Section 147 for publication of the name and address and the nature of the company as detailed in the section is to make the company itself continuously to bring to the notice of all those having any dealing with it the fact of its being a company with or without limited liability.

Change of Name :

A company may change its name by a special resolution and with approval of the Central Government signified in writing. However, if through inadvertance or otherwise, a company is registered by a name which in the opinion of the Central Government is identical with, or too closely resembles, the name of an existing company, the company may change its name, by ordinary resolution and with the previous approval of the Central Government.¹⁷

It may be noted that the change of name does not affect any rights or obligations of the company, or render defective any legal proceedings by or against the company. Legal proceedings which might have been continued or commenced by or against the company by its former name may now be continued by its new name.¹⁸ But legal proceedings commenced by a company in its former name shall not be protected and an appeal by such a company which no longer in existence on the register of companies is not competent.¹⁹ It should, however, be noted that the alteration is only effected only in the name and not in the identity of the company.²⁰

(II) Registered office or Situation Clause :

As per the provisions of the Act every company must have a registered office either from the day its begins to carry business or within 30 days of its incorporation whichever is earlier.²¹ It can be changed by following the provisions laid down under sections 17 and 146 of the Act.

Significance of registered office :

This clause decide and disclose the domicile or home of the company. A company is legal person, and as a person it must have its homw. By the expression 'home' we mean the office at which its registers have to be kept and where service of process on it may be effected. During the war, this clause plays an important role. It decides the character of the company, that is to say it decides whether it is an enemy company or friendly company.²²

This disclosure of registered office helps those, who deals with the company in the following ways :

Firstly they can inspect registers kept by the company for ascertaining any matter disclosed in those registers. Secondly, it also helps those who contemplate to enter into contractual relation with the company, to decide whether the company is friendly company or enemy

company. It may be noted here that as per Section 11 of the Indian Contracts Act, 1872, a person is declared to be incompetent to contract, who is disqualified from contracting by any law to which he is subject. An alien enemy is one of them. A company may acquire enemy character. An Indian cannot enter into contract with a company whose registered office is situated in a country which is at war with India. Public policy requires that an Indian should not enter into contract with a person, who resides voluntarily in a country which is at war with India.

(iii) Objects Clause :

This clause is regarded as most important clause in the Memorandum of Association. It discloses the objects of the company, which defines and confines the scope of operation of the company and once registered it can only be altered only by complying the provisions of the Act, particularly section 17 of the Act. It explains to the members and other persons dealing with the company the scope of the activity of the company.

Justification for disclosure of objects in the Objects Clause :

Lord Cranworth L.C. , observed ²³ that " the legal personality of a company exists only for the particular purposes of incorporation as defined in the objects clause".

In *Egyptian Salt & Soda Co. Ltd., v. Port Said Salt Association Ltd.*,²⁴ it was observed that "the purpose of the objects clause is to enable subscribers to the Memorandum to know the use to which their money may be put and to enable creditors and persons dealing with the company to know what is permitted range of enterprises or activities is.

Pointing out the effect of objects clause Lord Cairns observed that²⁵ "the objects clause has two fold effect : It states affirmatively the ambit and extent of vitality and power which, by law, are given to the corporation and it states, if it is necessary to state, negatively, that nothing shall be done beyond that ambit and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified.

Stressing the need for statement of objects in the Memorandum, Lord Parker rightly observed²⁶ that "the statement of objects in a memorandum is intended to serve a double purpose. In the first place it gives protection to the subscribers who learn from it the purpose to which their money can be applied. In the second place, it gives protection to persons who deal with the company and who can infer from it the extent of the company's powers.

The narrower the objects, the less is the subscribers risk, but the wider such objects the greater is the security of those who transact business with the company, this is because wider objects clause would provide protection against the Ultra Vires rule.

Companies (Amendment) Act, 1965 - Effect Thereof :

An attempt was made in 1965 for removing the lacuna found in Section 13 of the Act. Before the Amendment Act of 1965, it was customary to make the objects and purposes in a company's Memorandum as wide as possible. This was done in order to obviate the tardy and cumbersome procedure of applying to the Court, when some new venture was contemplated to be undertaken and at the same time defeat the doctrine of ultra vires. It may be noted that Section 17 of the Act lays down the provisions for alteration of object clause, which is considered to be tardy and time consuming. The practice of making the objects clause as wide as possible in scope held out ample opportunity for a company to participate in activities which were very remote in character and far removed from the principal and ancilliary objects for which the company was incorporated.

In order to put some check on this practice, the Act was amended in 1965 on the recommendations of Vivian Bose Commission of Inquiry,²⁷ which recommended that every

company shall clearly states its purposes and objects under two separate categories, viz.

- (a) The principal and ancilliary objects, which the company intends to pursue, and
- (b) All other objects which are separate from the principal and ancilliary as mentioned in item(a) above.

It further recommended that provision should be made in the Act to the effect that a company shall not engage itself in any activities coming within the scope of clause(b) unless, such activities are sanctioned by a special resolution of the company in General Meeting.

Fully endorsing the above recommendation, the Daphtary-Sastri Committee advised that :

Statutory provisions should be made, therefore, whereby even at the initial stage, the shareholders have an opportunity to inform themselves of the principal industrial or business activity the company would embark upon. The promoters, signatories to the Memorandum and the first directors of a company should be required to obtain the approval of the company in General Meeting by a special resolution, of the decision of the directors regarding the activities of the company shall engage in the first instance.

Thereafter, the sanction of the company in general meeting by a special resolution should also be obtained, if the directors later on propose to engage in new activities. Every such resolution shall be incorporated in all copies of the memorandum of the company. Provisions should be made in the Capital Issue (Control) Act for informing the Controller of the starting of a fresh business enterprises in accordance with the special resolution. A copy of the special resolution enlarging the business of the company should be furnished to the Registrar of companies of the State.

In giving effect to the recommendations, however, the joint Select Committee excluded existing companies from the operation of the new provisions.²⁸

Position after the Amendment Act of 1965 :

Now the objects clause in Memorandum of every company has to state :

(i) Main objects of the company to be pursued by the company on its incorporation and objects incidental or ancilliary to the attainment of the main objects, and

(ii) Other objects of the company not included in the above clause. Further, in case of a company (other than trading corporation) whose object are not confined to one State, the States to whose territories the objects extend has also to be stated.

The purpose of this amendment is to enable shareholders and other interested persons to have clear idea of the main objects and other objects. This combined with the amendment of Section 149 inserting new provisions therein will afford an opportunity to shareholder to inform themselves of the actual business or businesses in which the company is engaged or proposes to engage.

As mentioned, the Memorandum of Association defined and confined the powers of a company. Any act done contrary or in excess to the scope of the activity of the company will be ultra vires to the company, i.e. beyond the legal powers and authority of the company and shall be wholly void and not binding on the company. Acts ultra vires to the company can neither be legalised nor ratified even with the unanimous consent of all the members of the company. This doctrine is a by-product of the philosophy of disclosure. It suggest that company cannot undertake work not disclosed in its Memorandum.

Disclosure of powers in the Memorandum :

In setting out the objects of a company its memorandum usually sets out several powers which the company will be entitled to exercise in carrying out its objects. Though, the practice of inserting powers in the objects clause was

criticised in *Cotman v. Brougham*,²⁹ the practice has become so common and wide spread that the Registrar usually does not refuse to register a Memorandum containing, besides its objects, the several powers which a company may exercise in effecting its objects. The result is to bury beneath a mass of words the real object or objects of the company with the intent that every conceivable form of activity shall be found included somewhere within its terms. This practice of incorporating powers in the memorandum is required to be curtailed by appropriate legislation.

Alteration of Objects Clause - Need for proper Disclosure :

The change in the objects clause is most complicated affair. The limitations laid down by section 17 of the Act are procedural as well as substantial. These limitations have been put up by the legislature to prevent too easy an alteration of the objects contained in the memorandum, to afford additional protection to the investors and creditors of the company.

(A) Procedural Limits :

A company can effect change in its objects clause by :

- (i) A special resolution of its shareholders,
- (ii) Confirmation thereof by the Company Law Board on a petition made by the company.

These requirements are statutory and company must be complied with them. However, the Patna High Court³⁰ has held that "where a special resolution was found ineffective for want of 21 days notice in calling and holding the meeting for passing the special resolution, the unanimous consent of 95% or more of the shareholders would be sufficient for making the resolution effectively as a special resolution.

It may be submitted, with due respect that Section 171(2) only provides that a general meeting may be called by giving shorter notice than 21 days if consent is accorded thereto, as provided therein by all the members in the case of an annual general meeting and by 95% of the holders of voting rights or voting power as provided therein, in the case of any other meeting. That section does not dispense with the necessity of calling and holding the meeting necessary for passing the required special resolution and Section 192(4) covers only cases of resolution agreed to by all the members. There is no power under the Act for dispensing with the calling and holding of a general meeting for passing a resolution as a special resolution or validating a defective resolution by subsequent consent of 95% of the members.

Confirmation depending on due Disclosure :

So far as second procedure is concerned, the special resolution passed at the meeting is required to be confirmed by the Company Law Board (formerly High Court) after satisfying itself that due disclosure has been made by the company. The company Law Board will confirm the alteration only when it is satisfied that :

(a) Sufficient notice has been given to every debenture holders and to every other person whose interest is likely to be affected by the proposed alteration, and

(b) If any creditor raises a valid objection his consent has been procured or his claim has been satisfied, and

(c) A notice of the petition has also been served on the Registrar and he has been given reasonable opportunity to appear before the Company Law Board and state his objections and suggestion, if any, with respect to the confirmation of the alteration, and

(d) Alteration is fair and reasonable to the interests of the members.

The above provisions imposes statutory obligation on the Company Law Board to satisfy itself that full disclosure of proposed alteration has been made by the company to the

members, creditors, Registrar and outsiders whose interest is likely to be affected by the alteration.

Besides these procedural limitations section 17(1) also lays down substantive limitations. It provides that a company may change its objects clause only so far as the alteration is necessary for any of the following purposes :

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

So far as substantive limitations are concerned, it may be said that it restrict the right of the company to alter its objects clause. As discussed earlier, company should be discouraged from incorporating powers in the objects

clause. However, Section 17(1) itself contains powers in the form of substantive limitations. The two purposes i.e. (i) to sell or dispose of the whole or any part of the undertaking, and (ii) to amalgamate with any other company or body or persons, cannot be regarded as objects of the company.

Taking into consideration the provisions of Sections 17 and 149 of the Act, it may be stated that alteration of objects clause is quite a cumbersome process. The promoters of the company, therefore, add a number of Sub-clauses to the objects clause enabling the company to carry on almost every conceivable kind of business. This practice defeat the very purpose of having an objects clause. It is, therefore, suggested that procedure for its alteration should be simplified. The Companies (Amendment) Act, 1974 has taken a right step in this direction. Now confirmation by the Court, which used to be lengthy process has been replaced by confirmation from the Company Law Board.

Recently it has been recommended³¹ "that the law relating to alteration is well settled and therefore, there does not seem to any reason to follow detail procedure. It has been suggested that there should be no necessity for making application either to the Company Law Board

or to any other authority and the company can, on its own alter the objects clause of memorandum by passing the necessary special resolution. It has been further suggested that in any case any member or members should have a right to apply to the Company Law Board, which should look into the grievance, if any, and pass orders as it may deem fit. As a measure of protection of the shareholders a right may also be given to the Registrar and the Government of the State in which the registered office is situated, to move the Company Law Board. As it is the Registrar has to be heard before any alteration in the memorandum is approved, and, therefore, no great right is being given to him". It has also been recommended for the adoption of Section 5 of the English Companies Act, 1948, which contains the following provisions :

(1) A company may, by special resolution, alter its objects for any one of seven specified purposes.

(2) But, within twenty one days ³² of the passing of the resolution, application to the Court may be made by or on behalf of the holder, who have not voted in favour of the resolution ³³ of not less than 15 per cent ³⁴ of nominal value of the issued share capital of any class. Notice has to be given to the debenture holders too.

(3) If such an application is made the alteration will not be effective except to the extent that it is confirmed by the Court.

(4) If, however, no application is made to the Court within twenty one days the alteration cannot subsequently be impugned, Section 5(a) expressly provides that the validity of the alteration shall not be questioned in proceedings whether under this section or otherwise.

(5) The net effect of these provisions is that so long as more than 85 per cent of the shareholders have voted for the amendment or so long as one takes proceedings within 21 days of the resolution, companies now have complete freedom to change their objects.

So far as Sacher Committee's recommendations are concerned, it may be submitted that justifications given by the Committee in Para 17-6 of the Report is not wholly tenable. The utility of the statutory provisions cannot be judged from the number of cases decided but it should be judged from the utility purposes. The purpose of these provisions is prevention rather than cure.

Further, Committee has not taken into consideration the second purpose of the objects clause viz. to give protection to the creditors and other persons dealing with

the company. If these recommendations are implemented it will encourage disgruntled members to stall the progress of the company by making application to the Company Law Board.

So far adoption of Section 5 of the English Companies Act, is concerned it may be submitted that Jenkin Committee had recommended for alteration of some of the provisions of the section 5.

(iv) Liability Clause-Disclosure of Nature of Liability :

In this clause the company must disclose whether the liability of the members is limited or unlimited. In the case of a company limited by shares or by guarantee the memorandum must disclose that the liability of the members is limited. It implies that a shareholder cannot be called upon to pay anything more than the unpaid portion of the shares held by him.

The Memorandum of a company limited by guarantee must further state that each member undertakes to contribute to the assets of the company if wound up while he is a member or within one year after he ceases to be so, towards the debts and liabilities of the company as well as the cost and expenses of winding up and for the adjustment of

the rights of the contributories among themselves not exceeding a specified amount.

Here attention may be drawn to the provisions of section 322 which provides that by making disclosure in the memorandum, the liability of the directors or manager may be made unlimited.

Ordinarily, the liability clause cannot be altered so as to make the liability of the members unlimited. However, alteration which is likely to impose additional liability on a member or which is likely to compel a member to buy additional shares of the company after the date on which he becomes a member, cannot be made except with the consent of the members concerned in writing.

(v) Capital Clause - Disclosure of Authorised Capital of the Company :

As per the provisions of the Act, the memorandum of a company limited by shares must disclose the amount of share capital with which the company is to be registered and its division into shares of a fixed amount. This capital is usually called authorised capital. It sets the limit of capital available for issue and the issued capital can never exceed that limit.

In the case of unlimited company which has share capital divided into shares of definite amount, although liability of each member is unlimited as against the

creditors of the company, the liability on the shares is the only liability to the company, so long as it is a going concern.³⁵ If authorised capital exceeds Rs,100 lacs than the company is required to obtain certificate from controller of Capital Issue.

Disclosure in respect of Share Capital :

The share capital particulars requires to be filed, showing details of company's capital-nominal, issue and paid up capital. The authorised capital will of course appears in the capital clause of the Memorandum of Association. If it is increased or reduced or if the shares are consolidated, sub-divided or converted into stock, notice must be given to the Registrar.

(a) Alteration of Capital :

As per the provisions of the Act, alteration in the capital clause of the memorandum may be of the following type :

- (a) Alteration proper (Sections 94 to 97)
- (b) Reduction of Capital (Sections 100 to 105)
- (c) Variations of the rights of the shareholders
(Sections 106 to 107)
- (d) Creation of Reserve liability (Section 99)

Section 94 empowers the company to alter its share capital by altering the Memorandum of Association. Section 97 provides that where a company having a share capital, whether its shares have or have not been converted into stock, has increased its share capital beyond the authorised capital, it shall file with the Registrar, a notice of the increase of capital within thirty days after the passing of the resolution authorising the increase. The Registrar shall thereupon record the increase and also make any alteration which may be necessary in the Company's M.A. & A.A. or both. Before the Companies (Amendment) Act, 1965 the period for giving notice to the Registrar was 'fifteen days'.

So far as the provisions of Section 97 are concerned, it was held by the Court ³⁶ that "where a special resolution has been passed increasing the share capital, notice of the increase must be given to the Registrar even though the new shares may not have been 'issued' to any shareholders".

Here attention may be drawn to new section 94-A added by the Companies (Amendment) Act, 1974. This section was inserted with a view to dispense with the necessity of passing a resolution for alteration of memorandum and filing with the Registrar of the requisite documents showing increase of share capital, by an order of the Central

Government under Section 81(4).

It provides that where the Central Government issues an order for conversion of debentures taken from the company or loans given to the company into shares under section 81(4) or where in pursuance of an option attached to debentures issued or loan raised by the company, any public financial institution has converted such debentures or loans into shares, and where the conversion has effect of increasing the nominal share capital of the company, the Central Government shall send a copy of the order to the Registrar, so that he may effect the necessary alteration in the memorandum.³⁷

The object of this section seems to save company from calling general meeting for passing the necessary resolution and thereby save the company from expenses.

It may be submitted that this section unnecessary becomes operative in cases, where the conversion is within the limits of the existing nominal share capital. In such cases there is no reason why the nominal share capital should be increased further.

(b) Notice to Registrar (Section 95) :

In order to provide upto date information in respect of share capital of a particular company, Section 95(1) provides for notifying the Registrar about alteration

in the share capital within thirty days after the alteration, Sub-section (2) imposes a duty on the Registrar to carry on necessary alteration in the M.A. & A.A. of the company.

The object of this section is to provide latest informations about share capital to the creditors and other persons dealing with the company. However, no time has been fixed for Registrar for making necessary changes in the M.A. & A.A. Some time limit is required to be specified in this respect, so as to achieve the object of the section in real sense i.e. to say to provide latest informations to the creditors and other persons dealing with the company.

(c) Reduction of Share Capital :

The law regards the capital of a company as something sacred and does not permit its reduction except when all the formalities as required by the provisions of the Companies Act have been complied with.

In connection with share capital Lord Harchell observed³⁸ that "the capital may, no doubt, be diminished by expenditure upon and reasonably incidental to all the objects specified. A part of it may be lost in carrying on the business operation authorised. Of this all persons trusting the company are aware, and take the risk....

I think they have a right to rely on the capital remaining undiminished by any expenditure outside these limits, or by the return of any part of it to the shareholders".

In the same case, Lord Watson said that "one of the main objects contemplated by the legislature, in restricting the power of limited companies to reduce the amount of their capital as set forth in the MA, is to protect the interests of the outside public who may become their creditors. In my opinion the effect of these statutory restrictions is to prohibit every transactions between a company and a shareholder, by means of which the money already paid to the company in respect of his shares is refunded to him, unless the Court has sanctioned the transaction. Paid up capital may be diminished or lost in the course of the company's trading, that is a result no legislation can prevent, but persons who deal with and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call, and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business".

Echoing the concern shown by the English Court, the framers of the Companies Act, has provided certain safeguards under the Companies Act, 1956. A company limited by shares is prohibited from purchasing its own shares.³⁹ For the same reason very strict conditions have been laid down in case of forfeiture of shares by a Company.

The statutory power of reducing capital is mainly governed by section 100, which permits reduction of capital by a company limited by shares or a company limited by guarantee having a share capital, only with the sanction of the Court.

Section 103 provides that the order of the Court confirming the reduction must be produced before the Registrar. It also provides for filing of certified copy of the order with the Registrar for registration... The Company is also required to file minute (approved by the Court), showing with regard to the share capital altered by the order :

- (a) the amount of the capital
- (b) the number of shares upto which it is to be divided,
- (c) the amount of each share, and

(d) the amount, if any, at the date of the registration deemed to be paid on each share. The minute, when registered, is deemed to be substituted for the corresponding part of the memorandum i.e. capital clause and is valid and (v)aluable as if it had been originally contained in the memorandum.

It may be said that this section provides for duty of disclosure of the fact of reduction of share capital to the Registrar, how-ever it amounts to disclosure to the public. This is because once registered it becomes a part of capital clause of the company's M.A., which being a public document, anybody can read and make himself aware about the share capital of the company. Further attention may be drawn to the provision of the Act, according to which, disclosure of the fact of reduction of capital may be made directly to the public. Under section 102 (2) (a) the Court has been given discretionary power to direct a company to add to its name the words 'and reduced' for a specified time. The company may also be directed to publish reasons for the reduction for public information. The object of all these provisions is to bring to the notice of the persons dealing with the company about certain important matters of the company.

So far as provisions of Section 102 are concerned, it

may be submitted that it should be made obligatory for the company to add to its name, as the last words "and reduced" for a period of two subsequent financial years and non compliance should be treated as misdescription of the name of the company. The company should also be compelled to disclose to the public reasons for the reduction of share capital.

Procedure for Reduction of Share Capital (Section 100 to 103 and 105) :

(1) Section 100 provides that the company must pass a special resolution for the reduction of capital. Before the company can do so the power to reduce share capital must be provided in the A.A. An authority to do so given by the M.A. is no avail.⁴⁰

(2) Application to the Court for Confirmation :

Sub-Section (2) of Section 100 provides that the company must then apply to the Court by petition for an order confirming the reduction. The duty of the Court is to look after the interest of the creditors and different classes of shareholders.

In this connection Lord Simon⁴¹ observed that "important though its task is to see that the procedure, by which a resolution is carried through, is formally correct and that

creditors are not prejudiced, it has the further duty of satisfying itself that the scheme is fair and equitable between the different classes of shareholders".

Is the Court Concern with the motive for the reduction?

So far as this question is concerned it was held⁴² that "in all cases the Court will consider whether the reduction is fair and equitable though it will not be concerned, with the motive for the reduction, such as the intention to avoid the effect of a threatened nationalisation; or avoid or diminish tax liability or Estate duty.

Penalty for Concealing Name of Creditors etc.

In case of reduction of share capital the interest of creditors is required to be safeguarded, and must be safeguarded by the Court. For this purpose duty is imposed upon the Court for settling the list of creditors. In order to enable the Court to perform its duty, the company is bound to disclose the name of all creditors. In case of non-disclosure or for concealing name of creditors, section 105 lays down penalty. It provides that if any officer of the company :

- (a) knowingly conceal the name of any creditor entitled to object to the reduction,
- (b) knowingly misrepresents the nature or amount of the debt or claim of any creditor, or

- (c) abets or is privy to any such concealment or misrepresentation as afforsaid, he shall be punishable with imprisonment for a term which may extend to one year, or with fine or both.

The above provisions declares the intention of the legislature to safeguard the interest of creditors and general public. This was reflected in the case of Cormosteel (Private) Limited. & Others V. Jairam Das Gupta & Others⁴³ where it was observed that "the object behind prescribing the procedure in section 101 to 103, save in special circumstances as contemplated in Section 101 (3), the Court to give notice to the creditors, is that the members of the company may not unilaterally act to the detriment of the creditors behind their back. If such a procedure were not prescribed, the Court, might, unaware of all facts, be persuaded by members to confirm the resolution for reduction of share capital and that might cause serious prejudice to the interests of the creditors.

Publication of Authorised As Well As Subscribed and Paid Up Capital :

Section 148 provides that where any notice, advertisement or other official publication or any business letter, bill head or letter paper of a company mentions the authorised

capital such notice, advertisement or other publications or such letter, bill head or letter paper, shall also contain a statement, in a equally prominent position and in equally conspicuous character of the amount of the capital which has been subscribed and amount paid.

This provision provides for disclosure of subscribed and paid up capital on papers etc. issued by the company.

(d) Disclosures to be made in the return of allotment

Details regarding the issued and paid up capital must similarly be given in a return of allotment which is required to be filed within thirty days of allotment.

Section 75 analogous to section 52 of the English Companies Act provides that within thirty days of allotment of shares by a company, the company must file with the Registrar a statement known as return of allotment. The disclosures required to be made in such return are :

- (a) Particulars about the number and nominal amount of the shares allotted for cash, the names, address and occupations of each of the allottees, and the amount paid on each share.

In order to have clear picture about the amount received on allotment, a proviso was added by the Companies (Amendment) Act, 1965, which provides that the company must not show in

such return any shares as have been allotted for cash if such cash has not been actually received in respect of such allotment. This provision of the Act seeks to impose a duty on the promoters and directors of a company to ensure that the share capital reflects cash and other valuable assets and is not supported by merely book adjustments.

While making recommendation for the amendment of Sub-Section (1) (a), the Daphatry Sastri Committee observed that "the share capital of a company must be supported by and be reflective of the existence of cash and valuable assets and should not represent mere book adjustments based on promisory note or the taking over by another of the liability to pay. Auditors must inquire, wherever it is stated that cash has been paid towards subscriptions to share capital, whether cash has, in fact, passed, and if cash has not, in fact, so passed they should satisfy themselves that the position as stated in the account books and the balance-sheet is correct, regular and not mis-leading.

What is Payment in Cash ?

It was held by the Courts⁴⁴ that "by payment in cash is meant bonafied transaction between a company and an allottee of shares which if the company were to bring an action against the allottee for calls, would support a

plea of payment, constitutes payment in cash. 'Cash' is actual money or instruments or claims which are generally used and accepted as money. Thus Bank Cheques, demand bills of exchange, bank drafts, letters of credit and te other orders of payment of money on presentation may be rated as cash. Its characteristic features is that it is available for disbursement. Thus marketable securities, deposits under restrictions and account not immediately collectible are not, in ordinary business transactions, considered as 'cash' as they are not readily available for use. But there is no reason why the cancellation of a genuine debt by mutual consent cannot be treated as payment in cash. Whatever constitutes the cancellation of a genuine debt due by the company, and whatever payment is presently enforceable against the company, such as loan amount or consideration payable for property purchased, will constitute payment in cash.

As per clause (b) company is also required to file particulars about the shares (not being bonus shares) allotted as fully or partly paid up for any consideration other than cash.

Palmer observes⁴⁵ that "where shares are issued as fully of partly paid up in consideration of property thereafter to be sold to the company or services to be rendered to the

company or by way of compromise, the issue is for consideration other than cash. But if the shares are allotted on a cash basis though the amount is actually paid later, that will not come under clause (1) (b) as the amount credited as paid in cash.

In this connection, Company Law Department⁴⁶ issued following clarification :

the allotment of shares by a company to a person in lieu of a genuine debt due to him is in perfect compliance of the provisions of section 75(1).

In this connection it is clarified that the act of handing over cash to the allottee in returning the same cash as payment for the shares allotted to him is not necessary for treating the shares as having been allotted for cash. What is required is to ensure that the genuine debt payable by a company is liquidated to the extent of the value of the shares.

With due respect, I would like to submit that in strict sense payment in cash means, payment made in current currency of the country. Payment made through any negotiable instruments such as promisory note, bill of exchange or cheque cannot be considered as payment in cash, as the

payment made through negotiable instrument is always regarded as conditional payment. Here attention may be drawn to Section 45 (1) of the Indian Sales of Goods Act, 1930. It provides that a seller is deemed to be unpaid seller (i) when the whole of the price has not been paid or tendered (ii) When a bill of exchange or other negotiable instrument has been received as a conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise. So far as this condition is concerned it may be said that when payment is made by a negotiable instrument, it is usually a conditional payment, the condition being that instrument shall be duly honoured. Therefore, payment made through bill of exchange or other negotiable instrument cannot be considered as payment in cash. It may be mentioned that 'share and stock' are included in the definition of goods and therefore, governed by the provisions of Sales of Goods Act.

Another question which arise in this connection is, Can company discharge its debts by making payment in cash?

As far as company law and company precedents are concerned ordinarily a company cannot make payment in cash, except sundery debts. Therefore, there is no question of handling of cash by the company and allottee of shares.

Looking to this, the question of payment in cash is required to be re-examined.

Further as per rule 5 of the Appendix the copies to be filed with the Registrar under clause (b) of Sub-Section (1) is required to be verified by an affidavit of a responsible officers of the company.

The required details include the names and addressess of the allottees, but of course, the return will not give details of members to whom the shares are transferred after allotment. To ascertain this the inquirer will have to inspect the company's register of members or rely on the annual return, if that is sufficiently recent for this purpose. But as many of the shares may be held by nominees he may be unable to find out who the true owners are.

2 ARTICLES OF ASSOCIATION

2-A Meaning : The second documents which must be filed alongwith the Memorandum of Association for the incorporation of a company is Articles of Association. The A.A. are the rules and regulations or by-laws for governing the internal affairs of the company. They may be described as the internal regulations of the company governing its management and embodying the powers of the directors and officers of the company as well as the rights of the shareholders.

The Companies Act, 1956 defines Articles of Association as "Articles of Association of a company as original framed or as altered from time to time in pursuance of any previous Companies Law or of this Act, including, so far as they apply to the company, the regulations contained, as the case may be, in Table B in the Schedule annexed to Act of 1857 or in Table A in the first Schedule annexed to the Indian Companies Act, 1882 or in Table A in the First Schedule annexed to the Indian Companies Act, 1913 or in Table A in Schedule I of this Act."⁴⁷

In *Ashbury Railway Carriage and Iron Co. V. Riche*, it was held that "the articles defined duties, the rights and the powers of the governing body as between themselves and the company at large, and the mode and the form in which the business of the company is to be carried on and the form in which changes in the internal regulations of the company may from time to time be made."

Lord Cairns while giving the difference between Memorandum and Articles of a company, stated, "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."⁴⁸

In another case⁴⁹ it was held that "the Memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. The Articles are the internal regulations of the company".

Statutory Provisions - Obligation to Register Articles of Association :

A public company limited by shares may not file a separate set of articles. But an unlimited company, a company limited by guarantee or a private company must prepare their own articles which be register alongwith the memorandum of the company.⁵⁰

Disclosure to be made by an unlimited company :

In the case of an unlimited company, the articles must state the number of members with which the company is to be registered and if it has a share capital, the amount of share capital with which it is to be registered.⁵¹

Disclosures to be made by a Company limited by Guarantee :

In the case of a company limited by guarantee, the articles must state the number of members with which the company is to be registered.⁵²

Disclosures to be made by a Private Company :

In the case of Private Company, articles must contain

three restrictions which make it private company.⁵³ As per the provisions of the Act⁵⁴ 'Private Company' means a company which, by its articles,

- (a) restricts the right to transfer its shares,
if any,
- (b) limits the number of its members to fifty not including -
 - (i) persons who are in the employment of the company and
 - (ii) persons, who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased; and
- (c) prohibits any invitation to the public to subscribe for any shares in, or debentures of the company.

2-B. CONTENTS OF ARTICLES OF ASSOCIATION

The company may make any regulations as it think fit. The only limitation of the freedom of the company is that the articles should not be against the provisions of the Companies Act or its Memorandum of Association. Any clause of the articles which violates any of the provisions of the companies Act or Memorandum will be null and void.

The articles of a company generally deal with the following matters :

- (i) The exclusion, total or partial of table A.
- (ii) Adoption or execution of preliminary contracts.
- (iii) Definition of important terms and phrases
- (iv) Share capital and rights attached to different classes of shares.
- (v) Procedure as to making of calls and forfeiture of shares.
- (vi) Appointment of managerial personnel e.g. Directors, managing director etc. their rotation, powers (including borrowing) and duties.
- (vi) Rules as to :
 - (a) transfer and transmission of shares
 - (b) issue of share warrants
 - (c) general meetings
 - (d) common seal of the company
 - (e) dividend, reserves and capitalisation of profits
 - (f) accounts and audit
 - (g) alteration of share capital
 - (h) Lien on shares
 - (i) remuneration of managerial personnel
 - (j) issue of redeemable preference shares

- (k) paying commissions and fixing rate thereof
for subscribing or agreeing to subscribe
etc. for any share in the company
- (l) paying interest out of capital
- (m) winding up of the company

In framing Articles, care must be taken to see that regulations framed do not go beyond the powers of the company itself as contemplated by the Memorandum nor should they be such as would violate any of the requirements of the Companies Act itself.

It may be noted that in United Kingdom and in India great reliance is placed on the articles of association as a limitation upon the powers of the directors of a company. The articles set out the powers of the directors, not the responsibilities of the company as a whole. They provide for the delegation of powers to various officers of the company for the day-to-day and also long term management of the company, and according to the Rule in Royal British Bank V. Turquand⁵⁵ any transaction entered into by an officer which is inconsistent with the terms of the articles is invalid unless it is approved by the company in general meeting.

2-C ALTERATION OF ARTICLES OF ASSOCIATION :

A company has an inherent powers to alter its articles to suit ~~its~~ requirements from time to time. Section 31 lays down that a company may alter its articles by a special resolution. Any alteration so made shall be valid as if originally contained in the articles and be subject in like manner to alteration by special resolution. The power to alter articles cannot be taken away by any provision in the memorandum or articles⁵⁶ and alteration of articles with retrospective effect was held valid provided it was bonafide and for the benefit of the company as a whole.⁵⁷

However, there are certain restrictions on the nature and extent of alterations that can be made in the articles. They are as follows :

- (1) Alteration can neither be beyond the provisions of the Companies Act nor the memorandum of association. Articles may, however, be altered to explain ambiguous portions or to supplement the memorandum with regard to those things upon which it is silent.⁵⁸
- (2) Alteration should not sanction anything which is illegal or against public policy.⁵⁹

- (3) Alteration seeking to impose an additional liability on a member of the company after the date on which he became a member, to take shares more than what he has already taken or to pay any money than what he is liable to pay on his share shall not be binding upon him unless he agrees in writing to such an alteration except in the case where the company is club or any other association and the alteration provides for increase in the rate of subscription by the members.⁶⁰
- (4) The power to alter the articles must be exercised in good faith for the benefit of the company as a whole.⁶¹ Alteration made bonafide and in the interest of the company shall be valid even if they are likely to effect adversely the personal interests of some of the members of the company. Alteration so as to give power to ~~to~~ the directors to require any shareholder who competed with the company's business to transfer his shares at full value is valid and binding upon the members of the company for it will be beneficial to and in the interests of the whole company.⁶²
- However, alteration will not be valid if it has been made for the benefit of an aggressive, vindictive or fraudulent majority.⁶³

Alteration in breach of contract :

Some times an alteration may result in a breach of contract with an outsider. In British Murac Rubber Syndicat V. Alperton Rubber Co.⁶³ it was held that a company was not at liberty to alter the articles in such a breach of contract. However, in an Indian case⁶⁴ it was held that a company may alter its articles even if it causes breach of contract with the outsider. It has statutory power to do so. Where the contract with the outsider is wholly dependent on articles, alteration would be operative, and, accordingly, the person accepting appointment purely on the terms of the articles takes the risk of those terms being altered, and will be bound by the altered articles. But the situation will be different if apart from the articles, there is an independent contract. In Southern Foundaries Ltd. V. Shirlaw,⁶⁵ S was appointed Managing Director in a company for ten years by an agreement. Subsequently, the company was amalgamated with another company and new articles were adopted. The latter gave power to the company to dismiss a director, and accordingly S was removed from office as director and the company treated him as having ceased to be one. He sued the company for wrongful repudiation of the contract. It was held that dismissal was breach of contract and therefore

the company was liable for damages.

It may be submitted that the decision of Madras High Court in the case of Chittambram Chettiar V. Krishna Aiyanger⁶⁶ is in consonance with the principle that articles do not constitute any contract between company and outsider.⁶⁷

Governmental and Judicial Control on the Power of
The Company to alter its Articles :

Certain provisions of the articles cannot be altered except with the prior approval of the Central Government. They are :

- (a) any alteration which has the effect of converting a public company into a private company.⁶⁸
- (b) any alteration relating to the appointment or reappointment of a managing or whole time director or a director not liable to retire by rotation in the case of a public company or private company which is a subsidiary of a public company,⁶⁹ and
- (c) any alteration resulting in an increase in the remuneration of any director including a managing director or whole time director in the case of a public company or a private company which is a subsidiary of a public company.⁷⁰

(d) Where by an order of the Court on application under sections 397 or 398 (for relief in case of oppression or mismanagement) the company is required to alter its memorandum or articles, the company will then be precluded without the consent of the court from making any further alterations inconsistent with the order of the Court.⁷¹

Looking to the above, it may be stated that power of a company to alter its articles is not an absolute power.

2-D. EFFECTS OF REGISTRATION OF MEMORANDUM AND ARTICLES OF ASSOCIATION :

Section 36 (1) provides that subject to the provisions of the Act, the Memorandum and Articles of Association shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained a covenants on its and their part to observe all the provisions of the memorandum ^{and} articles.

How Far Articles are Contract :

It was observed ⁷² by Ashbury J. that "though the articles can neither constitute a contract between the company and an outsider not give any individual member special contractual rights beyond those of the members

generally, yet they do infact constitute a contract between a company and its members in respect of their ordinary rights as members... generally articles dealing with the rights of members as such should be treated as statutory agreement between them and the company as well as between themselves interse".

In Halsbury's Laws of England, the view expressed in this connection⁷³ is "the Articles constitute a contract between the company and a member in respect of his rights and liabilities as a shareholder and the company, may sue a member and a member may sue a company to enforce and restrain breaches of the regulations contained in the articles dealing with such matters. The purpose of the articles is to define, the position of the shareholder, or as shareholder, not to bind him in his capacity as an individual. The Articles do not constitute a contract between the company and a member in respect of rights and liabilities which he has in a capacity other than that of member."⁷⁴ But "where such rights and liabilities are the subject of a written agreement, the articles will not be imported unless they are referred to."⁷⁵

Thus, the articles bind the company to its members, the members to the company and the member to each other.

(a) Member bound to the company :

Article constitute a contract between the company and members and therefore every member is bound by the articles as if every one of them had contracted to conform to them. It was held that Articles of Association is a "Contract of the most sacred character" between the company and each member, binding the members to the company under a statutory convent.⁷⁶ This point is well illustrated in the case of *Boreland Trustees v. Steel Brothers & Co.Ltd.*⁷⁷ In this case the articles provided that the shares of any member who became bankrupt should be sold to person at a price fixed by the directors. B the holder of 73 shares, was adjudicated bankrupt. His trustees in bankruptcy wanted to sell these shares at their true value. It was held that the trustees in bankruptcy was bound by the articles and could not claim the shares against the company.

Similarly in *Bradford Banking Company v. Briggs*⁷⁸ the articles of a company provided that the company shall have a first charge on shares for the debts due to it from the members. A members owing money to the company borrowed money from a bank on the security of the shares. It was held that the company could have priority because of the provision in the articles.

(b) Company Bound to the Members :

The company is also bound by the provisions of the articles to its members. Any member can sue the company to prevent any breach of the articles which would affect his right as a member. The company must exercise its rights, as against any member, only in pursuance of and in accordance with the articles and not otherwise.

In the case of *Johnson v. Lyttle's Iron Agency*⁷⁹ a forfeiture of shares, irregularly effected by a company, was set aside at the instance of the aggrieved member~~s~~ as the company did not comply with provisions of the articles.

Between Members inter se:

Although there is no express agreement between the members of the company, yet articles regulate their rights inter se. But such rights can be enforced only through the company. However, the contractual force given to Articles by the section is limited to matters arising out of the company relationship of the members as members and does not extend the company relationship.⁸⁰ As per Lord Herschell⁸¹ "the established position is that the articles constitute a contract between each member and the company and there is no contract in terms between the individual members of the company, but the Articles do not, any the less, in my opinion, regulate rights inter se.

Such rights can only be enforced by or against a member through the company or through the liquidator representing the company; but I think that no member has, as between himself and another member any right beyond that which the contract with the company gives". However, Bombay High Court⁸² held otherwise. According to Bombay High Court "the contractual application of the Articles is not confined to the company relationship only but may extend to other dealings between members.

In *Rayfield V. Hands and others*⁸³ it was held that the rights of shareholders as shareholders, and the extent to which such rights are regulated by the articles could be enforced by one member against another without joining the company as party.

Not Binding on the Company in relation to Outsider :

The articles do not constitute a contract between the company and outsiders. Thus for instance where the articles provided for remuneration to be paid to promoters, it does not give any right of action to promoters against the company.⁸⁴ Similarly in *Brown V. La Trinidad*⁸⁵ where B was to be appointed a director till 1888, as provided in the articles but was removed earlier, the Court held that articles do not constitute a contract between company and

outsider and therefore Brown was not entitled to bring any action against the company.

It may be noted that even a member cannot enforce provisions of articles in some capacity other than that of members. In *Eley v. The Positive Government Life Assurance Company*⁸⁶ the articles provided that Eley should be Solicitor of the company. He would not be removed from his office except for misconduct. He also became a member of the company. He acted as Solicitor for some time but ultimately removed from office without any misconduct. He sued for breach of contract but the Court held that he could not bring action against the company because the right which he attempted to enforce was conferred upon him in a capacity other than that of a shareholder, and that articles do not constitute a contract between the company and an outsider.

But where an individual entered into a contract with a company to serve as a director and the articles of the company required the director to have a share qualification as set out therein and fixed his remuneration, it was held that though the articles did not constitute a contract between the company and the director, yet the director was entitled to recover his remuneration against the company

as fixed by the articles because the terms of the articles were deemed to have formed a part of his contract with the company.⁸⁷

2-E. CONSEQUENCES OF REGISTRATION

(i) - Constructive Notice of Memorandum and Articles of Association :

(ii) Doctrine of Indoor Management

(I) Doctrine of constructive notice :

Both Memorandum and Articles of Association are considered to be public documents. They are available for public inspection in the Registrar Office.⁸⁸

Every person who deals with the company is deemed to know the contents of these two documents.⁸⁹ This is known as "doctrine of constructive notice". It is presumed that individuals dealing with the company have not only read these documents but that they have also understood their proper meaning.⁹⁰ A person dealing with the company in a way contrary to provisions of the Memorandum or Articles will have to bear the consequences of the lapse.

It was rightly observed⁹¹ that "Every joint stock company has its memorandum and articles of association... open to all who are minded to have any dealings whatsoever with the company, and those who so deal with them must be

affected with notice of all that is contained in these documents.

Consequently, if a person enters into a contract which is beyond the powers of the company, he cannot acquire any rights under the contract against the company. Thus for example, if the articles provides that a bill of exchange must be signed by two directors, a person dealing with the company must see that this is done. If he has a bill signed by only one director, he cannot claim under it.

A similar problem arose in *Kotla Venkaswami v. Ram Murthi*⁹². In this case all deeds etc., were to be signed by the managing director, the secretary and a working director as per articles of the company. R accepted a deed from the company which was signed by a secretary and a working director on behalf of the company. It was held that R could not have accepted such a deed as it was not signed by the required persons and hence was invalid".

(II) DOCTRINE OF INDOOR MANAGEMENT

As discussed, every person dealing with the company is deemed to have constructive notice of the contents of the memorandum and articles of the company. Hence, any person dealing with the company in a manner not permitted by the charter or the byelaws of the company, shall be

deemed to have dealt with the company at his own risk and cost and shall have to bear the consequences thereof.

However, this rule is subject to one limitation. The outsiders dealing with a company are entitled to assume that as far as the internal proceedings of the company are concerned, everything has been regularly done. They are bound to read the registered documents and to see that the proposed dealing is not inconsistent therewith. But they are not bound to do more; they need not inquire into the regularity of the internal proceedings of the company.⁹³ An outsider is not required to investigate into the compliance of all the rules of internal management. This is because a person can be presumed to know the constitution of the company, but not what may or may not have taken place within doors that they are closed to him.⁹⁴

This limitation is known as the 'Doctrine of Indoor Management' or the rule in *Royal British Bank v. Turquand*.⁹⁵ In this case the directors of the company had issued a bond to T. They had power under the Articles to issue such bonds provided they were authorised by resolution of the company. No such resolution was, however, passed by the company. The Court held that Turquand could recover the amount of the bond from the company on the ground that he was entitled to assume that the resolution had been passed. It was

further observed that the duty of observing internal managerial procedure such as regarding constitution of the Board, quorum, voting, internal resolutions and regulations etc. had been imposed upon those who are responsible for the management of affairs of the company.

The same was emphasised in the case of Premier Industrial Bank Ltd. v. Carton Mfg. Ltd.⁹⁶ where it was observed that "if the directors have power and authority to bind the company but certain preliminaries are required to be gone through on the part of the company before that power can be duly exercised, then the person contracting with the directors is not bound to see that all these preliminaries have been observed. He is entitled to presume that the directors are acting lawfully in what they do".

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It was again confirmed that "person who contracts with an individual director of a company knowing that the Board has power to delegate its authority to such an individual, can assume that the power of delegation has been exercised".

Similarly, where the articles provided that the directors could allot shares only to the existing members and that share could be allotted to outsiders only after the approval of shareholders in a general meeting, it was held that any allotment made to outsiders even without the approval

of the company in general meeting, was valid. Outsiders were entitled to assume that the directors must have obtained the approval of the general meeting of the company.⁹⁸

It may be submitted that the rule is of great utility in the world of commerce. But for this rule, the form of company organisation would not have been that popular. It is based on the principle of justice and public convenience. Firstly, the office of the Registrar is a public office and hence any person dealing with the company must ensure that the proposed contract with the company is within its powers. He cannot be expected to know more about what is happening inside the company. No one would like to deal with a company, if he is also required to ascertain the regularity of the internal proceedings in respect of the proposed transaction.

Secondly, the person would be unwilling to deal with the company if the company could escape liability by denying the authority of officials to act on its behalf in the absence of this rule.⁹⁹ It was observed¹⁰⁰ that "the wheel of commerce would not go round smoothly if persons dealing with the company were compelled to investigate thoroughly the internal machinery of a company to see if something is not wrong."

It may be said that the doctrine of constructive notice protects the company against outsiders, whereas the doctrine of indoor management seeks to protect outsiders against the company.

Limitations

The protection provided by the doctrine of indoor management to the outsiders is not an absolute protection. This doctrine is subject to the following exceptions:

(1) Knowledge of Irregularity :

The doctrine of indoor management is based on the principle, that outsider dealing with the company is entitled to assure that so far as internal proceedings are concerned everything have been complied with. However, a person dealing with the company will not be entitled to the protection under this rule if he has noticed, actual or constructive, that the prescribed procedure has not been complied with by the company.¹⁰¹

Thus where Company A lends money to company B on a mortgage of its assets and the procedure laid down in the articles for such a transaction was not complied with and the directors of the two companies were the same, it was held that the mortgage is not binding. It may be presumed that Company A had notice of irregularity through it's directors.¹⁰²

It was rightly observed that 'this rule is based on

common sense and any other rule would encourage ignorance and condone dereliction in duty.¹⁰³

(2) Forgery : It may be noted here that rule in the Turquand case does not protect a person where forgery is involved. A company cannot be held liable for forgeries committed by its officers.

In the case of Ruben v. Great Fingall Ltd.,¹⁰⁴ the Secretary of the company issued a share certificate by forging the signatures of two directors under the seal of the company. It was contended by the plaintiff that it was not his duty to ~~verify~~ the signatures, whether the signatures were genuine or not was a part of internal management. The Court held "that the certificate is not binding on the company as the rule in Turquand's case does not protect forgery. In this connection Lord Loreburn observed :

It is quite true that person dealing with limited liability companies are not bound to inquire into their indoor management and will not be affected by irregularities of which they have no notice. But this doctrine, which is well established applies only to irregularities that otherwise might affect a genuine transaction. It cannot apply to a forgery.

(3) Negligence on the Part of the Outsider :

Where a person dealing with a company could discover the irregularity if he had made proper inquiries he cannot claim the benefit of the rule of indoor management.¹⁰⁵ The protection of this rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.

In the case of *Underwood v. Bank of Liverpool*,¹⁰⁶ the sole director paid cheques drawn in the name of the company in his own account. It was held that "the Bank was put upon inquiry before crediting the cheques drawn in favour of the company in the account of the director. The Bank was not entitled to rely upon the ostensible authority of the director".

Similarly a bank was put upon inquiry where the directors of the company secured their indebtedness by a charge upon the assets of the company. It was held that "the bank was not entitled to the benefit of the charge which had not in fact been authorised."¹⁰⁷

Yet in another case it was held that "even the unusual magnitude of the transaction may ~~not~~ put a person dealing with the company upon inquiry as to its being authorised."¹⁰⁸

In an Indian case¹⁰⁹ the plaintiff accepted transfer of the company's property from its accountant, the transfer was held to be void because such a transaction is apparently beyond the scope of the accountant's power. It puts the person dealing with the company into inquiry. The plaintiff should have insisted on seeing the power of attorney executed in favour of the accountant by the company. Even a delegation clause is not enough to make the transaction valid unless the accountant is in fact authorised.

(4) No Knowledge of Articles :

Further the rule cannot be invoked in favour of a person who did not in fact read the company's Memorandum and Articles, and consequently did not act in reliance on those documents, Slade J. expressed¹¹⁰ this exception in the following terms :

The doctrine of constructive notice of a company's registered documents such as its Memorandum and Articles and its Special Resolutions does not operate against a company, but only in its favour. The doctrine operates against the person who failed to inquire but does not operate in his favour".

In order to claim protection, under the rule of indoor management, knowledge of Articles, is essential. This rule is based on the principle of estoppel and a person who

did not consult the company's Memorandum and Articles cannot be protected under this rule.

(5) Acts ordinarily Beyond the apparent Authority:

An outsider will not be protected by the rule of indoor management if the act of the agent is one which would not ordinarily be within his powers simply because under the articles the power of making such a contract might have been entrusted to him. The outsider can hold the company liable only where the power had in fact been delegated notwithstanding a delegation clause to that effect in the articles. The fact of Anand Bihari Lal case provide a clear illustration to support this point.

Similarly, where the Branch Manager of a bank draw and endorsed bills on behalf of his company without having any authority from the company, it was held that drawing of bills was not within the ordinary ambit of powers of this branch manager and the company was not bound unless the authority was in fact delegated to him to this effect.¹¹¹

3. JUDICIAL CONTROL OF COMPANY - DOCTRINE OF ULTRA VIRES:

Perhaps the most important principle in relation to judicial control of companies and public corporation is the 'doctrine of Ultra Vires', which may be considered as a by-product of doctrine of disclosure.

The term ultra vires, was first used to denote excess of legal authority by independent statutory bodies and Railway Companies in the middle of 19th century,¹¹² though the main features of the doctrine to which this name was given had already been taking shape over a long period in relation to the powers of Common Law corporation. In popular sense ultra vires includes all exercise of power beyond the competency of the person exercising that power.

3.A ESSENCE OF THE DOCTRINE :

As per Markby J. the phrase ultra vires is applicable only to acts done in excess of the legal powers of the doer, as distinguished from want of jurisdiction, and illegality. This may be called essence of the doctrine. This doctrine, which in England applies to the acts of the executive was, in the colonies subject to its rule, applicable to the acts of the colonial legislation also.¹¹³

Indian Law on judicial control of administrative action, therefore, developed on similar lines as the anglo-saxon law.¹¹⁴

According to H.W. Ballantine,¹¹⁵ the mischievous doctrine of ultra vires has long been in almost hopeless confusion. This confusion has resulted from lack of

precision in the meaning ascribed by Judges in the term of ultra vires.

According to H.L. Oleck,¹¹⁶ 'possibly there is no term in the whole law used as loosely and with so little regard to its strick meaning as the term ultra vires.

It was rightly said that 'the Ultra-vires rule has a long and somewhat tangled history'.¹¹⁷

3-B. MEANING :

The meaning of the term ultra vires is simply 'beyond powers'. In popular sense these words includes all exercise of power beyond the competency of the person exercising that power. It is action in excess of the powers possessed by a person (which includes body corporate), within the above limitations.

In speaking of a citizen-we do not speak of any action being ultra vires. To a citizen or subject whatever is not expressly forbidden by the laws is permitted, it is only when the law has called into existence a person-an artificial person-for a particular purpose or has recognised its existence such as corporation, company etc. that the power is limited to the authority delegated expressly or by implication and to the object for which it was created. What is not permitted expressly or by implication,

by the statute or Act is prohibited, not by any express prohibition of the legislation, but by the doctrine of ultra vires.¹¹⁸

Thus in the case of *Colman v. Eastern Countries Railway Company*¹¹⁹ Lord Langdale M.R. in restraining the company from acting as they proposed to do said " I am clearly of opinion that the powers which are given by an Act of Parliament, like that now in question, extend no further than is expressly stated in the Act, or is necessarily and properly required for carrying into effect the undertaking and works which the Act has sanctioned. How far these powers, which are necessarily or properly to be exercised for the purpose intended by the Act, extend, may very often be a subject of great difficulty. We cannot always ascertain what they are unless the acts done can be proved to be in conformity with the powers given by the special Acts of Parliament, under which these acts are done, they furnish no authority whatsoever. I believe they have the power to do all such things as are necessary and proper for purpose of carrying out the intention of the Act of Parliament and they have no power of doing anything beyond it."

In another case¹²⁰ while re-affirming the principles laid down in *Colman's Case*, Lord Langdale M.R. held that

"companies possessed funds for objects which are distinctly defined by Act of Parliament, cannot be allowed to apply them for any other purpose whatsoever, however, beneficial or advantageous it may appear either to the company or to individual members of the company.

In the case of *Salomon v. Laing*¹²¹ it was held "that a corporation incorporated by the Act of Parliament was bound to apply all the monies and property for the purposes directed or provided for by the Act, and for no other purposes whatsoever."

In another case¹²² Lord Callenham L.C. held that "those who subscribed for the purpose specified by the Act, had a right to have their monies applied to such purposes exclusively". In this connection Lord Cranworth observed¹²³ "I am clearly of opinion on all the authorities, and all principles, that it is the province of the Court to prevent such an illegal contract from being carried in effect, because on the principle that has been so often laid down, this Court will not tolerate that parties shall lay out one farthing of their funds out of the way in which it was provided by the Legislature that they should applied."

In *Attorney General V. Great Northern Railway Company*¹²⁴ Kindersley V.C. restrained the company from dealing in

coal, holding that though an Act of Parliament constituting Railway Company may contain no prohibition in express terms against the company's engaging in any business there is in every such Act an implied contract to that effect. Even if the great body of shareholders agree to carry on a business different from that for which the company was constituted, a single shareholder has a right to say that it shall not be done".

It may be submitted that this is the case which has conferred a right on the shareholder to restrain a company from doing an ultra vires act. Further it may be stated that all the above cases dealt with the misapplication of the corporate funds. They were all brought before the Court of Equity. The Common Law Courts also applied the doctrine to the extent of holding that a contract even under the seal of company, cannot in general be enforced, if its object is to cause the corporate property to be directed to purposes not within the scope of the Act of incorporation.

Thus in the case of *The East Anglian Railway Company v. The Eastern Counties Railway Company*¹²⁵ it was held that "the Statute incorporating the defendant company gives no authority respecting bills in Parliament promised by the plaintiffs, and we are, therefore, bound to say that

any contract relating to such bills is not justified by the Act of Parliament, is not within the scope of the authority of the company as a corporation, and is therefore, void". In this case the suit was on a contract under the seal of the defendant Railway Company to pay expences of the plaintiff company to promote certain bills in Parliament.

In another case¹²⁶ Lord Cranworth L.C. after reviewing all the cases decided by the Courts of both Equity and Common Law observed that "It must, therefore, be now considered as well settled doctrine that a company incorporated by Act of Parliament for a special purpose, cannot devote any part of its funds to objects ^{un}authorized by the terms of its incorporation however, desirable such application may appear to be". It may be described as rule which would be applied to those acts done by the organ of the company not authorised by the objects disclosed in the memorandum of Association.

Justification of the Application of Doctrine :

On careful consideration of above cases, we find that the doctrine is applied because the corporation or the company, as the case may be, has its legal existence for a particular purpose only, and that purpose is a creation of law.

In this connection observation made by Lord Selborne¹²⁷ is noteworthy. "He observed "I say that a statutory corporation created by the Act of Parliament for a particular purpose, is limited, or to all its powers; by the purpose of incorporation as defined in that Act. The present and all other companies incorporated by virtue of the Companies Act, 1862, appears to me to be statutory incorporation within this principles... Contracts for objects and purposes foreign to or inconsistent with, the Memorandum are ultra vires of the corporation itself. And it seems to me far more accurate to say that the inability of such companies to make such contracts rest on an original limitation and circumscription of their powers by the law, and for the purposes of their incorporation, that it depends upon some express or implied prohibition making acts unlawful which otherwise they could have had a legal capacity to do".

3-C. GROWTH OF THE DOCTRINE :

The doctrine if of modern growth. It is a creation of 19th century. This doctrine first began to take definite shapes in cases upon acts done by railways companies formed under special Acts of Parliament. The great railway companies of England was being projected and developed about the first quarter of the last century. Almost immediately

questioned were raised as to the exact nature of the powers possessed by or granted to them. The very first case, in which the doctrine was prominently brought before the Courts, and distinctly recognised as a guiding principle in the determination of question relating to the power possessed by companies was *Colman V. Eastern Countries Railway Company*.¹²⁸ In this case Lord Langdale, M.R. observed that "companies of this kind possessing most extensive powers have so recently been introduced into this country, that neither the legislature nor the Court of justice have been yet able to understand all the different right in which their transactions ought properly to be viewed. We must, however, adhered to ancient general and settled principles, so far as they can be applied to great combinations and companies of this kind... We are to look upon these powers as given to them in consideration of a benefit which, notwithstanding all other sacrifices, it is to be presumed and hoped, on the whole will be obtained by the public. But it being the interest of the public to protect the private right of all individuals, and to defend them from all liabilities beyond these, necessarily accompanies by the powers given by the general Acts, these powers must always be carefully looked into".

In 1851, the Court of Common Plea, held that a railway

company incorporated by Act of Parliament, cannot even with the assent of all its shareholders legally enter into a contract involving the application of any portion of its funds to purposes foreign to those for which it is introduced.¹²⁹

It may be submitted that from 1846 to 1855 i.e. from the decision in Colman case¹³⁰ to that of Eastern Countries Railway Company v. Hawkes most of the cases were connected with railway companies.

(I) DOCTRINE OF ULTRA. AND CHARTERED COMPANIES

The chartered companies are companies incorporated under a special charter granted by a Monarch. The powers and nature of business of a chartered company are defined by the charter which incorporates it.

The case of Sutton's Hospital¹³² has generally been taken to establish that a chartered corporation has all the powers of a natural person in so far as an artificial entity is physically capable of exercising them, if it misuses its power by exceeding the objects in the charter, proceedings in the nature of quo-warranto~~to~~ could be taken to restraint it. A corporation always risked forfeiture of its charter for abuse of its powers.

In this connection Holt C.J. observed¹³³ that "a corporation's charter may be forfeited, if the trust be

broken and the end of the institution be prevented.

A corporation has a definite object and its capacity was limited; and if it presumed to act outside them, it endangered its very existence. This is but the germ of the doctrine of ultra vires which has been so greatly developed by the recent decisions. In other words, it is in connection with the statutory companies arising out of the railway boom that we should expect to find the germ of the modern ultra vires doctrine."

It may be mentioned that there was no question of a partnership acting ultra vires in the strict sense. As per the law of partnership, the acts of one partner might not bind his fellow partners if the acts were outside his actual or apparent authority but they could always be ratified by all the partners. The common type of joint stock company prior to 1844 was nothing but merely enlarged partnership, and to it the ultra vires doctrine could have no application.

(II) DOCTRINE OF ULTRA VIRES AND JOINT STOCK COMPANIES :

In 1844 a General Act was passed in England enabling all companies to obtain from an office in London a certificate of incorporation without applying either for a charter

or for an Act of Parliament. But the principles of limited liability was not recognised. It was only in the year 1855 that an Act was passed enabling companies registered under the General Act of 1844 (except Insurance Companies), to obtain a certificate of incorporation. By this Act the position of the normal joint stock companies had changed radically when limited liability was introduced, then for the first time, there was a widespread need for application of the doctrine in the interest of creditors and general public. These companies were limited, so that the need for the rule was apparent, moreover, the elaboration of such a rule was facilitated by the Act of 1856 which superseded the deed of settlement and replaced it by two documents, the Memorandum of Association and Articles of Association. In the Memorandum the objects had to be stated and the Act made no provision for its alteration.

Ashbury Rail, Carriage & Iron Co. Ltd. V. Riche's Case¹³⁴

In England a company was incorporated with the objects (a) to make and sell, or land on hire, railway carriages and wagons; (b) to carry on the business of mechanical engineers and general contractor, (c) to purchase, lease, work and sell mines, minerals, land and buildings.

The directors entered into the agreement for financing the construction of a railway in Belgium. There was some evidence that this agreement had been ratified by all the members, but later was repudiated by the company.

It is significant of the general state of legal opinion at that time, that in the Court of Exchequer it was not even argued that ratification, if proved would not be effective. The argument proceeded^{ed} solely on the question whether the members with full knowledge had or had not agreed. Only on appeal to the Exchequer Chamber the point was taken that even the unanimous consent of all the shareholders could not effectively ratify what was beyond the company's power as expressed in the Memorandum, and on this point Court was equally divided. Finally, the House of Lords unanimously held that, that ratification was legally impossible if the contract was beyond scope of the Memorandum of Association.

Lord Cairns observed that "the term 'General Contractors' must be taken to indicate the making generally of such contracts as are connected with the business of mechanical engineering. If the term general contractor 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 in the Memorandum in place of specifying the particular kind of business would virtually point to the carrying on the business of any kind whatsoever and would, therefore, be altogether unmeaning. Hence, the contract was entirely beyond the objects in the Memorandum. If so, it was thereby placed beyond the powers of the company to make the contract. If so... it is not a question whether the contract ever was ratified or was not ratified. If it was a contract void at its beginning, it was void because the company could not make the contract. If every shareholder of the company... had been in the room and every shareholder... had said that it is a contract which we authorise the director to make (it would be void). The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which by the Act of Parliament they were prohibited from doing".

In the above case, the Court had been called upon to decide whether they should equate registered companies with partnerships and chartered corporations, or whether they should apply to them the rule which they were slowly evolving in connection with statutory corporations. They chose the latter solution. But shortly afterwards the strict rule was extended to such bodies¹³⁵ leaving chartered companies as an exception. However, in case of chartered

companies also it was held that "a chartered corporation may be restrained by injunction at the suit of a member from exceeding its expressed objects."¹³⁶

The doctrine of ultra vires as laid down in the Ashbury's case was affirmed by the House of Lords in Attorney General V. Great Eastern Ryul Co.¹³⁷, but Lord Selbourne gave a qualified approval to the doctrine by adding that the doctrine of ultra vires "ought to be reasonably and not unreasonably, understood and applied... and whatever may fairly be regarded as incidental to or consequential upon, those things which the legislature has authorised, ought not to held by judicial construction to be ultra vires."

In the case of Deucher V. Gas Light & Coke Co.¹³⁸ Lord Selbourne's principle was applied. In this case a gas company was empowered to make and supply gas, manufacture and sell residuals arising from gas making and to provide such apparatus and materials as it deemed require for those purposes. To convert a particular residual, caustic soda was required. After purchasing caustic soda, for a number of years, it decided to manufacture its own soda. Held, it was not ultra vires the company.

Palmer¹³⁹ says " a company is formed to buy, sell and deal in coal." It may for the purpose of carrying

out this object, employ labour, open shops, and hire lorries, purchase, supplies, draw and accept bills of exchange, borrow and give security, have a banking account, employ agents and pay bonuses and pension to employees.

(III) DOCTRINE OF ULTRA VIRES AND COURTS IN INDIA

The Courts in India have simply been following in the foot steps of the Courts of England. Though the decisions of the English Courts are not binding on Indian Courts, still they provide a very valuable guidelines with regards to certain doctrines which may be said to a creation of English Courts. Reasons for this, in the first place, the Indian Laws and particularly Indian Companies Act is based on English Law, and secondly Indian Courts followed the English Jurisprudence. Thus in the matter of Port Canning Land Investment & Company Ltd.¹⁴⁰ Phear J. laying down the law that if the directors of a joint stock company engaged in a business in which they cannot engaged according to the plain meaning of the memorandum, whatever is done by the directors, as on behalf of the company, must be treated as having been done by them without authority, for their powers as agents of the company, did not extend thus far, and they could not acquire power to bind the company qua company, from any conduct on the part of the shareholders.'

An incorporated company has power to do everything which is not illegal or actually prohibited to it by the terms of its incorporation. This is true as regards the means of carrying into effect the purposes for which the company is incorporated. The principle does not apply outside that limit. The Company, is prohibited from engaging in undertakings which do not fall among the objects of its incorporation."

The interest of the public on the one hand, and of the shareholders on the other, requires that the directors shall be rendered powerless to use the strength and the means of the company, and to pledge its credit beyond the scope of them."

In another case ¹⁴¹ Wilson & Porter JJ. held that "the general principles of law applicable to this question are authoritatively laid down by the House of Lords in *Ashbury & Co. v. Ritche* and *Attorney General v. Great Eastern Railway Company*. For the present purpose, we think the result may be sufficiently stated by saying that the powers of a company depend upon its Memorandum or other instrument of incorporation and it can do nothing which that document does not warrant expressly or impliedly. A company therefore formed to carry on one trade cannot engage in another. But, on the other hand, this doctrine must be

reasonably understood and applied. And a company, in carrying on the trade for which it is constituted, and whatever may be fairly be regarded as incidental to or consequential upon that trade, is free to enter into any transaction not expressly prohibited."

In *Dehangir R. Modi V. Shamji Ladha*,¹⁴² Sargent J. said "a long series of decision of Courts of Law and equity in England had decided that an incorporated joint stock company can do not act which is not expressly authorised by the Act of Parliament under which it is incorporated, on the deed of settlement of the company. It is therefore, to Memorandum and Articles of Association that we must turn to determine whether these transactions are expressly or impliedly authorised, or as it has been sometimes expressed whether they fall within the scope of the objects for which the company was established... By the objects for which a company is established are ofcourse meant the operations to be carried out after the company is formed, and cannot refere to acts which precede the formation of the company and which must ex necessitate rei have been performed before the company can be said to have an object . . . at all, or atleast to be capable of realising one."

In another case the Bombay High Court¹⁴³ held "the company is so to speak, identified by its Memorandum. A person, therefore, who is asked to take shares in a projected company of which he is shown the memorandum and consents to do so, does so upon the full understanding that the document shown to him, or a true copy of it, will be registered as the memorandum. The company in which he agrees to take shares is the company to be incorporated by the registration of that document."

In *A. Lakshmanaswami Mudaliar V. I.I.C of India*¹⁴⁴ the directors of a company who were authorised 'to make payments towards any charitable or benevolent object, or for any general public or useful object,' donated Rs. 2,00,000 to a trust formed for the purpose of promoting technical and business knowledge. The shareholders had, by a resolution authorised the directors to do so. The payment was held to be ultra vires on the ground that company's funds could not be directed to every kind of charity even if there were unrestricted powers to that effect in the company's memorandum. The money could be spent only for such charitable objects which were useful for the attainment of company's own objects."

It may be submitted that in respect of ultra vires doctrine, the India Courts have followed English Courts.

In the case of Shamuggur Jute Factory Company's case¹⁴⁵ Wilson and Porter JJ. relied on the principles laid down by Lord Selbourne in the case of Attorney General v. Great Eastern Rail Co.¹⁴⁶

(IV) EVASION OF THE DOCTRINES

It can hardly be doubted that the ultra vires rule was salutary in its intentions. At the time it prevented trafficking in company registration, it ensured that an investor in a Gold Mining company did not find himself holding shares in a fried fish shop, and it gave those who allowed credit to a limited company, some assurance that its assets would not be dissipated in unauthorised enterprises.¹⁴⁷ Although it may have been valuable to the members in restraining the activities of their directors, it was merely a nuisance in so far as it prevented the company from changing its activities in a direction upon which all were agreed. Hence, businessmen specially found means of minimising its effects.

As per the provisions of the Companies Act, the company's objects should be set out succinctly in only one or two paragraphs. The idea was that the promoters should simply specify in general terms the business which it was prepared to carry on, the powers which it required

as incidental to that business were not intended to be specified as these would be implied by law. Since the case of Attorney General v. Great Eastern Railway, the Courts, have incorporated the rule in a liberal spirit and agreed that everything reasonably incidental to the main object of the company will be intra vires.

The Methods Used for Evasion

The methods used by the businessmen to evade the ultra vires doctrine were :

- (1) They preferred to set out in the memorandum the ancillary powers; and
- (2) they preferred to name all the other businesses which they might conceivably want it to turn in the future.

The result was these methods makes it less hazardous to enter into transactions with a company, for the likelihood of their being ultra vires is remote. On the other had it affords little assurance of the preservation of the company's assets and less control over the activities of directors.

In the recent case,¹⁴⁸ in England, Court of Appeal held that "it was effective to empower the company to undertake any business which the directors bonafied thought could

be advantageously carried on as an adjunct to its other businesses. In this case Court of Appeal apparently approved of a clause providing that the company may carry on any other trade or business whatsoever which can in the opinion of the Board of Directors be advantageously carried on as ancilliary to any of the above business. From this it would appear that the modern practice is to water down the ultra vires rule as regards dealings of the company with third parties.

(V) ATTEMPTED CURBS ON EVASION-LEGISLATIVE MEASURES :

In India an attempt has been made by the Parliament to curb the evasion of the ultra vires rule by amending the provisions of the Companies Act, 1956. Before the Companies (Amendment) Act, 1965 came into force, it was customary to make the objects and powers in company's memorandum as wide as possible. This was done in order to achieve two goals:

(1) to obviate the tardy and cumbersome procedure of applying to the Court (now Company Law Board) when some new venture was contemplated to be undertaken, and (2) to defeat as far as possible the ultra vires rule.

The practice of making the object clause as wide as possible in scope held out ample opportunity for a company to participate in activities which were very remote in

character and far removed from the principal and ancillary objects for which the company was incorporated.

But now the objects clause of every company has to state :

- (i) main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects; and
- (ii) other objects of the company not included in the above clause.

Further, in the case of company (other than trading corporation) with objects not confined to one State, the State to whose territories the objects extend. This clause seeks to implement the recommendation of the Daphtary-Sastri Committee based on the observation contained in Paras 2 to 6 of the Commission's Report.

The purpose of the amendment is to provide for clear definition of the main and subsidiary objects of a company in its memorandum and also to enable shareholders and other interested to have a clear idea of the main objects and other objects. The amendment gives effect to the following recommendations of Vivian-Bose Inquiry Commission¹⁴⁹:

- "(i) The Act should be suitably be amended to provide that every company shall clearly state its purposes

and objects under two separate categories, viz.

- (a) the principal and ancilliary objects, which the company intends at the time of its incorporation to pursue and
- (b) all other objects which are separate from the principal and ancilliary one mentioned in item(a) above.

- (ii) A provision should be made in the Act to the effect that a company shall not engage itself in any activities coming within the scope of clause (b) unless such activities are sanctioned by a special resolution of the company in general meeting."

Fully endorsing the above recommendations, the Daphtary-Sastri Committee advised that :

"Statutory provision should be made, therefore, whereby even at the initial stage the shareholders have an opportunity to inform themselves of the principal industrial or business activity the company would embark upon. The promoters, the signatories to the Memorandum and the first directors of a company should be required to obtain the approval of the company in general meeting by a special resolution of the decision of the directors regarding the activities the company shall engage in, in the first instance.

Thereafter, the sanction of the company in general meeting by special resolution should also be obtained, if the directors later on propose to engage in new activities. Every such resolution shall be incorporated in all copies of the Memorandum of the company. Provision should be made in the Capital Issue (Control) Act for informing the controller of the starting of a fresh business enterprise in accordance with the special resolution. A copy of the special resolution enlarging the business of the company should be furnished to the Registrar of companies of the State.

In giving effect to the recommendation, however, Joint Select Committee excluded existing companies from the operation of the new provisions. The reason for the exclusion of existing companies was to save them from calling of general meeting for the alteration of the object clause, which would involve tremendous time and effort not commensurate with the results intended.

3.D MODERN APPROACH

(I) Under English Law :

In England the Cohen Committee in its report (June 1945) while criticising the impracticability of the doctrine remarked:¹⁵⁰

"In consequences, the doctrine of ultra vires is an illusary protection of the shareholders and yet may be a pitfall for third parties dealing with the company. For example, if a company which has no power to carry on a taxi-cab service, nevertheless does so, third person who have sold the taxi-cab to the company or who have been employed to drive them, may have no legal right to recover payment from the company. We consider that as now applied to companies, the ultra vires doctrine serve no positive purpose, but in on the other hand a cause of unnecessary prolixity and vexation". The Committee proposed that it should ^{be} reformed so that as regard third parties a company would have all the powers of a natural person and the object clause in the Memorandum would operate solely as a contract between the company and its members regarding the extent of the authority conferred on its directors and officers; in other words, companies, would in this respect be equated with partnership.

So far as this recommendation is concerned, it may be stated that Committee has not given due consideration to the doctrine of 'constructive notice i.e. the fact that those dealing with the company would still be deemed to have notice of the contents of the Memorandum of Association, so that, notwithstanding the doctrine of indoor management,¹⁵¹

third parties might be no better off, since they would be deemed to have had notice that the directors or other officers were exceeding their authority. This recommendation, however, not incorporated either in the English Companies Act, 1948 or in the subsequent Amendments.

The Jenkin Committee, went further and recommended that the constructive notice rule should also be abolished,¹⁵² and even actual knowledge of the contents of Memorandum and Articles of Association should not deprive a third party of his right to enforce the contract if he honestly and reasonably failed to appreciate that they precluded the company or its officers from entering into the contract. It further recommended that the Companies Act should contain a list of common form powers which, in the absence of express provision to the contrary would be impliedly incorporated. This according to Gower¹⁵³ would not eradicate practice of proliferating objects. The Committee however, opined against the abolition of ultra vires doctrine. Assailing the recommendation of Jenkin Committee to retain doctrine of ultra vires and still to make an ultra vires contract binding in relation to third parties J.N. Thomson¹⁵⁴ advocated a careful consideration of the recommendation of the committee.

This criticism resulted into the achievement, i.e. it leads to its partial abolition in respect of all contracts entered into with companies after January 1, 1973. Under the European Communities Act, 1972 if a person deals with a company in good faith, any transaction decided on by the directors is to be regarded as being within the powers of the company and such a person need not enquire further.¹⁵⁵

The objective of this provision is to guarantee the security of the transaction between the company and person dealing with it. Despite this, it must be remembered that the doctrine can be raised by the third party against the company.¹⁵⁶ On the otherhand company can no longer seek shelter under the doctrine against someone who has dealt with it in good faith.¹⁵⁷

(II) POSITION IN U.S.A.

It has been stated that 'the decision of the House of Lords in Ashbury Railway Carriage & Iron Co. v. Riche was influential in bringing about the adoption by the Supreme Court of the so called 'Federal Rule' that ultra vires contracts are void because the corporation does not have legal capacity to make them.'¹⁵⁸

The position in the early years in the U.S.A. was on par with the Indian position or the unmodified English

position prior to the European Communities Act, 1972. Professor Dodd, clarifying the position of ultra vires doctrine in U.S.A. in the initial stage remarks¹⁵⁹:

In the absence of any known rule of the common law vesting corporation with general contractual capacity both the traditional theory of corporations as legislative created artificial persons and the early nineteenth century tendency to view business corporations with considerable suspicion as form of special privileges, made it very natural for American Lawyers to regard contracts which are not within the scope of a business corporation's charter powers as wholly void.

But in the recent years, the approach to ultra vires acts has undergone substantial change in the U.S.A. As a result, the ultra vires doctrine is no longer as important as it once was.¹⁶⁰

Summing up the modern approach to the doctrine of ultra vires Professor Henry C. Menn¹⁶¹ says :

By the modern approach, an ultra vires act if not a public wrong is not illegal. The question, is not one of 'capacity' but of powers. While the corporation may not exceed its powers, it can in fact do so and suffer the consequences.

Now in U.S.A. there are statute dealing with the defence of ultra vires. The Model Business Corporation Act has abolished the ultra vires doctrine except for shareholders injunction proceedings against the corporation action, by the corporation or those suing in its behalf against its officers or directors, or proceedings by the State to dissolve or enjoin corporations.

Discussing the current trend of modern Statute dealing with the ultra vires doctrine in the U.S.A., Professor Horman D. Lattin observed :¹⁶²

Statutes are gradually eliminating ultra vires as a defence either for the corporation or one dealing with it. Injunctions to prevent contemplated ultra vires acts or to stop the corporation from further ultra vires transactions together with the possibility of holding corporate representatives who have intentionally or negligently bound the corporation to an ultra vires contract sufficiently protect the shareholders. The State may always take the life of such corporation or enjoin it from further pursuit of ultra vires projects, so the public interest, if such there be, is protected. Third person dealing with a corporation must, as in other agency cases, find out at their peril whether the

corporate representative is acting within the scope of his authority express, implied or apparent. But he need not go further... By these statutes, we have come reasonably close... in some, the mark has been hit... to giving the corporation having sought ancient doctrine as a satisfactory solution of our problems of ultra vires.

(III) POSITION IN INDIA

In India the Bhabha Committee observed "for the present we do not think that the evil is either serious or wide spread as to call for immediate action, and at the same time, found it difficult to devise a working formula under which restrictions could be imposed on their powers to do so. Without introducing an element of rigidity into their construction that might on occasions seriously prejudice their interest or impede their efficient working and the growth of industries."

The Committee has no solution to offer and instead preferred to rely on the expressed growth of responsible judgement among the managerial personal and the likely creation of a greater degree of alertness on the part of the shareholders. No immediate action was contemplated by the Committee as in their opinion the evil of the company's

indulgence in activities very remotly connected with their principal business was not so serious or wide spread as to call for immediate action.

The Vivian-Bose Commission which was constituted to inquire into matter relating to Dalmia Jain Airways Ltd. recommended for division of objects clause of Memorandum of Association into two parts. The recommendations of Commission leads to the Companies (Amendment) Act, 1965¹⁶⁴

It may be submitted that surprisingly, no Commission or Committee has taken into consideration the development, which has taken place in England or other countries in respect of Ultra vires doctrine. Even the Sachar Committee has not taken into consideration the provisions of European Communities Act, 1972.

Conclusion

An assessment of the doctrine of ultra vires, concludes on a skeptic note about the continued application of the doctrine.

Though, the doctrine has some justification and its usefulness to shareholders and creditors was recognised, it has now outlived its utility and if at all it offers any protection it is quite illusory. Therefore, Cohen Committee has recommended for its abolition, but for want

of significant legislative effort in the direction of its abolition, it has survived. The situation sufficiently underlies the need for legislative move for the abolition of the ultra vires rule with such care as would assure sufficient protection to the unwary third party.

In view of the conclusion drawn on the basis of the difficulties and harsh effect of the doctrine, what seems to be needed is :

(1) abolition of the ultra vires rule in so far as it affects the capacity of companies, alongwith the abolition of the doctrine ^{of} constructive notice;

(2) to provide that a company can carry on any business or other activity and exercise any power to the same extent as a natural person of full capacity except contract of personal nature;

(3) the existing provision in the Memorandum as regards power of company and any like provision in Memorandum in future should operate as a contract between a company and its members.

It is hoped that these suggestions, if implemented, would mitigate the hardship of rule on the unwary third party.

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