CHAPTER-3
CORPORATE PERSONALITY AND THE DOCTRINE OF
ULTRA VIRES

1. CONCEPT OF CORPORATE PERSONALITY

The word ‘person’ is derived from the Latin word “persona” which meant a mask worn by actors playing different roles in the drama. Until the sixth century the word was used to denote the part played by a man in life. Thereafter, it began to be used in the sense of a living being capable of having rights and duties. Many writers have restricted the use of term personality to human being alone, because it is only they, who can be subject matter of rights and duties and, therefore, of legal or juristic personality. But it must be stated that the term personality has a far wider connotation in law and includes Gods, angels, idols and corporations etc, although they are not human beings. On the contrary, there may be living persons in olden times such as slaves, who were not treated as persons in the eyes of law, because they were not capable of having rights and duties and the slavery is now completely abolished in all civil societies of the world. Likewise, in Hindu law an ascetic (Sanyasi) who has renounced the world ceases to have any proprietary rights and his entire estate is passed on to his heirs and successors and his legal personality completely lost.

A. DEFINITION OF LEGAL/JURISTIC PERSON

Jurists have defined persons in different ways. German jurist Zitelmana considers “will” as the essence of legal personality. To quote him, “personality is the legal capacity of will, the bodily-ness of men for their personality is a wholly irrelevant attribute”.

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204 P.N. Mullick V P.K. Mullick 1925 LR 52; Ind App 245 Cited From Prof. Aggrawal Nomita’s Jurisprudence 8th Ed.2010 Page 169
205 Saloman V Saloman (1987) AC 22
207 Ibid
Salmond defines a person as “any being to whom the law regards as capable of rights and duties. Any being that is so capable, is a person, whether human being or not and nothing that is not so capable is a person even though he be a man”. Thus ‘persons’ in juristic terms are of two kinds, namely natural and legal. The former are human beings capable of rights and duties while the later i.e. the legal persons are being who may be real (natural) or imaginary (artificial), in whom law vests rights and imposes duties and thus attributes personality by way of fiction. A juristic person is not a human being. It may be any other subject matter; either a thing or a mass of property or group of human beings to which they attributes personality. In other words, juristic persons may be defined as things, mass of property or an institution upon whom the law confers a legal status and who in the eyes of law possess rights and duties as a natural person.

JURISTIC PERSONS

Juristic or legal person is one to which law attributes legal personality. Normally legal personality is granted by law to all human beings. Legal personality, being an artificial creation of the law, may be conferred on entities other individual human beings. The law, in creating legal persons, always does so by personifying some real thing. Though it is not necessary for law to personify, since the law might, if it so pleased, attribute the quality of personality to a purely imaginary being but personification, in fact, conduces so greatly to simplicity of thought and speech that its aid is invariably accepted. Law may, if it so provides withdraw personality from certain human beings. Being the arbitrary creation of the law, legal persons may be of as many kinds as the law pleases. Corporations are undoubtedly legal persons and the better view is that registered trade unions and friendly societies are also legal persons, though not registered as corporations.

The conception of legal personality is not limited in its application. There are several distinct varieties of such persons, notably-

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208 Fitzgerald P.J.; Salmond on Jurisprudence 1988 (12th Ed.) page 299
209 Supra Note 206, Page 315
211 State Trading Corporation of India V Commercial Tax Officer, AIR 1963 SC 1811
The first class of legal persons consists of corporations, namely those which are constituted by the personification of groups (e.g. corporation aggregate) or series of individual (e.g., for corporation sole).

The second class is that in which corporations or objects selected for personification are not a group or series of persons but an institution. The law may, if it pleases, regard a church, a hospital, a university or a library as a person. That is to say it may attribute personality not to any group of persons connected with the institution, but to the institution itself. English Law does not indeed, so deal with the matter. The University of London is not the institution that goes by that name but a personified and incorporate aggregate of human beings namely, the Chancellor, the Vice Chancellor, Fellows and Graduates. It is to be noted, however, that notwithstanding this tradition and practice of English Law, legal personality is not limited by any logical necessity or indeed by any obvious requirement of expediency to the incorporated bodies of individual persons. In India, institutions like a university\textsuperscript{212}, a temple\textsuperscript{213}, public authorities, etc. are considered to be legal persons.

The third kind of legal person is that in which the corpus is some fund or estate devoted to special uses- a charitable fund for example, or a trust estate, or the property of a dead man or of a bankrupt. Here, also English Law prefers the process of incorporation. If it chooses to personify at all, it personifies not the fund or the estate, but the body of persons who administer it. Yet the alterative viz., of personifying the fund or estate is equally possible and may be equally expedient.

B. PURPOSES OF INCORPORATION

The most important purpose of incorporation is to enable traders to embark upon commercial venture with limited liability. This is possible only by the incorporation of the limited liability company. Company\textsuperscript{214} is so formed by a number of persons becoming shareholders and registering the company under companies Act. By becoming a shareholder, the member contributes or promises to contribute a stated amount of money for the furtherance of common objects of the company. His liability

\textsuperscript{212} Bansidhar V University of Rajasthan AIR 1963 Raj 172
\textsuperscript{213} Baba Kishore Dev V State of Orissa AIR 1964 SC 1501
\textsuperscript{214} Defined under Section 3 of the Act
is limited to his share that is the contribution made by him. If the venture of the company ends in disaster, he will not be called upon to meet the claims of the creditors of the company from his other assets. The assets of the company (including the share capital promised but still remaining unpaid), would alone be answerable for the claims of the company’s creditors. In this way the shareholders are able to trade with limited liability. This is one of the most important purposes of incorporation and it cannot perhaps be served by any other device known to the law.

There are other purposes also served by incorporation but those can be served by other means as well. The fiction of corporate personality is introduced for the purpose of bestowing the character and features of individuality on a collective and changing body of men. Incorporation assimilates the complex form of collective ownership to the simpler form of ownership. In case there are number of persons who are owners of the same property, difficulty arises as to its distribution as well as to its management. To avoid this, law creates fictitious legal person viz., the corporation or company etc. to which it attributes the rights and duties that would ordinarily attach to the beneficiaries. This fictitious person is endowed by law with the capacity of dealing with the property as the representative of the co-owners and of figuring in legal proceedings on behalf of its members.

This purpose of incorporation may be served also by means of trusteeship. The trustees can represent the body of co-owners for the purpose of suing and being sued. However, it must be observed that incorporation secures the object in view much better than trusteeship. Thus, a corporation becomes a continuous entity endowed with a capacity for perpetual existence. It is provided that a company has a perpetual succession and a common seal. Trustees, on the other hand, being mortal may have to be changed from time to time. The element of permanence is absent in trusteeship. Incorporation, thus, secures not only the element of unity but that of permanence as well. Incorporation can, therefore, be regarded as an indispensable legal concept of abiding value.²¹⁵

²¹⁵ Supra Note 210 Page 179
C. KIND OF CORPORATIONS

Corporations are of two kinds:

I. Corporation aggregate
II. Corporation sole

I. CORPORATION AGGREGATE

A Corporation aggregate is a group of co-existing persons, a combination of persons who are united together with a view to promote their common interest which is generally the business or commercial interest. It has been defined as a collection of individuals united into one body under a special denomination, having perpetual succession under an artificial form vested by the policy of the law with the capacity of acting in several respects as an individual, particularly of taking and granting property, of contracting obligations and of suing and being sued, of enjoying privileges and immunities, in common and of exercising a variety of political rights, more or less extensive, according to the design of its institution or the powers conferred upon it, either at the time of its creation or at any subsequent period of its existence.  

Under Indian Law, corporation aggregate are all those bodies or associations which are incorporated under a statute of Parliament or State legislature. In this category come all trading and non-trading associations which are incorporated under the relevant laws like the state trading corporation, Municipal Corporation, Roadways Corporations, the public companies, State bank of India, Reserve bank of India, The life insurance corporation, the Universities, Panchayats, Trade Unions, Co-operatives Societies. In fact these are some examples of corporate aggregate.

In Board of Trustees V State of Delhi, the Supreme Court discussed in detail the characteristics of corporate aggregate. In this case the court was examining the question, namely, whether the Board of Trustees, Ayurvedic and Unani Tibia College is a corporation aggregate or not. The court held the Board is not a corporation. Their Lordships observed that the most important point to be noticed in this connection is that in the various provisions of the Societies registration Act,

\[216\] Halsbury’s Laws of England, (3rd Ed.) Vol. 9 P.4 cited from Supra Note 210 page 180
\[217\] AIR 1962 SC 458
1860, there are no sufficient words to indicate an intention to incorporate. On the contrary the provisions show that there was an absence of such intention. Hence the Board is not a corporation aggregate because the essential characteristic of a corporation aggregate, namely, that of an intention to incorporate the society is absent. The court observed in this case that a corporation aggregate has one main capacity, namely, its corporate capacity. The corporate aggregate may be a trading corporation or a non-trading corporation. The usual examples of a trading corporation are:

1. Chartered companies
2. Companies incorporated by special Acts of Parliaments
3. Companies registered under companies Act etc.

However non-trading corporations are illustrated by:

1. Municipal corporation
2. District Boards
3. Benevolent institutions
4. Universities etc.

The court further observed that an essential element in the legal conception of a corporation is that its identity is continuous, that is, that the original member or members of which it is composed are something wholly different from the incorporation itself; for a corporation is a legal person just as much as an individual. In fact the essential of a corporation consist in the following:

1. Lawful authority of incorporation
2. The person to be incorporated
3. A name by which the persons are incorporated
4. A place and
5. Words sufficient in law to show incorporation.

No particular words are necessary for the creation of a particular corporation; any expression showing an intention in corporation will be sufficient.\footnote{218 Supra Note 210 Page 180}
CHARACTERISTICS OF CORPORATE AGGREGATE

The essential characteristic of a corporation aggregate is that it possesses a personality distinct from that of its members. This doctrine was first approved by the House of Lords in *Soloman V Soloman & Co. Ltd.*\(^{219}\) the facts of the case are as follows- One Mr. Soloman was the owner of a business which he turned in to a limited liability company. The other members of the company were his wife and children. The total number of issued shares were 20,007 of which Soloman took 20,001 shares and his family members took the remaining six. Soloman also took mortgage debenture to the amount of pound 1000 in part payment for the business. Later on the company became insolvent. The trial judge and the court of appeal held that the creditors had the prior claim to the assets since the company was a mere sham. The House of Lords reversed this, holding that the company was in law a person distinct from Soloman and that, therefore, Soloman was preferentially entitled to the assets as the secured creditors.

Another important case dealing with a company as a separate entity from its members is *Farrar V Farrar Ltd.*\(^{220}\) Justice Lindley said in this case- “A sale by a person to a corporation of which he is a member is not, either in the form or in substance, a sale by a person to himself. To hold that it would be to ignore the principle which lies at the root of the legal idea of a corporate body and that idea is that the corporate body is distinct from the persons composing it. A sale by a member of a corporation itself is in every sense a sale, valid in equity as well as at law.

The leading American case on the point is *People’s Pleasure Park V Rohleder*\(^{221}\), where the question was whether a restrictive covenant that title to land should never pass to a colored person operated to prevent a transfer to a corporation of which all the members were Negroes. It was held that the corporation was distinct from its members and that the transfer was valid.

\(^{219}\)(1897) AC 22 )P. 51 Cited from Supra Note 210 Page 181-182
\(^{220}\)(1898) 40 Ch. D 395, 409
\(^{221}\)61 South Eastern Rep. 794
Indian courts have also recognized the judicial personality of a company or corporation distinct from the members which compose it. In fact, this principle had secured a place in India even earlier than Soloman’s case.

The decision of the Calcutta High Court in Kondoli Tea Co. Ltd., Re²²², seems to be the first on the subject. In this case certain persons transferred a tea estate to a company and claimed exemptions from Ad valorem duty on the ground that they themselves were the share-holders in the company and therefore it was nothing but a transfer from them to themselves under another name. Rejecting this, the Court observed that “the company was a separate person a separate body altogether from the share holders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons”. In a number of other cases this principle has been recognized.

II. CORPORATION SOLE

Corporation sole is an incorporated series of successive persons. It implies two persons to exist under the same name, the one a human being and the other, the corporation sole, which is a creature of the law and continues to exist though the human beings changes. “The live official comes and goes”, said Salmond in a passage which has become the classic description of the corporation sole, but this offspring of the law remains the same for ever”. The most outstanding example of Corporation Sole is the Crown (in England). Two persons are deemed to be occupying the throne of England- one the queen in flesh and blood and the other is the Corporation sole which is the creature of law. This Queen never dies though the Queen in flesh and blood may die.

In India various offices like that of the Governor of the Reserve Bank of India, the State Bank, The Post Master General, The General Manager of Railways, the Registrar of Supreme Court and High Courts etc. which are created under different statute are some example of Corporation sole. In Govind menon V Union of India²²³, the Supreme Court pointed out the main characteristic of corporation sole. The court observed the Corporation sole is not endowed with a separate legal

²²² (1886) ILR 13 Cal 43 Cited from Supra Note 210 Page 182
²²³ AIR 1967 SC 1274 Cited from Supra Note 210 Page 187
personality. It is composed of one person only who is incorporated by law. The same person has a dual character, one as a natural person and the other as Corporation sole, the later being created by Statute. In this case the court rejected the contention of the appellant that the commissioner has a separate legal personality as corporation sole under section 80 of the Act, (Madras Hindu Religious and Charitable Endowment Act 19 of 1951, which states that the commissioner shall be a corporation sole and shall have perpetual succession and a common seal and may be sued in his corporation name) and that he is exempt from disciplinary proceedings for any act or omission committed in his capacity as commissioner. Their lordships observed, “In our opinion, the object of the legislature in enacting section 80 and 81 of the Act was to constitute a separate fund and to provide for the vesting of that fund in the commissioner as a corporation sole and thereby avoid the necessity of periodic conveyance in the transmission of title to that fund.224

The idea of corporation sole originated according to Maitland with a piece of land, known as the parson's globe, which was vested in a parson in his official capacity. Difficulties arose as to the conveyance (legal paper transferring ownership of property) of the Seisin225 to a person for the benefit of church. The Corporation sole was invented so that the Seisin could be vested in it. Today, under English law, there are number of bodies which can be said to be examples of Corporation sole. Noted them are a parson, a bishop, public trustee, the postmaster General etc.226

D. CROWN AS THE CORPORATION SOLE

Section 40(1) of the Crown proceedings Act 1947, sharply underlines the distinction between sovereign as an individual and the corporation sole. The Act does not apply to proceedings, by or against the Queen in her private capacity. This invariably leads to the conclusion that the Crown is Corporation sole meaning thereby the queen who adorns the Crown, is different from the one (i.e. the corporation sole)

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224 Supra Note 210 Ibid
225 Means Feudal Possession
226 Supra Note 210 Ibid
which is the actual owner of the throne- being the creation of law. The chief manifestation of this is to be seen in the proclamation that is made on the death of the reigning monarch in England. The proclamation says, “The king is dead, long live the King”. It thus refers both to the individual who has died and to the Corporation sole which survives, i.e. which never dies but lives for ever. If this device of Corporation sole is not accepted the following consequences would result on the death of a ruling monarch:-

1. Pending actions in the Royal Court would lapse on the King’s death and would have to be restarted when a new sovereign occupies the throne.
2. Parliament would stand dissolved and
3. Crown appointments would be automatically terminated.227

E. POSITION IN INDIA

Article 12 of the Constitution of India provides that the State includes the Government and parliament of India and the legislature of each state. What is the position of Indian State? It is a juristic person. In Shiv Prashad V Punjab State228, the Punjab High Court observed-

The natural and obvious meaning of the expression is that person is a living human being, a man, woman or child, an individual of the human race. In law the word includes natural person and artificial persons like corporation and joint stock companies, but it does not include a State or Government229, for although a state is a moral person, having an understanding and a will, capable of possessing and acquiring rights and of directing and fulfilling obligations, the state in its political organization is entirely different and distinct from the inhabitants who may happen to reside there.

Again in the State of Punjab V The Okara grain Buyers Syndicate Ltd.230, the court observed that a state is not a juristic entity for the reason that it does not partaken the characteristic of or satisfy in whole the definition of a corporation. The state is an organized political institution which has several of the attributes of a

227 Supra Note 210 Page 187
228 AIR 1957 Punj. 150 Cited from Supra Note 210 Ibid
229 State of Rajasthan v Rikhabchand, AIR 1961 Raj 64
230 AIR 1964 SC 660
corporation, e.g. under article 300 of the constitution the Government of the Union and the Government of a State are able to sue and be sued in the name of Union of India and of the Government of the State as the case may be.

As regards Ministers of Indian Government, they are appointed by the President or the Governors and are officers within the meaning of articles 53 and 154 of the constitution. They are in law, subordinate to the executive head and so are not personally liable for their acts of commission and omission. They are not directly liable in a court of law for their official acts. They have no legal or constitutional entity. Any person aggrieved by them can bring a suit against the Union of India or the State as the case may be. Consequently they are not corporation sole. Like any other servant of the Government the Ministers are not liable personally. In either case it is the state whether at the centre or in the federated units which is liable in torts and contracts.

To conclude, it can be said that when there is an aggregate of persons forming a body corporate we call it a corporation aggregate. But when there is not a body of persons, but a fund or an estate or an officer-bearer by himself, we call it or him a corporation sole. In a corporation aggregate there are two or more members at one time but in corporation sole there is only one member at a time. Corporation aggregate is endowed with separate legal personality whereas a corporation sole is not endowed with a separate legal personality.

F. CORPORATION WHETHER A CITIZEN

Citizenship as defined in Part II of the Constitution of India indicates only natural persons and not juristic persons, like corporations. To throw more light on the subject we are examining certain case laws on the topic.

1. In State Trading Corporation of India v Commercial Tax officer, in this case Supreme Court held that company or corporation is not citizen of India and cannot, therefore claim such of the fundamental rights as have been conferred upon citizens. The citizenship conferred on a citizen as per the

231 State of Rajasthan v Vidyawati, AIR 1962 SC 933
232 New Marine Coal Co. v Union of India, AIR 1964 SC 15
233 Supra Note 210 Page 188
234 AIR 1963 SC 184
provisions of the Constitution is concerned only with natural persons and not juristic persons. In this case the State Trading Corporation was sought to be taxed in respect of sales affected by them in the course of their business operation. The corporation contended that its transaction related to inter-state sales and was therefore, exempted from taxation under Article 286(1). The impugned tax was therefore, an infringement of its fundamental right under Article 19 (1) (g) of the Constitution. The Supreme Court, however, held that the State Trading Corporation was not a citizen and therefore could not claim the right under Article 19(1) (g).

2. In *Tata Engineering & Locomotive Co. V State of Bihar*[^235], the petition was filed by the company and some shareholders also joined it. They argued that though the company was not a citizen but its shareholders were citizens and if it was shown that all its shareholders were citizens the veil of corporate personality might be lifted to protect their fundamental rights. The court rejected this argument and held that “If this plea is upheld, it would really mean that what the corporations and companies cannot achieve directly can be achieved by them indirectly by relying upon the doctrine of lifting the corporate veil”.

3. In *Heavy Engineering Mazdoor Union v State of Bihar*[^236], it was held that the mere fact that the President of India and certain officers of the Central Government, in their official capacity, held the entire share capital of the respondent company does not make the company as an agent either of the President or the Central Government. The company and its shareholders are distinct entity.

4. In *Bank nationalization case*[^237], the court held that “A measure executive or legislative may impair the right of the company alone, and not of its shareholders: it may impair the rights of the shareholders and not of company, it may impair the right of the shareholders as well as of the company. Jurisdiction of court to grant relief cannot be denied when by state action, the

[^235]: AIR 1965 SC 40  
[^236]: AIR 1970 SC 82  
[^237]: AIR 1970 SC 564
rights of the individual shareholders are impaired, if that action impairs the rights of the company as well. The test in determining whether the shareholder’s right is impaired is not formal; it is essentially qualitative, if the state action impairs the right of the shareholders as well as of the company the court will not, only upon technical ground, deny itself jurisdiction to grant relief. A shareholder is entitled to the protection of Article 19 of the Constitution. The fundamental rights of the shareholders as citizens are not lost when they associate to form a company. When their fundamental rights as shareholders are impaired by state action their rights as shareholders are protected. The reason is that the shareholder’s rights are equally and necessarily affected, if the rights of the company are affected”.

5. The above case of Bank nationalization was followed in by Supreme Court in Bennett Coleman & Co. V Union of India. In that case, the question was whether the shareholder, the editor, the printer have right to freedom under Article 19 of the Constitution. Relying on the Bank Nationalization case the court held that the protection of Article was available to a shareholder, editor, printer and publisher of a newspaper. The court said the rights of shareholders with regard to Article 19 (1) (a) were protected and manifested by the newspapers owned and controlled by the shareholders through the medium of the corporation. The individual rights of speech and expression of editors, directors and shareholders are all exercised through their newspapers through which they speak. The press reaches the public through the newspapers. The shareholders speak through their editor. The locus standi of the shareholders is beyond challenge after the ruling of this Court in the Bank Nationalization case.

6. In Godhra Electric Co. Ltd. V State of Gujarat, the court held that though a company was not a citizen under Article 19 but a shareholder, a managing director of a company had right to carry on business through agency of company and if that right was taken away or abridged he was not disabled.

238 AIR 1973 SC 106
239 AIR 1975 SC 32
from challenging the validity of the provisions of any Act, which affected his right.

7. *D.C. & G.M. V Union of India*\(^{240}\), following the decisions of *Bank Nationalization and Bennett Coleman’s case*, the Supreme Court in this case held that writ petition filed by a company complaining denial of fundamental rights guaranteed under Article 19 is maintainable. In the matter of fundamental freedom guaranteed by Article 19, Desai, J held, the right of a shareholder and the company which the shareholders have formed are co-extensive and the denial to one of the fundamental freedom would be denial to the other. The judge pointed out that this is the modern trend and suggested that the controversy on the point should be put to an end by passing appropriate legislation.

2. **THEORIES OF CORPORATE PERSONALITY**

Law treats a corporation aggregate and a corporation sole as persons. About the nature of their personality different theories have been advanced. These theories have either a political undertone in so far as they attempt to project the nature of relationship between the state and the groups existing within the state or provide a philosophical explanation about the existence of such persons created by law or try to meet the practical implications of the existence of such groups as legal persons. The courts have not, however, consistently followed any particular theory in dealing with various problems relating to corporation and have, by and large, being guided by practical considerations. These theories are not a mere existence in intellectual acrobatism but lead to important legal and practical consequences.\(^{241}\)

Various theories of corporate personalities are discussed below.

A. **THE FICTION THEORY**

According to some jurists, a corporation has a fictitious personality. This fictitious personality is attributable to the necessity for forming an individual

\(^{240}\) *AIR* 1983 SC 937  
\(^{241}\) Paton, G.W. *A Text Book of jurisprudence* 1972 4rth Ed (Oxford University) page 410 Cited from Supra Note 210 Page 189
organization existing by itself and managing for its beneficiaries, that is to say, the members of it and its affairs. In Roman law, we know of the ‘persona ficta’. Savigny developed the concept of the persona ficta. He called fictitious persons by the term ‘juridical persons’. Juridical persons are those who exist only for juridical purposes. While in the case of a natural person, he is born with a personality which the law has merely to recognize, it is otherwise in the case of an artificial or juridical person whose personality is created by the law (there being no personality apart from this fictitious creation by the law).\textsuperscript{242}

Michoud has raised several objections to the fiction theory.\textsuperscript{243} One of the arguments against the theory is that from the point of view of ownership, the fiction theory takes us nowhere. If a corporation aggregate be only an imaginary person which exists only in the eyes of the law, how can a non-existing (imaginary) person hold property?

Next it has been argued that a corporation has rights. But rights can only be had by real persons; so a corporation must be real and not an imaginary person. Against these arguments it can be replied that property can be held and rights owned and exercised by a body of persons instead of by each member of such body, for it is that body which is recognized for the purposes of convenience and ownership of property and rights as a separate entity.\textsuperscript{244}

Another argument against the fiction theory is that its upholders “mistake the part played by the legislator”. “The legislator makes nothing by itself. He only considers social want, social good and social evil, and gives effect to what society generally considers as good or proper. It is idle, therefore, to suggest that the legislature creates the personality of the corporation”. But here again it may be said that this argument of the realists is fallacious. The legislation of the corporations creates it, in recognition of the economic necessity and business convenience, resulting from such recognition. Even the public opinion demands and is in real need of such recognition which the legislature satisfies. Undoubtedly the legislator, like the

\textsuperscript{242} Sethna Jehangir M.J., on “jurisprudence” 3rd revised Ed.(1973) Page 593-595
\textsuperscript{243} Michoud; La theorie se la Personale Morale, 3\textsuperscript{rd} Ed. 1924 page 18
\textsuperscript{244} Supra note 242 ibid
judge, can create something new, and something worthy, or give effect to what is a commercial convenience or an economic facility.\textsuperscript{245}

\textbf{B. THE REALISTIC THEORY}

According to another theory regarding personality of the corporation, a corporation has a real and not a fictitious, personality. Its reality is psychic. Gierke is a leading exponent of realist Theory which refutes the fiction theory. The realistic theory maintains that a corporation has a real psychic personality recognized, and not created, by the law. The realist theory is also known as the sociological theory of the group personality of the corporation. The upholders of the realist theory are found not only over the continent but also in England. They hold that the collective will is, in psychology, different from the individual. An individual, all by himself may come to a particular decision; but in association with others he may come to a totally different decision. The will of the many is different from the will of an individual. So a corporation has a real psychic will, and is, therefore, not a fictitious creature of the law but a psychic personality recognized by the law.

The realistic theory, however, is incapable of being applied to a corporation sole, because the theory of the ‘collective psychic will does not come in the case of a corporation sole where there is a single natural person whose will does not stand supported by the will of any one else’ (there being none else). Moreover, taking the case of an artificial person as a corporation sole, as for example, an universitates bonorum (like a public fund or estate), we may say that the question of the collective will cannot arise, because a public fund or estate has no collective will; there is the will of its administrator. The realist theory can have significance only in the case of a corporation aggregate. We may say that it is from the point of view of convenience and a continuing existence (despite demise and insolvency of its members), with a limited liability of its members and a separate liability of the incorporation, that the law has thought it fit to give corporations separate fictitious personality.\textsuperscript{246} The realist

\textsuperscript{245} Ibid page 595-96
\textsuperscript{246} Ibid Page 594
theory asserts that group personality has the same features as a human personality. The groups have a real mind, a real will and a real power of action.\textsuperscript{247}

C. THE CONCESSION THEORY

The concession theory of the personality of the corporation, which is akin to the fiction theory, but not identical with it, says that legal personality can follow from law alone. It is by grace or concession alone that the legal personality is granted, created or recognized. The grace of the state and its law prevails. This theory is, to an extent, correct; it is correct, in the sense only that all rights, whether human or corporate, flow from what the law gives, and where the law does not give anything, at least, its recognition is necessary to validate, maintain or perpetuate what already exists or is conferred by nature or what man has taken or created for himself. In all civilized societies, man can assume his rights, only through the force of the law at his help and to his recognition.\textsuperscript{248}

D. THE BRACKET THEORY

The bracket theory of the personality of the corporation maintains that the members of a corporation have their rights and liabilities referred to the corporation itself, simply from the point of view of convenience. To determine, however, the real nature of the corporation and its state of affairs, the brackets have to be removed, for the names of the members of the corporation are kept in brackets. If and when the brackets are removed, one would be able to see what the corporation is, what its true nature is, and how its members are revealed through the removal of brackets. The great defect, however, in the reasoning of the upholders of this theory of corporate personality is that rights, duties and liabilities are thought to be possessed by natural persons alone and not by corporations which are legal entities. The bracket theory is also known as Jhering’s theory, as Jhering was its exponent. It was developed in France by Vareilles-Sommieres.\textsuperscript{249} However, to understand the real nature of the

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\textsuperscript{247} Maitland F.W, Introduction to Gierke’s Political Theories of the Middle Age; F. Hallis Corporate Personality, 1\textsuperscript{st} Ed. 1913 page 137; 146
\textsuperscript{248} Supra Note 242, Page 597
\textsuperscript{249} Ibid
\end{flushright}
corporation, we must remove the bracket to find out the actual position of the company.250

E. THE ORGANISM THEORY

The organism theory of the personality of the corporation is the one that expounds that the corporation, like an organism, has members (limbs), head and other organs. The individual also has a head, a body with limbs that satisfy inter-dependent functions. Corporations, such as the state, the university, the club, social and public utility organizations, have also limbs in them and wills of their own. A corporation, according to this theory, is a subject of legal rights and is liable to duties also. According to this theory, a subject of legal rights need not be a human being. Any being or body with a will of its own and a life of its own can have legal rights and can be subject to legal duties and liabilities. What is essential, according to this theory, is that such a being or body must have a will of its own.251

According to the organism theory of the personality of the corporation, corporations are social organisms, while human beings are physical organisms. Corporations are different from those who are their members, and their wills are also different from the wills of their individual members, for it is not what individual members decide at meetings of the corporations while passing resolutions; it is what the corporation as a body decides. The will of each individual member of the corporation gets submerged into the will of the corporation. Individual A may not at all be in accord with the resolution finally passed by the corporation; individual B’S views may now stand much modified by the final resolution; individual members enter into discussions at their meetings, and finally what is decided may be much different from the original views entertained by the individual corporator. The final resolution is therefore the will of the corporation.252

250 Soloman v Soloman Co. Ltd., (1897) AC 22
251 Supra Note 242 Page 598
252 Ibid
F. THE OWNERSHIP THEORY

Another theory of the personality of the corporation is the ownership theory. Developed by Brinz, Bekker, Demelius, and elaborated by Planiol, the ownership theory of the personality of the corporation asserts that legal rights can be had by human beings and not by corporations. According to this theory, the so-called juristic person that is the corporation is not a person at all. It is “subject less property” destined for a particular purpose, according to Planiol, subject less rights are “legal monsters”. He holds that fictitious personality is not an addition to the class of persons, but is only a matter of owning or possessing property in common. It is only a “form of ownership”. He adds “collective ownership is, so to speak, hidden from our eyes by the existence of fictitious beings to which we ascribe, at least in a certain measure, the attributes of personality, which are reputed owners, creditors or debtors, which make contracts, and sustain legal proceedings like true persons. All the collective ownerships are attributed to fictitious persons, of which each is reputed the single owner of a mass of goods, and the collective ownership appears as itself an individual ownership; a conception as false as useless. Consequently instead of teaching that we have two kinds of ownership, it is taught that there are two kinds of persons.”

The ownership theory has some significance when it is used with reference to estates and funds which are corporations sole. But apart from this it does not hold good, in so far as it denies the existence of the corporate personality as such.

G. THE PURPOSE THEORY

According to this theory personality is only enjoyed by human beings, they alone can be the subjects of rights and duties. The so called juristic persons are not persona at all. Since they are distinct from their human substratum, if any, and since rights and duties can only vest in human beings, they are simply ‘subject less properties’ designed for certain purposes.

The main implication of this theory is that law protects certain purposes and the interest of individual beings. “The property supposed to be owned by juristic

253 Cited by Dean Pound Roscoe in his Jurisprudence 1959 (By West Publishing Co) Vol. IV, p 255
254 Supra Note 242 Page 599-600
persons does not belong to anything; but it does ‘belong for’ a purpose and that is the essential fact about it. All juristic or artificial persons are merely legal devices for protecting or giving effect to some real purpose, e.g., a trade union\textsuperscript{255} is the continuing fund concerned and the purposes for which it is established.”

H. THE KELSEN’S THEORY

Another important theory worth noting is Kelsen’s Theory of corporate personality. According to Kelsen, personality is “only a technical personification of a complex of norms, a focal point of imputation which gives unity to certain complexes of rights and duties”. Kelsen shows that there is no significant difference between the legal personality of an individual and that of corporation, for in the case of both what is known as legal personality is nothing but a complex of norms, that is to say, what is constituted by the bundle of rights and duties and liabilities centering round, and the norms which rule the behavior of individuals are also the norms that determine the rights and duties of corporations. For organizing rights and duties, a convenient legal device is that of legal personality.\textsuperscript{256}

The greatness of Kelsen’s theory lies in the concept of personality as a complex of norms, giving unity to certain complexes of rights and duties. The acceptance of Kelsen’s theory as a correct theory, like the acceptance of the Quasi-Realist or Quasi-Fiction Theory of personality of corporation, opens out a new avenue in favor of corporations being entitled to enjoy fundamental rights under the constitution where such rights are guaranteed. If there be no difference between the ‘personality’ of a natural being and that of a non-natural being like the corporation, why should fundamental rights be denied to the corporation and why should it be said that corporations are not ‘persons’? Why should Acts, like the Citizenship Act in India, lay down that the term ‘person’ does not include a corporation or any body of persons whether corporate or incorporate? Under the modern law, as it should be, relating to corporations, Kelsen’s theory should be a welcome theory, as it would

\textsuperscript{255} Bonser V Musicians Union, (1956) AC 104
\textsuperscript{256} Supra Note 242 Page 600
enable the recognition of the corporation as a person as much as a natural person, and would entitle it to greater rights as also subject it to greater duties than at present.257

3. LIFTING THE VEIL OF CORPORATE PERSONALITY

As we know that after incorporation a company becomes a legal person separate and distinct from its members. It has a corporate personality of its own with rights, duties and liabilities separate from those of its individual members. Thus, a veil of incorporation exists between the company and its members and due to this a company is not identified with its members. In order to protect themselves from the liabilities of the company, its members often take the shelter of the corporate veil. Sometimes this corporate veil is used as a vehicle of fraud or evasion of tax etc. To prevent unjust and fraudulent acts, it becomes necessary to lift the veil of the corporation or disregard the corporate personality to look into the realities behind the legal façade and to hold the individual member of the company liable for its acts or liabilities.258

In State of U.P. V Renusagar Power Co.259, the court held that the concept of lifting the corporate veil is a changing concept. Its frontiers are unlimited. However, it depends primarily on the realities of the situation.

In The Deputy Commissioner V Cherian Transport Corporation260, the court has held that the company is a legal person distinct from its members. It is capable of enjoying rights and being subject to duties which are not the same as those enjoyed or borne by its members. In certain exceptional cases the court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal façade.

The corporate veil has been lifted by the courts and legislatures both in the interests of justice, equity and good conscience.

In Sugar India Ltd. V Chander Mohan Chadha261, the Supreme Court has made it clear that it is not open to the company to ask for unveiling its own cloak and

257 Ibid
258 Rai Kailash on Company Law 10th Ed. 2006 Page 47
259 (1992) 74 Comp. Case 128 (SC)
260 (1992) 74 Comp. Case 563 (Mad)
261 AIR 2004 S.C. 4368
examine as to who are the directors and shareholders and who are in reality controlling the affairs of the company.

The doctrine of the lifting the veil of corporate personality is a doctrine that advocates going behind and looking behind the juristic or corporate personality of a body corporate. Undoubtedly, as a general rule, a company is a person distinct and separate from its members. But, in exceptional cases, that veil of corporate personality can be lifted; and looking behind the veil, one could see the corporate personality fading away. Law courts have, in exceptional cases, cracked the shell of corporate personality and have looked upon a corporation and its members from a different point of view. Courts have lifted the veil, with the objective of preventing fraud. In such cases the members of the corporation are considered as persons working for the corporation. In *Tata Engineering & Loco-motive Co. Ltd. V State of Bihar*\(^\text{262}\), although the veil was not lifted, however the doctrine of lifting the veil of the corporation was considered at great length.

The law is complicated by the facts that the courts do not always take account of the distinct personality of a company. It renders impossible to any consistent theory as to the nature of personality and emphasizes more strongly than anything else the need to proceed empirically in understanding the law. The courts do in some cases pierce (lift) the veil of legal personality in order to detect and redress frauds upon creditors; the evasion of obligations or statutes or to suppress tax evasion.

In England, the problem was faced soon after War. The court may lift the veil of personality for a number of reasons-

Firstly- it may be done to ascertain whether a company is to be treated as an ‘Enemy Company’ in times of War. Thus during the First World War in *Dalmer Co. Ltd. V Continental Tyre & Rubber Co. (Great Britain) Ltd.*\(^\text{263}\), a company which was registered in England and which should normally be treated as an English Company was nevertheless held by the House of Lords to be an enemy company because, all its directors and its shareholders except one were Germans. This is, however, not a departure from the general rule that a company is distinct from its members, it only

\(^{262}\) 1964, 1 S.C.J. 666
\(^{263}\) (1916), 2 AC 307
shows that its character whether friendly or enemy is to be ascertained by looking behind the veil.

A different view has been expressed in case of Kuemgel V Donnersmarch\textsuperscript{264}, where it was held that a company which acquires enemy character in this way still remains An English Company, if it had been registered in England.

Secondly, public policy may make it necessary to lift the veil of a legal personality to look at the realities of a situation.

Thirdly, it may become necessary to disregard corporate personality in order to prevent fraud.

4. DOCTRINE OF CONSTRUCTIVE NOTICE OR KNOWLEDGE

A. EVOLVED BY COURTS IN U.K.

In regard to company transactions, the doctrine of constructive notice was evolved by the Courts in UK for the protection of the company against third parties dealing with the company, in that they are presumed to have the knowledge of the company’s public documents, that is the documents filed by the company and kept together with the facts recorded in the relevant register by the Registrar, which are open to public for inspection with the right to have certified copies of, extracts from them as needed by them from the registrar (which is also provided under section 610 of the our Companies Act 1956), irrespective of whether the third parties have the knowledge of the same fact or not. According to section 610 these documents and registers are kept in accordance with the rules under the Destruction of Records Act, 1917.\textsuperscript{265}

The documents filed by companies are final, once those are taken on record by the Registrar, endorsement subject to the companies being free to file revised documents to rectify any error or mistake in the documents, earlier filed as permitted by regulations 17 of the companies Regulations 1956, with the reasons, which the registrar is bound to take on record, that is both the documents exist on file. The Registrar has no power to de-register any documents already registered by him, however the requirement for the Registrar to publish public notices in the official

\textsuperscript{264} (1965) 1 All ER 46
\textsuperscript{265} Taxmann’s Company Law by Krishnamurti D.S.R., 2006 Ed. Page 294
Gazette in respect of alterations to the memorandum and articles of association of companies provided for in the English Act, is not present in our Act, except in case of publication of the resolution for voluntary winding up under section 485 by the company, and the notice for striking the name of the company off the register under section 560 of the Act by the Registrar. In the result, it is for the outsider who intend to deal with the company to be informed of the contents of such documents available for inspection at the Registrar’s office as well as statutory records available for inspection at the registered office of the company in their own interest, and even if they do not do so they are deemed in law to have done so and have the knowledge of contents, and they will not be heard to say that they did not do so.\(^{266}\)

The special features of this doctrine is that every person dealing with the company is presumed to have notice of all the documents filed with the registrar of companies, which further mean that every person dealing with the company has read these documents and understood them in their true perspective. Hence if any party dealing with the company does not have actual notice of the contents of these documents, it is presumed that he has an implied (constructive) notice of them. Consequently, if a person enters into a contract which is beyond the powers of the company, as defined in the memorandum, or outside the limit set on the authority of the directors as per the memorandum or articles, he cannot, as a general rule, acquire any rights under the contract against the company.

In one of the Madras case that of Kotla Venkataswamy V Chinta Ramamurthy\(^ {267}\), the articles of association of the company required that all documents should be signed by the managing director, secretary and the working director on behalf of the company. A deed of mortgage was executed by the secretary and the working director only. The court held that no claim would lie under such deed. The learned judge observed that the mortgagee should have consulted the articles before the deed was executed. Therefore, even though the mortgagee may have acted in good faith and the money borrowed applied for the purpose of the company, the mortgage was nevertheless invalid.

\(^{266}\) Ibid page 295  
\(^{267}\) AIR 1934 Mad 579
Thus, persons dealing with a body corporate, incorporated company or a society are bound to take notice of disabilities imposed on the body corporate and its officials by the memorandum and articles or other documents of constitution.\textsuperscript{268}

B. DOCTRINE OF CONSTRUCTIVE NOTICE SUBJECT TO FOLLOWING DOCTRINES

I. DOCTRINE OF INDOOR MANAGEMENT

II. DOCTRINE OF HOLDING OUT

I. DOCTRINE OF INDOOR MANAGEMENT:-

Doctrine of constructive notice is subject to the doctrine of indoor management. According to the doctrine of indoor management, an outsider dealing with the company is required to see that the authority of dealing had been given by the articles to the person with whom the outsider is dealing but he cannot be assumed to do any more: he is not expected to enquire whether the proper procedure has been followed for the delegation of the authority to the person with whom the outsider is dealing.\textsuperscript{269}, he may be presumed to have the knowledge of the constitution of the company but not what may or may not have taken place within the indoors which are closed to him.

The doctrine entitles the outsiders dealing with the company to assume that the things have been done in accordance with the provisions and proceedings stated in the articles of association of the company. Thus every outsider is entitled to assume the regularity of internal proceedings unless he has the knowledge of the irregularity. The doctrines implies responsibility on the person in-charge on the management of the company to see that all the rules of internal management of a company are complied with and the company will be liable to the outsider for the acts of its directors or agents even if the internal formalities or internal procedures have not been complied with. An example will make the point more clear. If the articles give power to the managing agent of the company to borrow money with the approval of directors but the managing agent borrows without such approval, the lender will not be effected by such irregularity; he may presume that before borrowing, the management agent has

\textsuperscript{268} Taxmann’s Company Law & Practice By Majumdar AK 1995 Ed. Page 143
\textsuperscript{269} Bigger Staff V Rowatt’s Wharf (1896) 2 Ch. 93
taken approval of directors and consequently, the company will be bound by the loan. However, if the lender has the knowledge of the irregularity, the position would be quite different. The lender will not be protected and consequently the loan will not be binding on the company.\textsuperscript{270}

The object of this doctrine is to protect the outsider with a company. The doctrine is based on the business convenience, for business could not be carried on if every body dealing with the apparent agents of a company was compelled to call for evidence that all internal regulations had been duly observed. Since memorandum and articles of association of the company are public documents which are open to the public inspection, an outsider is presumed to have the knowledge of their contents but the details of internal procedure are not open to public inspection and therefore it would be unfair if an outsider dealing with the company is presumed to have the knowledge of the details of internal procedure (the rule of internal management).\textsuperscript{271}

The doctrine was first developed in the case of \textit{Royal British Bank v Turquand}.\textsuperscript{272} The doctrine of indoor management is also known as rule in \textit{Turquand’s case}. In this case the directors were empowered by its registered deed of settlement\textsuperscript{273} to borrow on bond such sums as should be authorized by a general resolution passed at a general meeting of the company. The company borrowed money and issued a bond signed by two directors under the seal of the company. When the lender sued on the bond, the company contended that there had been no resolution authorizing the loan and therefore the bond was given without authority and consequently it was not binding on the company.

The court rejected the contention of the company and held that borrowing might be authorized by a resolution of the company, the plaintiff (the lender) had right to assume that the necessary resolution had been passed. The doctrine of indoor management developed in the above case is based on reason and justice. It has been applied by the courts in a number of cases to secure justice. However, there are few exceptions to the doctrine of indoor management.

\textsuperscript{270} Balsara Wathi Ltd. v A Parmeshwar, AIR 1957 Mad. 122
\textsuperscript{271} Supra Note 258 Page 115
\textsuperscript{272} (1856) 6 E & B 327 Exch Ch
\textsuperscript{273} Until 1862, memorandum and articles were found in one document called “deed of settlement”
EXCEPTIONS
1. Notice of irregularity
2. Suspicious circumstances inviting inquiry
3. Forgery
4. No knowledge of contents of articles

II. DOCTRINE OF HOLDING OUT-

The Doctrine of constructive notice is also subject to the doctrine of holding out. Hence the doctrine of holding out creates an exception to the doctrine of constructive notice. If a person is held out by the company as its officer, the act of the person falling within the actual or ostensible authority of the officer will be binding on the company. For example, Mr. A is held out by the company as its managing director, while in reality he has not been appointed to the office of managing director. The act of Mr. A will be binding on the company, provided it falls within the actual or ostensible authority of the managing director.\(^\text{274}\) Thus, if the company represents that a person is an officer and the act of the officer will be binding on the company. The doctrine of holding out is based on the doctrine of estoppels which say that a person cannot be allowed to deny the truth of his statement. In the above referred case of \textit{Freeman & Lockyer}\(^\text{275}\), The court has held that a contractor can hold the company liable for a contract made on its behalf on the ground of holding out if the following are proved:-

1. That a presentation that the agent or the officer had authority to enter, on behalf of the company, into a contract of the kind sought to be enforced was made to the contractor.
2. That such representation was made by a person or persons who had actual authority to manage the business of the company either generally or in respect of those matters to which the contracts relates.
3. That the contractor was included by such representation to enter in to contract, that is, that he in fact relied upon it; and

\(^{274}\) Freeman & Lockyer V Buckhurst Park Properties (Mangal) Ltd. (1964) 2 Q.B. 480 Cited from Supra Note 258
\(^{275}\) Ibid
4. That under its memorandum or articles the company was not deprived of the capacity either to enter into a contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent.

5. MAIN OBJECTS RULE OF CONSTRUCTION

The *ultra vires* doctrine confines corporate action within fixed limits. While it handicaps the ambitious manager, it lays a trap for the unwary creditor. That is why there has been a revolt against it almost ever since its inception. The businessman has always endeavored to evade the limitations imposed by the doctrine on their freedom of action. One of the methods of bypassing *ultra vires* is the practice of registering memoranda containing a profusion of objects and powers.\(^{276}\)

For example in *Cotman V brougham*\(^ {277}\), the House of Lords had to consider a memorandum which contained an objects clause with thirty sub-clauses enabling the company to carry on almost every conceivable kind of business which a company could adopt. Such an objects clause naturally defeats the very purpose for which it is there.\(^ {278}\)

In a bid to control this tendency the courts adopted “main objects rule” of construction. The rule owes its origin to the decision in *Ashbury case* where it was held that the words “general contractors” must be read in connection with the company’s main business. *German Date Coffee Co., Re*,\(^ {279}\) is another illustration of its application.

The memorandum of the company stated that it was formed for working a German patent which would be granted for manufacturing coffee from dates; for obtaining other patents for improvements and extension of the said invention; and to acquire and purchase any other invention for similar purposes. The intended German patent was never granted, but the company purchased a Swedish patent, and also established works in Hamburg, where they made and sold coffee from dates without any patent.

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276 Cotman v Brougham, 1918 AC 514  
277 Ibid  
278 Sangal, Ultra vires and Companies; The Indian Experience (1963) 12 ICLQ 967  
A petition having been presented by two shareholders, it was held that the main object for which the company was formed had become impossible and, therefore, it was just and equitable that the company should be wound up. The court said: “In construing a memorandum in which there are general words…..They must be taken in connection with what are shown by the context to be the dominant or main objects. It will not do under general words to turn a company for manufacturing one thing into a company for importing something else. Taking that as a governing principle, it seems to be plain that the real objects of this company which is called German Date Coffee Co. was to manufacture a substitute for coffee in Germany under a patent. It is what the company was formed for and all the rest is subordinate to that.”

This principle will, however, be of no help where a company is formed for general purposes as opposed to a defined subject-matter. Pointing this out in Kitson & Co. Ltd, Re, 280 the court said: “The impossibility of applying such a construction seems to be manifest when remembers that business is a thing which changes. It grows or it contracts. It changes; it disposes of the whole of its plant; it moves its factory; it entirely changes its range of products, and so forth. It is more like an organic thing. It must be remembered that in these substratum cases there is every difference between a company which on the true construction of its memorandum is formed for the paramount purpose of dealing with some specific subject-matter and a company which is formed with wider and more comprehensive objects.

With regard to a company which is formed to acquire and exploit a mine, when you come to construe its memorandum of association you must construe the language used in reference to the subject-matter, namely, a mine and accordingly, if the mine cannot be acquired or if the mine turns out to be no mine at all, the object of the company is frustrated, because the subject-matter which the company was formed to exploit has ceased to exist. But when you come to the subject-matter of a totally different kind like the carrying on of a type of business, then so long as the company can carry on that type of business, it seems that prima facie at any rate it is impossible to say that its substratum has gone.” The facts of the case were:

A company was incorporated with the object of

(a) Acquiring an existing engineering concern and

280 (1946) 1 All ER 435 Ca
(b) Carrying on the business of general engineering.

Subsequently, the company proposed to sell the original business and to embark upon other general engineering activities. Some of the shareholders petitioned for winding up of the company on the ground that the company’s substratum had disappeared. The court rejected the petition.281

As discussed above in *Cotman V Brougham*282, the main objects rule was excluded by a declaration in the objects clause that “every clause should be construed as a substantive clause and not limited or restricted by reference to any other sub-clause or by the name of the company and none of them should be deemed as merely subsidiary or ancillary.” The House of Lords expressed strong disapproval of the inclusion of such a clause, but their Lordships held that it excluded the “Main objects rule” of construction.

Thus the rule of construction has failed to prevent the evasion of *ultra vires*. And now the decision of the Court of Appeal in *Bell House Ltd. V City Wall Properties Ltd.*283 has stamped its approval upon another technique of evasion. In this case a company’s objects clause authorized it to carry on any other trade or business which in the opinion of the board of directors could be carried on advantageously in connection with the company’s general business. The court held the clause to be valid and an act done in bona-fide exercise of it to be *intra vires*. But a clause of this kind does not state any objects at all. Rather, it leaves the objects to be determined by the director’s bona-fide.284

6. PRELIMINARY CONTRACTS BEFORE INCORPORATION

A. AT COMMON LAW

1. BY PROMOTERS

   a. MEANING OF PROMOTER

   The meaning of the expression ‘Promoter’ exclusively for the purpose of fastening civil liability for misstatements in prospectus, is given in section 62(6) of

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281 Ferrom Electronics (P) Ltd V Vijya Leasing Ltd. (2002) 109 Comp Case 467 Cited from book at Supra Note 279 page 59
282 Supra Note 276 Ibid
283 (1966) 2 WLR 1323
284 Ultra Vires or the Directors Bona-fides, (1967) 30 Mod LR 566 Cited from book at Supra Note 279 page 68
the Indian Companies Act 1956, thus a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company; but otherwise the term is not defined in the Act, nor precisely in any of the decided cases. Rule 405(a) framed by the Security Exchange Commission in USA has it that a ‘Promoter’ is a person who, acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing a business enterprise.

In *Whaley Bridge Calico Printing Co. V Green & Smith*\(^{285}\), Bowen, L.J. stated that the term promoter connotes to sum up “in a single word a number of business operations, familiar to the commercial world, by which a company is generally brought in to existence.”

In *Twycross V Grant*\(^{286}\), Cockburn, C.J. stated that “a promoter is one who undertakes to form a company with reference to a given project and to set it going and……takes the necessary steps to accomplish that purpose.”

**(b). POSITION OF PROMOTERS**

In *Erlanger V New Sombrero Phosphate Co.*\(^{287}\), H. L. Lord Cairns said, the promoters “stand…….Undoubtedly in a fiduciary position. They have in their hands the creation and molding of the company, they have the power of defining how, and when, and in what shape and under what supervision, it shall start into existence and begin to act as a trading corporation……….I do not say that the owner of property may not promote and form a joint-stock company and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction.”

Till the time company has been incorporated it cannot contract or enter into any other act in the law. Nor, once incorporated, can it become liable on or entitled under contracts purporting to be made on its behalf, prior to incorporation,\(^{288}\) for

\(^{285}\) (1880) 5 QBD 109
\(^{286}\) (1877) 2 CPD 469 at 541 (CA)
\(^{287}\) (1878) 3 App. Cases, 1218 at 1236
\(^{288}\) Kelner V Baxter (1866) L.R. 2 C.P. 174
ratification is not possible when the ostensible principle did not exist at the time when the contract was originally entered into. Hence preliminary arrangements will either have to be left to mere “gentlemen’s agreements” or the promoters will have to undertake personal liability. Which of these courses will be adopted depends largely on the demand of other party. If our village grocer is converting his business into a private company of which he is to be managing director and majority shareholder he will obviously not be concerned to have a binding agreement with anyone. In such a case a draft sale agreement will be drawn up and the main object in the company’s memorandum will be to acquire his business as a going concern “and for this purpose to enter into an agreement in the terms of a draft already prepared and for the purpose of identification signed by………”. When the incorporation is complete the seller will ensure that the agreement is executed and completed.289

If, however, promoters are arranging for the company to take over someone else’s business, the seller will certainly, and the promoters will probably, wish to have a binding agreement immediately. In this event the sale agreement will be made between the vendor and the promoters is to cease when the company in process of formation is incorporated and enters into an agreement in similar terms, which once again, will be referred to in the memorandum. Agreements of this nature will be a necessary feature of nearly, every incorporation, and not only must the promoters make full disclosure to the company but, in addition, the company must give particulars of them in any listing particulars or prospectuses. Generally speaking, all material contracts must be disclosed unless entered into more than two years previously and in particular all those relating to property acquired or to be acquired by the company.290

II. BY COMPANIES

What, in practice, is a most frequent source of trouble is that those engaged in the formation of a company cause transactions to be entered into ostensibly by the company, when formed, cannot ratify or adopt the contract, unless it enters into a new contract.

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290 Ibid Page 99
contract. This, of course, does not mean that, in the absence of a new contract, the company or the other part can accept the delivery of the goods or payment without being under any obligation. But prior to the European Communities Act 1972 the legal position of the promoter and the other party seemed to depend on the terminology employed. If the contract was entered into by the promoter and signed by him “for and on behalf of XY Co. Ltd, then, according to the early case of *Kelner V Baxter*\(^{291}\), the promoter would be personally liable. But if, as is much more likely, the promoter signed the proposed name of company, adding his own to authenticate it then, according to *Newborne V Sensolid (Great Britain) Ltd*,\(^{292}\) there was no contract at all.”

However, on the entry of the United Kingdom to the European Community it was necessary to implement Art.7 of the First Company Law Directive. The relevant provision is now section 36C of the Act which reads:

“(1) A contract which purports to be made by or on behalf of a company, at a time when the company has not been formed, has effect, subject to any agreement to the contrary, as one made with the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly”.

The aim of this provision, in the line with that of the first company Law Directive, is to increase security of transactions for the third parties by avoiding the consequences of the contract with the company being a nullity. The protection is provided by giving the third party an enforceable contractual obligation, not against the subsequently formed company, but against the promoter, unless the third party agrees to forego that protection. In its first decision on the new provision the Court of Appeal held that such consent could not be deduced simply from the fact that the promoter signed as the agent of the company; an express agreement, presumably either in the contract itself or subsequently, on the part of the third party that the promoter should not be personally liable was required.\(^{293}\)

However, the presence of the statutory provision has also had an effect on the court’s perception of the common law in this area. In the same case, Oliver L.J. Said

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291 Supra Note 289 ibid
292 (1954) 1 QB, 45 Cited from Supra Note 289 page 99
293 Phonogram Ltd. V Lane (1982)1 Q.B. 938, CA, cited from book at Supra Note 289 Page 100
that the “narrow distinction” drawn in Kelner’s case\textsuperscript{294}, and the Newborne case\textsuperscript{295} did not represent the true common law position, which was simply: “does the contract purport to be one which is directly between the supposed principal and the other party, or does it purport to be one between the agent himself- albeit acting for a supposed principal- and the other party? This question is to be answered by looking at the whole of the contract and not just at the formula used beneath the signature. If after such an examination the latter is found to be the case, the promoter would be personally liable at common law, no matter how he signed the document.

III. BY NOVATION

After incorporation, a company may affect novation, that is, by entering into a new contract with the same party on the same terms afresh in discharge of the promoter’s contract, or this may be inferred from the acts and conduct of the party and such novation is valid. In Howard V Patent Ivory Mfg. Co.\textsuperscript{296}, section 36(4) of the 1985 English Act as replaced by section 36(1) by the 1989 of English Act which is adopted from section 9(2) of the European Community Act 1972 provides that “A contract which purports to be made by or on behalf of a company at a time when the company has not been formed has effect, subject to any agreement to the contrary, as one made with the person purporting to act for a company or as agent for it, and he is personally liable on the contract accordingly.” Novation is covered by the word “subject to any agreement to the contrary” in the section.

IV. ADOPTION OF CONTRACTS IN OBJECTS CLAUSE

For avoiding personal liability of promoters in respect of pre-incorporation contracts, the general practice preferred is to make out the agreement as between the third parties and the company under formation in its name even before incorporation, with a clause about it included in the objects clause of its memorandum, duly signed by third parties in advance on any date, and the party signed agreement left to the custody of an escrow or a bank on condition that it should be released against

\textsuperscript{294} Supra note 289, page 100
\textsuperscript{295} Ibid
\textsuperscript{296} (1888) 38 (Ch. D.) 156 Cited from Supra Note 265 page 226
execution and payment in full or in part by or on behalf of the company after its incorporation. Another safeguard model adopted is to make the pre-incorporation contract straightway between the third parties and the promoters conditional with a clause to the effect that the contract ceases to be binding on the parties in the event of abandonment of the formation of the company short of incorporation, and become binding on its novation by the company after its incorporation pursuant to a clause inserted in the objects clause of the company’s memorandum of association. Alternatively, such contracts are expressed as signed only for purpose of identification as between the third parties and the promoters and reduced in writing for clarity with the recital that it is only a memorandum of understanding or a gentlemen’s agreements.297

B. POSITION IN INDIA

I. RECTIFICATION OF PRE-INCORPORATION CONTRACT

Thus so far as the company is concerned, it is neither bound by, nor can have the benefit of, a pre-incorporation contract. But this is subject to the provisions of the Specific relief Act 1963. Section 15 of the Act provides that where the promoters of a company have made a contract before its incorporation for the purpose of the company, and if the contract is “warranted by the terms of incorporation” means within the scope of the company’s objects as stated in the memorandum. The contract should be for the purpose of the company. A person, who intended to promote a company, acquired a leasehold interest for it. He had it for sometime for a partnership firm, converted the firm into a company which adopted the lease. The lesser was held bound to the company under the lease.298

These preliminary contracts are inevitable and invariable arise with almost every new registration and incorporation of a company, and probable in recognition of this, our legal system is pro-active so far as the procedure is concerned. These preliminary contracts are governed under the provisions of section 15(h) and 19(e) of the Specific Relief Act 1963 and are enforceable by or against the new company,

297 Supra Note 265 Page 226
respectively, subject to the fulfillment of the conditions specified in the said sections. As a general practice, these are novated after the company’s incorporation, often supported by a clause inserted in the objects clause of the company’s memorandum of association as providing the linkage beyond doubt. The other general practices referred to above of reducing the operative terms in writing for clarity without entailing any liability on the promoters, are also in vogue, alternatively 299

According to a decision of the Supreme Court, the company has to accept the transaction but it is not necessary that the transaction should be mentioned in the company’s Articles. The very fact that the company was seeking a declaration of its ownership of the property which the directors had purchased for it before incorporation was sufficient to signify acceptance of the transaction. 300 A contract to allot shares after the company is incorporated is not for the purposes of the company so that the company cannot enforce it against the other party. 301 Section 19 of the Specific Relief Act provides that other can also enforce the contract if the company has adopted it after incorporation and the contract is within the terms of incorporation.

7. EVOLUTION OF CORPORATIONS
A. UNDER ANCIENT ROME

Corporations existed in Ancient Rome and were known as *Gildae* or *Universitatis*; and a large Part of Roman law is concerned with the regulation of trading companies and guilds. By the Roman law a corporation consisted of a number of individuals united by public authority in such a manner that they and their successors constituted as one person in law, with rights and liabilities distinct from those of its individual members. Cities, Colleges, Hospitals, Scientific and Trading Associations, and Societies for other public purposes could be so incorporated. They were generally authorized to make by-laws for the administration of their own affairs, so far as they were not contrary to the law of the land or their own special constitution. 302

299 Supra Note 265, Page 227
300 Jai Narain Parasrampuria V Pushpa Devi Saraf, (2006) 133 Comp Case 794 SC
301 Imperial Tea Mfg. Co. V Munchershaw (1889) 13 Bom 415
B. UNDER COMMON LAW

Corporations were known to the Common Law of England from the very ancient times. The right to create corporations is a part of the Royal prerogative. The King’s consent, either expressly or impliedly, was absolutely necessary to the creation of any corporation. The King’s implied consent was to be found in corporations which existed by force of:-

(1) The Common Law
(2) Prescription
(3) Implication. The methods by which the King’s consent was expressly given were either

(4) By charter or later patent of the Crown passed under the Great Seal or
(5) By Act of Parliament

By Act of Parliament, of which the royal assent was a necessary ingredient, corporation might undoubtedly be created.  

A corporation always risked forfeiture of its Charter for abuse of its franchises. A corporation had 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 recent decisions.  

From corporation to joint-stock companies of the present time was not easy step. The common law only knew of a corporation or a partnership formed for the sake of sharing profits. It did not recognize companies which were neither corporations nor partnerships. The courts treated as illegal any association for profit which attempted to arrogate to itself the privileges of a corporation, joint stock companies differed from corporations inasmuch as they did not obtain the sanction of the sovereign. They were created by the mere act and voluntary association of their members. They differed from partnerships inasmuch as the shares of a member could be transferred without the consent of the other members.  

In between the English Parliament passed Bubble Act 1720, with the intention of prohibiting the formation of fraudulent companies. But contrary to this, this act made the very business of promoting the formation of illegal companies, which

303 10 Rep. 29  
304 Supra Note 302 page 10
proved to be a great set back to the expanding trade and commerce. It was only within the 19th century that joint-stock companies struggled into existence, and after much opposition were recognized and countenanced by the legislature. Every obstacle was placed in their way, and by the Bubble Act, it was attempted to put them down as nuisance. But, notwithstanding this statute, joint stock companies increased both in number and importance. The Bubble Act was repealed in 1825, and by the Act of 1825, the Crown was empowered to grant charters of incorporation, and at the same time to declare that the persons so incorporated should be personally liable for the debts of the body corporate.\textsuperscript{305}

In common law, the Crown, though it had the power to grant charters of incorporations by Letters Patent under the great seal, had no power to declare that the persons incorporated by them shall be personally liable, like the members of partnership. By the Act of 1834, the Crown was empowered to confer on a company, without incorporating it, the privilege of suing and being sued in the name of a public officer. In 1844, a General act was passed enabling all companies (with some exceptions) to obtain from an office in London a certificate of incorporation without applying either for a charter or for an Act of Parliament. But by this act the principle of limited liability in its fullest sense was not recognized. All the members of every one of such companies were liable to the last farthing for its debts. The liability of the members was limited to a certain extent only; i.e. creditors could not proceed against them personally till they had satisfied the courts that the company was not in position to fulfill its obligations.\textsuperscript{306}

It was only in the year 1855, that an Act was passed enabling companies registered under the general Act of 1844 (other than Insurance companies), to obtain a certificate of incorporation. Subsequently in 1856 and 1857, almost all the previous statutes were repealed, and their most valuable provisions were consolidated, and extensive alterations of an entirely new character were introduced. The law was again codified in the year 1862. The doctrine of limited liability of persons associated together for the purpose of gain was for the first time fully recognized by this act.\textsuperscript{307}

\textsuperscript{305} Ibid, Page 11
\textsuperscript{306} Ibid
\textsuperscript{307} Ibid page 12
Corporations in England as described are not novelties. They are institutions of very ancient date. But the large partnership from which the modern business company evolved appeared on the English scene during the commercial revolution. Consequently, to meet the growing commercial needs of the nation, large unincorporated partnership came into existence, trading, however, in corporate form. The membership of each such concern being very large, the management of the business was left to few trustees. This resulted in separation of ownership from management. Trustees had the opportunity of trading with other people’s money. Rules of law applicable to such companies were not yet developed. Consequently, fraudulent promoters had a unique opportunity of exploiting public money. Many spurious companies were created which would appear only to disappear resulting in loss to the investing public. But it was only in 1844 that registration and incorporation of large partnership was made compulsory. The joint Stock companies Act 1844 was the first legislative measure which facilitated registration, although the concerns registered under it were still known as partnership and the principle of unlimited liability was maintained. The right to trade with limited liability was granted in 1855 by the Limited Liability Act of that year and a year later in 1856 the whole law relating to such companies was consolidated. Since then Companies Acts have been considerably amended, enlarged and improved upon until we get to the English Acts of 1948, 1862 and 1985 and of 1989.

C. UNDER INDIAN LAW

The history of the Indian Company Law began with the joint stock companies Act 1850. The Indian Companies Act of 1857 followed the English Acts of 1856 and 1857 in almost every particular. The English act having been repealed by the codifying Act of 1862, the Indian legislature followed suit by passing the Indian Companies act 1866. Between 1862 and 1882, several amending acts were passed by the Imperial legislature; so in 1882, the Act of 1866 was repealed, and an act was passed by the Indian legislature embodying all the changes that had taken place in the

308 MARSHAL L.J. in Bank of US V Dandridge, 12 Wheat (25 US 64,92)
309 Joint Stock Companies Act (7&8 Vict C 110)
310 By The Joint Stock Companies Act 1856, (19&20 Vict C 47)
311 Book at Supra Note 279 page 3
meantime in the English Acts. The Companies (Memorandum of Association) Act was passed in 1895 and this act also resembles the English Act of the same name.\textsuperscript{312}

Since then the cumulative process of amendment and consolidation has brought us to the most comprehensive and complicated piece of legislation, the Companies Act 1956 after repealing the Companies Act of 1913, based on the recommendations of Bhabha Committee. But even so it is not exhaustive of all the modes of incorporating business concerns. Organizations for business or commercial purposes can still be incorporated by special Acts of Parliament. The life Insurance Corporation of India, for example, has been incorporated for business in Life Insurance under the Life Insurance Corporation Act of 1956. Institutions so created are better known as “corporations”. Business firms or other institutions incorporated under the Companies Acts are known as companies. Companies Act is also not exhaustive of the whole of company law. It only amends and consolidates certain portions of company law. Common law has still a lot of role to play in this field. The duties of the corporate director and their social responsibilities, which at present is one of the most developing aspects of company law, are still largely governed by the principles of common law.\textsuperscript{313}

8. DEFINITION OF COMPANY

1. “The word company has no strictly technical or legal meaning”.\textsuperscript{314} In the terms of the companies Act 1956, a company means a company formed and registered under the Act. In common law a company is a legal person or legal entity, separate from, and capable of surviving beyond the lives of its members.\textsuperscript{315} Like any juristic person, a company is legally an entity apart from its members, capable of rights and duties of its own, and endowed with the potential of perpetual succession. But the company is not merely a legal institution. It is rather a legal device for attainment of any social and economic end and to a large extent publicly and socially responsible. It is therefore a combined political, social, economic and legal institution. Thus the term has been variously described, “it is a means of co-operation in the conduct of an enterprise”, a corporate device is one

\begin{footnotes}
\item[312] Supra Note 302 page 12
\item[313] Ibid
\item[314] BUCKLEY J in Stanely, Re (1906) 1 Ch 131, 134
\item[315] Saloman V Saloman & Co. (1895-99) All ER Rep 33 Cited from book at Supra Note 279 Page 1
\end{footnotes}
form of associated enterprise. It is an intricate, centralized, economic administrative structure run by professional managers who hire capital from the investors.\textsuperscript{316}

2. In a practical way, a company means a company of certain persons registered under the companies Act. Two or more persons, who are desirous of carrying on joint business enterprise, have the choice of either forming a company or a Partnership. Partnership is a suitable device for a small scale business which can be financed and managed by a small group of partners who take personal interest and there is a mutual trust and confidence among them. But where the enterprise requires a rather greater mobilization of capital which the resources of a few persons cannot provide, the formation of the company is the only choice. Even for small scale business the choice of a company would be better, as this is the only form of business organization which offers the privilege of limiting personal liability for business debts. Accordingly, the company has become the most dominant form of business organization.\textsuperscript{317}

3. The term “company” implies an association of a number of people for some common object or objects. The purpose for which men and women may wish to associate are multifarious, ranging from those as basic as marriage and mutual protection against the elements to those as sophisticated as the objects of the confederation of British Industry or a political party. However, in common parlance the word “company” is normally reserved for those associated for economic purposes i.e. to carry on business for gain. However, to say that company law is concerned with those associations which people use to carry on business for gain would be wrong- for two reasons.

Firstly- The law provides vehicles in addition to the company in which people can associate for gainful business.

Secondly- Companies incorporated under company’s Act may be used for carrying on not-for-profit businesses or for purposes which can only doubtfully characterized as businesses at all.\textsuperscript{318}

\textsuperscript{316} Livingston’s THE AMERICAN STOCKHOLDER, (1958) 67 Yale LJ, 1476

\textsuperscript{317} Lee Loevinger, THE LAW OF FREE ENTERPRISE, 59 (1949) Cited From book at Supra Note 279 page 1

\textsuperscript{318} Supra Note 289, page 3
9. CONSTITUTION OF COMPANY

The significance of the constitution of company is a remarkable feature of British company law, and the extent to which it leaves regulation of the internal affairs of a company, to the company itself through rules laid down in its constitution and, in particular, in its articles of association. In fact the principle is that the articles may deal with any matter which is not, or to the extent that it is not, regulated through any of the sources mentioned above. This is not stated explicitly in the Act, but is rather an assumption upon which the Act is drafted, too obvious to be worth stating. However, the crucial point is not the formal relationship between the Article and other sources of company law, especially the Act, but extent to which substantive matters, central to the company’s operation, are left to be regulated by the Articles.319

Examples of important matters which are regulated mainly by the articles are the division of powers between the shareholders and the board of directors and the composition, structure and operation of the board of directors. Many company laws regulate these matters through their company’s legislation, rather than company’s constitution, and this is true of system as otherwise different as those of Germany and the states of United States.320

In the American case, however, the legislation often uses default rules, which can be changed by appropriate provisions in the company’s constitution, so that , where this is the case, the shareholders can ultimately adopt the set of rules they want, as is the case in Britain. For example, paragraph 8.01 of the Model Business Act gives a broad management power to the board of a US company, but allows the shareholders, in the constitution or by shareholder agreement, to cut down that provision if they wish and allocate decision to themselves; whereas the directors of a British company have management powers only to the extent that they are given to the board by the articles. The ultimate division of powers between board and shareholders, in similar type of company, may thus be equivalent in the two countries. Nevertheless, since the shareholders control the constitution, the British approach can be said to represent the view that the shareholders constitute the ultimate source of managerial authority within the company and what the directors obtain their powers

319 Supra Note 289, Page 55
320 Ibid
by a process of delegation from the shareholders, albeit a delegation of a formal type which, so long as it lasts, may make the directors the central decision making body on behalf of the company. By contrast, the German and, even the American approach can be said to be based on the principle that the allocation of powers to the organs of the company is the result of a legislative act, even if, within limits, the shareholders may alter the initial legislative allocation. The importance of the articles of association in the British scheme is perhaps reflected in the provision in the Act authorizing the Secretary of State to promulgate “model” articles of association of companies limited by shares and, in particular, in the default status conferred upon the statutory model. Under this power the DTI has issued the famous Table A. The present Table A is that of 1985 replacing a version promulgated in 1948 which itself replaced version contained in earlier Acts.

However when a company limited by shares is formed, it will be treated as having adopted Table A articles, except to the extent that it chooses to have different articles, either in whole or in part. That choice may be expressed by adopting articles which, in one or more respects, are inconsistent with Table A, but Table will apply to govern matters which are not dealt with within the articles specified by the company. Table A perform a gap filling role in such a case, however, if the company wishes to avoid this impact of the Table, it must include in its articles, an article which specifically excludes the whole of Table A. The subsequent promulgation of a revised version of Table A will not affect companies already registered, but only those registered in future. Consequently there are many companies in existence for whom the relevant Table is that of 1948.

The aim of Table might be thought to be to reduce the costs faced by those forming the companies. Under the British structure the company can not work effectively without fairly elaborating articles and Table A which aims to supply that need for those who do not wish, or can not afford, to work out their own internal regulations. However the extent to which Table A achieves this objectives can be doubted, since there has been produced only a single model for all companies limited by shares. Given the range of companies incorporated under the Act, it is difficult to

321 English Companies Act 1948 Sch.- 1
322 Supra Note 289 Page 56
believe that a single model will fit all sizes of company. Many incorporators, no doubt, can afford to take professional advice on the matter. Even so, it might be thought that Table A should be aimed at those in a small way of business who are setting up a company and for whom the savings in transaction costs of ready-made set of articles may be significant. The company Law Review has taken a step in this direction by proposing the generation of a separate set of model article for private companies limited by shares.323

Despite the increasingly common usage of the phrase “THE COMPANY’s CONSTITUTION” it is not a term which is used generally in the Act and so is not defined generally by the Act. What is clear is that the terms of the company’s constitution are to be found at present in more than one document. At the formation stage, the Act concerns itself with two documents, the Memorandum of Association and the Articles of Association. These two documents are normally referred under the heading of “the Company’s Constitution”. They are however very different type of instruments. The memorandum of association must contain a specified minimum content and normally contains little more than the required subject-matter. The content of articles is very much under the control of those who establish the companies (the incorporators) and subsequently of the members of the company. It tends therefore to be quite an elaborate document and the point made in the previous section about the internal affairs of the company being regulated by the company’s constitution, applies especially to the articles of association.324

The “two document constitution” seems to be something the company registered under the Act inherited from statutory and chartered corporations, the memorandum of association corresponding to the statute or charter and the articles of association corresponding to the bye laws which, in practice, the statute or the charter would empower the corporation to make to supplement its provisions. This makes sense if it is desired to ensure that the basic constitution of body corporate shall be inflexible and not alterable without the consent of Parliament or the Crown. In theory that inflexibility applies to registered companies.325

323 Ibid page 56-57
324 Ibid
325 Ibid Page 57
The memorandum of association, laying down the company’s basic constitution, is alterable only to the extent permitted by the companies Act and under the early companies Acts the company itself had virtually no power to effect alterations. But today this principle has been abandoned and in one way or the other, every provision of the memorandum (except that fixing the country in which its registered office is to be situated) can be altered unless the memorandum expressly provides to the contrary. The required minimum contents of the memorandum is; the company’s name, objects, domicile, share capital (if any) and, if such be the case, that the liability of the members is limited and that it is a public company. Everything else is regarded as a matter of administration to be dealt with in the second document, the articles of association, which have always been capable of alteration by the shareholders.\footnote{Ibid page 58}

In the light of the developments, it is not surprising that the company Law Review recommended that the memorandum of association should cease to be part of the apparatus of British Company Law. Further, the term “constitution” should be formally introduced into the language of the Act and should be taken to refer to what we now know as the articles of association. The compulsory contents of the memorandum would still need to be communicated to the registrar of companies, in so far as other reform did not render some of the required items otiose, but that would be done in a simple information statement, along with other information which is required to be communicated to the registrar at the formation stage.\footnote{Ibid}

10. INCORPORATION AND REGISTRATION OF COMPANIES

A. INCORPORATION OF THE COMPANY

Incorporation is conferred on legal personality only for the purpose of the particular objects stated in the objects clause of its memorandum, and transactions, not authorized expressly or by necessary implication must be taken to have forbidden, but this view was not followed during early days and contrary to it, the view that a company has all powers of a natural person, unless it has been taken away expressly or by necessary implication was given a big support. In the year 1855 some important
developments took place, one of them was introduction of the principle of limited liability. After the introduction of this principle, it was possible to make the liability of the members limited. Before this the liability of the members was unlimited and hence the creditors of the company considered them protected, but after the development of the concept of limited liability, they found themselves in a miserable state. This necessitated a device to protect the creditors; this molded the minds of the pioneers towards the doctrine of *ultra vires*. In addition to it, the companies were required to have two important documents, the memorandum and articles.\(^{328}\)

The memorandum was to contain the objects of the company. The alteration of the memorandum was difficult. Thus the importance of the memorandum was realized and the management of the company was desired to observe the objects stated in the memorandum. All these created an atmosphere favorable for the development of doctrine of *ultra vires*. The term *ultra vires* is different from an illegal act or transaction although both are void. An act of the company which is beyond the objects is *ultra vires*, and therefore void even if it is legal, similarly an illegal act will be void even if it falls within the objects clause. Unfortunately the doctrine of *ultra vires* has often been used in connection with illegal and forbidden acts. Hence this kind of use should also be prevented.\(^{329}\)

Incorporation of the companies offers certain advantages to the business community as compared with all other kinds of business organization and following are the advantages of incorporation.

1. Independent corporate existence
2. Limited Liability
3. Perpetual succession
4. Right to own and acquire Property
5. Transferable Shares
6. Capacity to sue and be sued
7. Professional Management
8. Finances\(^{330}\)

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\(^{328}\) www.slideshare.net visited on 3rd Oct. 2011

\(^{329}\) Ibid

\(^{330}\) Supra note 279 page 12
B. FORMATION OF COMPANY

In the formation of the company, one of the important requirements, the promoters of the company has to comply with, is the preparation of the documents called the articles of Association and the Memorandum of Association.

Sec 2(28) defines “Memorandum” which means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act.

Section 13 of the Act states the requirement with respect to memorandum of association.

Section 14 provides that the form of memorandum should be such one of the forms in Table B, C, D and E, in schedule 1 of the companies Act 1956 as may be applicable to the company. However it is to be noted that Indian Companies Act fails to clearly define what is memorandum of association.

Hence, for proper understanding of what amounts to memorandum of association, one has to rely upon the observation made by Palmer, in this regard. Palmer observed that “it is a document of great importance in relation to the proposed company. Its importance lies in the fact that it contains the following fundamental clauses which have often been described as the condition of the company’s incorporation. These clauses are as under.

1. Name Clause.
2. Registered Office Clause
3. Objects Clause
4. Liability Clause and
5. Capital Clause.

Here the author has limited the scope of other factors pertaining to “Doctrine of Ultra Vires” and mainly examine the formalities in connection with the registration procedure.

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332 Of The Companies Act 1956
333 Palmer’s Company Law 20th Ed.1959 page 56
334 Supra note 331, ibid
C. PROCEDURE OF REGISTRATION

To obtain the registration of a company an application has to be filed with the registrar of companies. The application has to be made to the registrar of the state in which the registered office of the company is stated by the memorandum to be situated. The application must be accompanied by the following documents:

1. Memorandum of Association
2. Articles of Association, if necessary
3. The agreement, if any, which the company proposes to enter into with any individual for his appointment as its managing or whole-time director or manager.

The documents for registration must be supported by a declaration stating that all requirements of the act relating to registration have been complied with. The declaration must be signed by an advocate of the Supreme Court or of High Court or an attorney or a pleader entitled to appear before a High Court or a secretary, or a Charted Accountant, in whole-time practice in India who is engaged in the formation of a company or a person named in the articles as a director, manager or secretary of the company.

Section 12 of the companies Act 1956, states the mode of forming an incorporated company, it enables any seven persons (two for private company) to associate for any lawful purpose and to get themselves incorporated into a company with or without limited liability. They can do so by subscribing their names to a memorandum of association and by complying with other requirements.

When the requisite documents are presented for registration, the Registrar has to see whether they answer the requirements of the Act. He may, however, accept the declaration as sufficient evidence of compliance. He then registers the company in the office of the Registrar of the companies. Refusal to register on a ground which is not legitimate can be set right by a court order.

335 Section 33 of the Companies Act 1956
336 Supra Note 279 Page 36
337 Exclusive Board of the Methodist Church V U.O.I., (1985) 57 Comp Case 43 Bom
D. CERTIFICATE OF INCORPORATION

A certificate of incorporation is then issued by the Registrar which certifies “under his hand that the company is incorporated and, in the case of a limited company, that the company is limited. The conversion of an unregistered association into a company was not successful because the articles of the company which was registered did not carry a clause that the members of the association would become members of the company, nor there was any resolution to that effect. The association and the company remained different entities. The certificate of the incorporation brings the company into existence as a legal person. Upon its issue the company is born. For the Act provides that “from the date of incorporation such subscribers of the memorandum and other persons, as may from time to time be the members of the company, shall be a body corporate……..which is capable forthwith of exercising all the function of an incorporated company. The company’s life commences from the date mentioned in the certificate of incorporation and the date appearing on it is conclusive, even if wrong.338

E. CERTIFICATE AS CONCLUSIVE EVIDENCE

Not only does the certificate create the company, it also is “the conclusive evidence that all requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto and that the association is a company authorized to be registered and duly registered under this Act.”339

The memorandum of association of a company was signed by two adult persons and by a guardian of other five members, who were minors at that time, the guardian making a separate signature for each of the minors. The Registrar however registered the company and issued under his hand a certificate of incorporation. The plaintiff contended that this certificate of incorporation should be declared void. This is illustrated by the decision of the Judicial Committee of Privy Council.

Lord Mac Naughten said:-

Their Lordships will assume that the conditions of registration prescribed by the Indian Companies Act were not duly complied with; that there were no seven

338 Link Hire Purchase & Leasing Co. (P) Ltd. V State of Kerala (2001) 103 Comp Case 941
339 Section 35 of the companies Act 1956
subscribers to the memorandum and that the Registrar ought not to have granted the certificate of incorporation. But the certificate is conclusive for all purposes.\(^{340}\)

In England the question whether the registrar’s certificate is conclusive was decided so far back as 1867 by Lord Cairns….. In Peels case\(^{341}\) after signature and before registration a proposed memorandum of association had been altered without the authority of the subscribers so materially that the “alteration entirely neutralized and annihilated the original execution and signature of the document”. The company, however, was registered and the Registrar gave his certificate of incorporation. It was objected that the memorandum of association had not been signed by seven or indeed by any subscribers and that the provision of the Act had not been complied with. To that position Lord Cairns assented. But the certificate of incorporation, he said is not merely a \textit{prima facie} answer, but a conclusive answer to such objection. When once the certificate of incorporation is given nothing is to be inquired into as to the regularity of the prior proceedings. The Observations of Lord Chelmsford in Oakes V Turquand\(^{342}\) are to be of same effect. “I think”, said his Lordship, “the certificate prevents all recurrence to prior matters essential to the registration….. That it is conclusive……. That all previous requisites have been complied with

“Thus the position is firmly established that if a company is born, the only method to get it extinguished is not by assailing its incorporation, but by resorting to the provisions of enactments, which provide for the winding up of the companies”. This summary view of the position is to be found in the Judgment of CHANDRA REDDY C.J. in \textit{T.V. Krishna V Andhra Prabha (P) Ltd.}\(^{343}\).

In this case the Express Newspapers (P) Ltd was the leading publishers of the newspapers and weeklies. The government adopted certain recommendations of the wage board for improvement in the terms of service and salaries of the working journalists. Thereupon the Express Newspapers sold its undertaking to a new company known as Andhra Parbha Private Ltd. It was alleged that the new company was formed for illegal purpose of evading the new responsibilities imposed by the wage board and, therefore, the registration of the company should be declared void.

\(^{340}\) Supra Note 279, page 37-38
\(^{341}\) (1867) 2 Ch App 674
\(^{342}\) (1867) LR 2 HL 325
\(^{343}\) AIR 1960 AP 123
The court, however, did not assent to the proposition that the purpose for which the company was formed was in any way unlawful or opposed to the public policy and, therefore, held that company was validly incorporated. But even if some of the objects were illegal, the legal persona of the company could not have been extinguished by cancelling the certificate. Even in such a case the certificate is conclusive and the remedy would be to wind up the company. The illegal objects, however, do not become legal by the issue of the certificate, since section 12 of the Act clearly mention

That “persons associated for any lawful purpose may form an incorporated company.”

F. JUDICIAL REVIEW AGAINST REGISTRATION

In some English cases the courts have explored the possibility of reviewing the Registrar certificates and have come to conclusion that they should be open to Judicial Review. Accordingly, a company which happened to be registered for an unlawful object was ordered to be struck off.

The Kerala High Court has held that a writ cannot be issued to cancel the registration of a company under the companies Act.

11. MANAGEMENT OF CORPORATION

The next question that arises in connection with the corporate act and transaction, as to how does the corporation act or transact its business? Obviously it cannot act by itself; it can act through and by means of certain real persons duly authorized to act on its behalf. The officials of a corporation are generally described as its agents, but they are not agents in the same sense as the members of a partnership concern are agents of each other. In the latter, a partner has a general authority to bind his co-partners in respect of all acts and transactions coming within the scope of partnership business. The official of the corporation, on the other hand, have their

344 Universal Mutual Aid & Poor Houses Assn. V A.D. Thappa Naidu AIR 1933 Mad 16 cited from Supra Note 279, Page 38-39
345 R V ROC, (unreported) QBD, Dec 17 1980
346 Maluk Mohamed V Capital Stock Exchange Kerala Ltd. (1991) 72 Comp Case 333 Ker Cited from Supra Note 279, Page 39
authority limited by the instruments which authorize them to act on behalf of the corporation. Hence it follows that they cannot bind the company in respects of acts and transaction which go beyond their powers or which are not incidental to the legitimate exercise of the same. They may make themselves liable, but not the corporation; and those who deal with them should look to them, but not to the corporation. The latter are bound to consult the instruments which authorize the officials. If they do not, it is their own fault.\(^{347}\)

12. ARTICLE AND MEMORANDUM OF ASSOCIATIONS

A. ARTICLES OF ASSOCIATION

These are rules for the internal working of the company. Like the Memorandum, articles also constitute public notice, as a document subordinate to the memorandum. If the memorandum of association as a document is the grid determinant of the nature and character of a company, its articles of association is the document that lays down the rules of its working, essentially internal, with an out-door reach as notice to the new and prospective participants as members or creditors or others who intend to deal with the company, in respect of its capital raising and maintenance as well as recoveries and the modes of rewards of their returns on investment, though not the quantum, with or without adequate checks and balances they may be looking for as being ingrained into the web of company’s management.\(^{348}\)

Like the memorandum, the articles too, when registered, shall bind the company and its members, but not the outsiders, to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions contained in them, subject to the provisions of the Act, by a legal fiction contained in section 36 of the Indian Companies Act 1956. The articles (a subordinate document to the memorandum), and if there is a conflict between the two, it is the memorandum that prevails.\(^{349}\)

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347 Supra Note 302, Chapter 2 page 25
348 Krishnamurti DSR, Company Law (TAXMAN’S), 2006 Ed. Chapter 12, Page 333
349 Re Duncan Gilmour & Co. Ltd. (1952) 2 All ER 871, from Supra Note 348 page 333
B. LEGAL STATUS OF ARTICLES OF ASSOCIATION

The common law tends to classify the rule-book of all kinds of associations, whether they are clubs, trade union, friendly societies or other, as contractual in nature. The articles of association are no exception to this principle, though in this case the classification is done by the Act. Section 14 of the English Companies Act 1985 provides that the memorandum and the articles shall, when registered, bind the company, its members to the same extent as if they respectively had been signed and scaled by each member, and contained covenants on the part of each member to observe all their provisions and that money payable by a member to the company under the memorandum and articles shall be in the nature of a specialty debt (to which a longer limitation period applies than to simple debts).

The wording of this section can be traced back with variations to the original Act of 1844 which adopted the existing method of forming an unincorporated joint stock company by deed of settlement (which did, of course, constitute a contract between the members who sealed it) and merely superimposed incorporation on registration. The 1856 Act substituted the memorandum and articles for the deed of settlement and introduced a provision on the lines of the present section. Unhappily, full account was not taken of the vital new factor (namely that the incorporated company was a separate legal entity) and the words “as if….signed and sealed by each member” did not have added to them “and by the company”. This oddity has survived into the modern Acts (with the result that debt due from the company to a member under the contract, are not specialty debts). The Company Law Review wondered whether it was any longer appropriate to regard the articles of association as a contract, but in the end decided that the issue did not call for immediate resolution. What is clear, however, is that the articles constitute a rather particular form of contract, and the peculiarities of that contract need to be noted. 350

350 Supra note 289 page 58-59
C. ARTICLES WHEN COMPULSORY

Articles of association are the second document which has, in the case of some companies, to be registered along with the memorandum. The companies which must have articles of association are: 351

1. Unlimited companies
2. Companies limited by guarantee and
3. Companies limited by shares

This document contains rules, regulations and bye-laws for the general administration of the company. Schedule 1 of the Companies Act 1956 contains various model forms of memoranda and articles. The schedule is divided into several Tables. Each Table serves as a model for one kind of company. A company limited by shares may either frame its own set of articles or may adopt all or any of the regulations contained in Table A. 352

If the company does not register any articles, then Table A applies; if it does have some regulations, for the rest, as far as applicable, Table A applies, in so far as its regulations are not excluded. Other companies may adopt Table C, D or E. The chief advantage of adopting the appropriate Table is that its provisions are legal beyond all doubts. 353

Public companies are free to have or not to have articles. But they can not survive without articles of association because without any rules or regulations, they may not be able to hold in harmony the diversity of relations under which they have to function.

D. CONTENTS OF THE ARTICLES

Articles of association may prescribe such regulations for the company as the subscribers to the memorandum deem expedient. The Act gives the subscribers a free hand. Any stipulation as to the relation between the company and its members, and between members *inter-se* may be inserted in the articles. But everything stated

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351 Section 26 of the Indian Companies Act 1956
352 Section 28(1) of Companies Act 1956
353 As explained in Lock v Queensland Investment and Land Mortgage Co. (1986) 1 Ch 397
therein is subject to the companies Act. The document must not conflict with the provisions of the act. Any clause which is contrary to the provisions of the act or of any other law for the time being in force is simply imperative and void. Section 439 of the companies Act, for example confers the right on a shareholder to petition the winding up of the company in certain circumstances. This right cannot be excluded or limited by the articles. Similarly the articles cannot sanction something which is forbidden by the Act. Section 205, for example, declares that no dividend shall be paid by a company except out of profits of the company. The force of this section cannot be undone by any provision in the articles of association.\textsuperscript{354}

**E. ARTICLES IN RELATION TO MEMORANDUM**

Articles of association have always been held to be subordinate to the memorandum. If therefore, the memorandum and articles are inconsistent, the articles must give way. In other words, articles must not contain anything, the effect of which is to alter a condition contained in the memorandum or which is contrary to its provisions.\textsuperscript{355}

This is so because the object of the memorandum is to state the purpose for which the company has been established, while the articles provide the manner in which the company is to be carried on and its proceedings disposed off. This constitutes the principal difference between the two documents. In the words of Lord CAIRNS, the difference is this:

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.\textsuperscript{356}

In the words of BOWEN, L.J.\textsuperscript{357}:

There is essential difference between memorandum and the articles. The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. Those are the conditions introduced for the benefit of the

\textsuperscript{354} Noble V Laygate Investment Ltd. (1978) 2 All ER 1067
\textsuperscript{355} Baglan Hall Colliery Co. Re,(1870) 5 Ch App 346
\textsuperscript{356} Ashbury Railway Carriage Co. V Riche (1875) LR 7 HL 653
\textsuperscript{357} Guinness V Land Corporation of Ireland (1882) 22 Ch D 349, 381
creditors, and the outside public, as well as of shareholders. The articles of association are the internal regulations of the company.

Some of the conditions of incorporation contained in the memorandum cannot be altered except with the sanction of CLB. Articles of association on the other hand can be altered by a special resolution.\textsuperscript{358} If the memorandum ever comes to be, the difference between these two documents will disappear.

However under the English Companies Act 1948, the memorandum is alterable by a special resolution, sanction of the court being not ordinarily necessary, unless the alteration was challenged within 21 days by a qualified minority of shareholders or creditors.

But unless the \textit{ultra vires} rule is abolished, the memorandum will always differ from articles in principal respect. If a company does something beyond the scope of its objects stated in the memorandum, it is absolutely void and altogether incapable of ratification. Whereas anything done by the company in contravention of the provisions of its articles is only irregular and can always be confirmed by the shareholders. Now that the objects clause of the memorandum has become alterable by a special resolution only, a company should be in position to ratify or adopt a transaction, by introducing by means of special resolution suitable or requisite changes in the objects clause. Some of the clauses of the memorandum can be altered only with the sanction of the CLB.\textsuperscript{359}

Lastly it is suggested in Palmer’s Company Law\textsuperscript{360} with the authority of a passage in the Judgment of JESSEL MR in \textit{Anderson case}\textsuperscript{361}, that “though the articles cannot alter or control the memorandum, yet, if there is any ambiguity in the memorandum, the articles registered at the same time may be used to explain it, but not so as to extend the objects”. But this rule, as is shown in the above work itself, will not apply to the interpretation “of those portions of the memorandum of association which the Acts of the Parliament requires to be stated in the memorandum”. In any case to quote BOWEN L.J. again “it is certain that for anything which the Act of parliament says shall be in the memorandum, you must

\begin{footnotes}
358 Section 31 of the Companies Act 1956
359 Supra Note 336, Page 84
360 By Schmitthoff and Curry (1959) 20\textsuperscript{th} Ed. Page 58
361 (1876-77) 7 Ch D 75
\end{footnotes}
look to the memorandum alone. If the legislature has said one instrument is to be dominant, you can not turn to another instrument and read it in order to modify the provisions of the dominant instrument.\textsuperscript{362}

**F. LEGAL STATUS OF MEMORANDUM OF ASSOCIATION**

Much has been said about articles of association, which in principle applies to the memorandum of association as well. The memorandum is given contractual status by section 14 of English Companies Act 1985, whilst section 3 requires the memorandum to be as near as possible in the form specified by secretary of state in regulations. However the specified forms do not have the default status of Table A and, as such, are like the prescribed forms of articles for companies other than those limited by shares. Moreover, the memorandum does differ from the articles in having a mandatory minimum content. There is no general provision for the alteration of required statements, though today, all of them, except the registered office clause, are alterable by going through the relevant procedure laid down for the provision in question. Finally, in the standard case it is unusual for the memorandum of a particular company to stray very far beyond the statutory model. The creativity of the drafter of the company’s constitution displays itself normally in relation to the articles, rather than the memorandum, perhaps because the articles are, even today, more easily alterable than the memorandum and perhaps because the statutory models and, indeed, the history lying behind the division between the memorandum and articles encourage provisions relating to internal administration to be included in the articles rather than the memorandum. Consequently, we shall not consider the details of the memorandum any further here, but leave that task to those points later in this work, where we shall need to examine the mandatory provisions of the memorandum of association.\textsuperscript{363}

**13. RELATIONSHIP BETWEEN MEMORANDUM AND ARTICLES**

Memorandum is the charter of the company. It describes the constitution of the company and defines the scope of its activities and powers. Articles lay down the rules and regulations framed to manage its affairs. Articles are subordinate to the

\textsuperscript{362} Supra Note 279, Page 85
\textsuperscript{363} Supra Note 289, Page 65-66
provisions of the memorandum. They can be used to explain the objects laid down by the memorandum, but never to extend them. They cannot be used to modify the provisions of the Memorandum as the Memorandum is a contract between company and outsiders. Articles are a contract between the company and its members in the capacity of members. It is difficult to alter the clause of memorandum. But the articles can easily be altered by passing a special resolution and may even be altered retrospectively, Un-like the memorandum, articles need not be construed too meticulously.\(^{364}\)

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 governance as they think fit.\(^{365}\)

14. BINDING FORCE OF MEMORANDUM AND ARTICLES

Section 36\(^{366}\) declares:

Subject to the provisions of this Act, the memorandum and articles shall, when registered, bind the company and members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the memorandum and of the articles. In reference to the corresponding provisions in the English Act, Gower observes: “The exact effect of what is known section 20(1) of the Companies Act has long been one of the most baffling questions in company law.\(^{367}\)

This section aims to impart contractual force to the memorandum and articles. It is only the exact limits of that effect and the persons it is intended to cover that are somewhat uncertain.

The law may be stated in terms of the following propositions

1. Binding on members in their relation to the company
2. Binding on company in its relation to members
3. Not binding in relation to outsiders

\(^{364}\) Maheshwari R.P. and Maheshwari S.N. on Company law 7th Ed. 1987 Page 98
\(^{365}\) Ashbury Railway Carriage & Iron Co. V Riche (1875) LR 7 HL 653 At Page 670
\(^{366}\) Of Companies Act 1956
\(^{367}\) (1957) Camb L.J. 194
4. Binding between members

A. BINDING ON MEMBERS IN THEIR RELATION TO COMPANY

In the first place, the members are bound to the company by the provisions of the articles “just as much as if they had all put their seals to them, and had thus contracted to confirm to them. In the words of Lord Herschell: “It is quite true that the articles constitute a contract between each member and the company.”

In *Borland’s Trustee V Steel Bros & Co. Ltd.*:

The articles of association of the defendant company contained clauses to the effect that on the bankruptcy of a member his shares would be sold to a person and at a price fixed by the directors. B, a shareholder, was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at their true value. But it was held that “contracts contained in the articles of association” is one of the original incidents of the shares. Shares having been purchased on those terms and conditions, it is impossible to say that those terms and conditions are not to be observed.

B. BINDING ON COMPANY IN ITS RELATION TO MEMBERS

Just as members are bound to the company, the company is bound to the members to observe and follow the articles. Each member is entitled to say that there shall be no breach of the articles and he is entitled to an injunction to prevent the breach. This is clear from the section itself which says that “memorandum and articles shall bind the company”.

In *Wood V Odessa Waterworks Co.*:

the articles of the waterworks Company provided that the directors may, with the sanction of the company at general meeting, declare a dividend to be paid to the members. Instead of paying the dividend in cash to the shareholders a resolution was passed to give them debenture bonds. In an action by a member to restrain the directors from acting on the resolution, STIRLING J. held: “The question is whether that which is proposed to be done in

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368 Welton V Saffery, 1897 AC 299 Cited From Supra Note 279 Pages 85-88
369 (1901) 1 Ch. 279
370 (1889) 42 Ch D 636
the present case is in accordance with the articles of association of the company. Those articles provide that the directors may, with the sanction of a general meeting, declare a dividend to be paid to shareholders. *Prima facie* that means to be paid in cash. The debenture bonds proposed to be issued are not a payment in cash.” Accordingly the directors were restrained from acting on the resolution.

C. BUT NOT BINDING IN RELATION TO OUTSIDERS

Thus the articles bind the members to the company and the company to the members. But neither of them is bound to an outsider to give effect to the articles. “No article can constitute a contract between the company and a third person.” For example, in *Browne V La Trinidad*\(^{371}\), the articles of association of a company contained a clause to the effect that B should be a director and should not be removable till after 1888. He was, however, removed earlier and had brought an action to restrain the company from excluding him. It was held that there was no contract between B and the company. No outsider can enforce articles against the company even if they purport to give him certain rights.

I. WHO IS AN OUTSIDER?

The expression naturally means a person who is not a member. But even a member may be outsider. Section 36 creates an obligation binding on the company in its dealings with the ‘members’, but the word members in this section means members in the capacity as members, that is, excluding any relationship which does not flow from the membership itself. *Eley V positive Government Security Life Assurance Co.*\(^{372}\) is a leading authority:

The articles of a company contained a clause that the plaintiff (Eley) should be the solicitor to the company and should not be removed from his office unless there was misconduct. He was a member also. He acted as a solicitor to the company for some time, but ultimately the company substituted other solicitors for him. He brought an action against the company for breach of the contract in not employing him as a solicitor on the terms of the articles. His action was dismissed. Even a

\(^{371}\) (1887) 37 Ch D 1
\(^{372}\) (1876) Ex D 881
member cannot enforce the provisions of articles for his benefit in some other capacity than that of member.

The purpose of the memorandum and articles is to define the position of the shareholder as shareholder, not to bind him in his capacity as an individual. Thus “a third person who purports to have rights against the company would be precluded from relying on the articles as a basis of his claim and must prove a special contract outside the articles.” But sometimes the articles may create an implied contract between the company and third person. Where for example, on the footing of a clause in the articles a person is employed to serve the company in some capacity, such as a director, and he accepts the office, the terms of the articles are embodied in and form part of contract between the company and a director. Articles do not themselves form a contract, but from them you get the terms upon which the director is serving.

Following these principles the Lahore High Court held in a case before it that-

Where in pursuance of certain articles acted upon by the company, a member was appointed managing director and acted for eleven years in that capacity, the articles constitute an implied contract between the members and the company. If the company removes him from office, he would be entitled to damages for the breach.

D. HOW FAR BINDING BETWEEN MEMBERS

Lastly, how far do the articles bind one member to another? Unfortunately, on this point the law has yet to take a final shape. The companies Act does not purport to settle the rights of members inter se. It leaves these to be determined by the articles. Hence articles define the rights and liabilities of members. But whether those rights and liabilities can be enforced by one member against another is the moot point.

Lord Herschell said in Welton V saffery “It is quite true that articles constitute a contract between each member and the company, and that there is no contract in terms between individual members of the company; but the articles do not regulate their rights inter se. Such rights can only be enforced by or against a member through the company.” Memorandum and articles

373 Duraiswami V UIL Assurance Co. AIR 1956 Mad 316
374 Swabey V Port Darwin Gold Mining Co. (1889) 1 Meg 385 CA
375 Sardar Gulab Singh V Punjab Zamindara Bank Ltd. AIR 1942 Lah 47
376 (1897) AC 299
did not constitute a contract between members *inter se* although they regulated their rights which could be enforced through the company and that they only regulated the rights of the members *qua* members for the purpose of the company law.”

Thus in a case before the Calcutta High Court, a member of a company who had a commercial dispute of private nature with another member could not be compelled to refer the dispute to arbitration in terms of the company’s articles. The court said: “Articles do not affect or regulate the rights arising out of a commercial contract with which the members have no concern, rights completely outside the company relationship.”

It follows that the extent to which the articles seek to regulate the rights of shareholders as shareholders they can be directly enforced by one member against another member without joining the company as a party. The case of *Rayfields V Hands* lends support to this conclusion:

The plaintiff was a shareholder in a company. Clause 11 of the company’s articles required him to inform the directors of his intention to transfer his shares in the company and which provided that the directors will take the said shares equally between them at a fair value. In accordance with this provision the plaintiff so notified the directors, who contended that they were not bound to take and pay for the plaintiff shares. The articles, they said, could impose no such obligation upon them in their capacity as directors. This argument was brushed aside by the court by treating the directors as members. Accordingly the directors were compelled to take the plaintiff shares at a fair value and it was not considered necessary for the plaintiff to succeed in his action, that he should join the company as a party.

However, the Bombay High Court expressed different view in *Kanmaheswari V Bansidhar Jaganath*, in this case Gajendragadkar, J. (as he then was later on Chief Justice of Supreme Court of India) did not agree with the view expressed by Lord Herschell in *Welton’s case*.

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377 Khusiram V Hanutmal, (1948) 53 CWN 505, 520
378 Ibid
379 (1958) 2 WLR 851
380 Gower L.C.B. Welcomes the Decision in 21 MLR 101
381 AIR 1965 Bom. 459
382 (1897) Ac 299
“The articles of association do constitute a contract, not only between the company and its members, but even between members, *inter se*, though difficulties arise in determining the scope, nature and extent of the rights and obligations flowing from such articles of association in respect of the private transactions of members of association.”

“The articles of associations (may be compared) with that of an agreement signed by several executors containing the term that each will carry out and observe the stipulations in the agreement, and he has added that, “where there are mutual promises between parties to an agreement which amount to consideration moving from each to others, the terms in the document can be enforced by and against each party.”

It is noteworthy that Mr. Justice Gajendragadkar’s view finds favor later on in English case, *Layfield V Hands*. In this case the chancery’s court held that the members may compel enforcement of the provisions of the articles of association against another member without enjoining the company as a party.

15. OBJECTS CLAUSE IN THE MEMORANDUM OF ASSOCIATION

It is required under the law that the memorandum of association must state the objects for which the proposed company is established. Hence it is to be noted that the choice of the objects lies with the subscribers to the memorandum and their freedom in this respect is almost unrestricted. The only obvious restrictions are that the objects should not go against the law of the land and the provisions of the companies Act. For instance, law prohibits gambling, and no company can be incorporated for that purpose.

The companies (Amendment) Act 1965, requires that in the case of companies in existence, before this amendment, the object clause has to simply state the Objects of the company. But in the case of a company to be registered after the amendments act of 1965, the objects clause must be divided in to three sub-clauses, namely

1. Main Objects- this clause has to state the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.
2. Other Objects - this clause must state other objects which are not included in the above clause

3. State to which objects extend - in the case of non-trading companies, whose objects are not confined to one state, this clause has to mention the states to whose territories the objects extend.

The question arises here is as to why the objects clause is such a mandatory requirement. Therefore the court while considering this question in Wamanlal v Scindia Steam Navigation Co.\(^{384}\) rightly observed that the ownership of the corporate capital is vested in the capital itself. But in fact that capital has been contributed by the shareholders of the company and is held by the company as though in trust for them. Such a fund must obviously be dedicated to some defined objects so that the contributors may know the purpose for which it can be lawfully applied. The statements of objects, therefore, gives a very important protection to the shareholders ensuring that the funds raised for one undertaking are not going to be risked in another.

Secondly, such objects clause provides a certain degree of protection to the creditors. In reality, theme of the company’s objects gives the creditors a feeling of security.

Thirdly, as observed rightly by D.L. Majumdar\(^{385}\), that by confining the corporate activities within a defined field, the statement of objects serves a public interest also. It prevents concentration of economic power. Moreover as rightly observed by Avtar Singh, “any change of objects would require the approval of the Company Law Board thus giving the Company Law Board an opportunity to examine whether the proposed plan of diversification would not be against public interest”. But this requirement of seeking confirmation by CLB has been dispensed with and alteration of objects has become an internal matter.

Hence the aforesaid reason best explain the reason as to the mandatory requirement of the objects clause. The same reason requires that the company should devote itself only to the objects set out in the memorandum of association and to no others. In other words if the function of the memorandum “to delimit and identify the

\(^{384}\) AIR 1944 Bom. 131,135

\(^{385}\) Towards Philosophy Of the Modern Corporation By Majumdar D.L. 119 (1967)
field of industry within which the corporate activities are to be confined, as observed in *Port Canning & Land Investment Co.*\(^\text{386}\) “it is the function of the Court to see that the company does not move in a direction away from that field. In this background the doctrine of *ultra vires* comes to play in relation to company. The word *ultra vires* ordinarily means “beyond power” and in the present context can be said to mean that an action outside the objects clause of memorandum of association is *ultra vires* the company.\(^\text{387}\)

The subscribers to the memorandum of association give to the company any power they please, subject to the provisions of the general law and the companies Act. The main objects of the company will be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of main objects. But if a company wants to start a business included in “other objects” it shall have to either pass a special resolution to that effect or pass an ordinary resolution and obtain consent of central government. Similarly if a company existing before the commencement of the companies amendment Act 1965, wants to start any new business, which though included in its objects, is not closely related to the business which it has been carrying on at the commencement of the amendment act, it shall have to pass either a special resolution or pass an ordinary resolution and obtain the permission of the central government.\(^\text{388}\)

The purpose of the object clause in the memorandum of association is of four types.

1. It protects the investors in the company so that who are supposed to know the objects of the company for which their amount is going to be invested. Further an assurance is made to the investors that their amount of money invested here is not going in risky affairs.

2. This clause further protects the creditors of the company by giving them assurance that their due payments, not being diverted in any other kind of objects which are not authorized

\(^{386}\text{(1871) 7 Beng LR 583}\)

\(^{387}\text{Supra note 331, page 10}\)

\(^{388}\text{Ibid}\)
3. Collectively it serves public interest of shareholders, by ensuring that their hardened earned money is not being misused in unauthorized activities.

4. Lastly while concluding it can be assured that economic power of a particular corporation is not concentrated in the hands of few persons, which is also provided in our constitution.

A. THE OMNIBUS AND OTHER ALTERNATIVES

In the absence of an omnibus objects clause, the mere wide formulation of an isolated clause in the memorandum would not yield a satisfactory solution. This is because, the courts, by judicial construction, have made a distinction between object and power. If the court holds that a so-called object enumerated in the memorandum, is logically a mere power, then the clause would be construed as merely incidental or substantive objects of the company. In the matter of *Re Introductions Ltd*\(^{389}\) a situation was involved in which

(i) The company’s memorandum of association conferred on the company, an express power to borrow but,

(ii) The company borrowed money for a purpose that turned out to be a business not specifically mentioned in the object clause.

Hence the loan was held to be *ultra vires*, since the business for which it had been taken was *ultra vires*. The clause relating to borrowing merely conferred a power, and did not expand the width of the objects of the company. That was rationale of this judicial ruling.\(^{390}\)

In contrast, the doing of an act which is expressed to be, and is capable of being as an independent object of the company can not be *ultra vires*, for it is by definition, something which the company is formed to do, and so must be *intra vires*. Such an object has been defined as “substantive object”.

*In Re Horsley & Weight Ltd*\(^{391}\), a company had granted an annual retirement pension to a long term valued employee of the company, in recognition of his services to the company. This was affected by the company taking out a pension policy with

\(^{389}\) (1970) Ch 199, 209 (CA)
\(^{390}\) Bakshi P.M. on Corporations and ultra Vires Objects; Need for Reform in Company Law Journal Vol. 3 1985 page 127
\(^{391}\) (1982) Ch 442, 449(CA) Cited from Supra Note 390 Page 127
an insurance company for a premium of 10,000 pounds. The company was carrying
on several businesses, but one of its objects, as stated in memorandum of objects was
to “grant pension to employees and ex-employees”. One year after the employee’s
retirement the company was compulsorily wound up, owing large sum to creditors.
The liquidator of the company applied to the court for a declaration that the pension
policy was the property of the company, and that the procurement of the policy was
ultra vires the company. The trial judge and the court of appeal negated this objection.
The liquidator had argued that the provision of the pension was purely gratuitous and
had no practical advantage for the company. Further the authority to grant a pension
had to be read as conferring merely an ancillary “Power”. But the court held that the
authority of the company to grant pension to be a substantive object. According to the
court of appeal- “the objects of the company do not need to be commercial; they can
be charitable or philanthropic; indeed they can be whatever the original incorporators
wish, provided that they are legal. Nor is there any reason why a company should not
part with its funds gratuitously or for non commercial reasons, if to do so is within its
declared objects”.392

B. ALTERATION OF OBJECTS CLAUSE

Section 17(1) of the companies act 1956 provides that a company may by
special resolution, change the place of its registered office from one state to another
state or the company may change its objects so far as may be required to enable it

a. To carry on its business more economically and more efficiently or
b. To attain its main purpose by new or improved means; or

c. To enlarge or change the local area of its operation; or


d. To carry on some business which under existing circumstances may
   conveniently or advantageously be combined with the business of the
   company; or


e. To restrict and abandon any of the objects specified in the memorandum; or

f. To sell or dispose off the whole or any part of the undertaking or of any of the
   undertakings, of the company; or


g. To amalgamate with any other company or body of persons;

392 Supra note 390, ibid Page 127
Here we are only concerned with section 17(1) (d), which speaks about carrying on some business which under the existing circumstances may conveniently or advantageously be combined with the business of the company. Most of the alterations made in the objects clause fall with in the purview of this clause as this clause enables any company to diversify. This clause further allows a company to initiate new kind of business which has no relation to the existing business of the company only with the exception that the new business can be conveniently and advantageously be carried on with the existing business.

C. FEW CASE LAWS IN RELATION TO ALTERATION OF OBJECT CLAUSE

1. In Industrial Cables (India) Ltd. V Registrar of companies\textsuperscript{393} it was held that it was not necessary that the proposed new business must be ancillary to the existing business or businesses of the companies. The expression some business in section 17(1) (d) means and implies some new business not already provided for in the objects clause and not necessarily ancillary to the existing businesses. The proposed new business may even be entirely new and may amount to a departure from the old business.

2. In Straw Products Ltd. V Registrar of companies\textsuperscript{394}, the Orissa High Court, on examination of section 17(1) (d) and the law bearing on the subject, laid down the following principles:

The language of section 17(1) (d) permits the alterations in the memorandum of association of the company to enable it to carry on a business which is entirely a new business and departure from the business already carried on provided:-

(a) That such a business is one which can conveniently and advantageously be combined with the existing business of the company and

(b) That this must be so under the existing circumstances and not under hypothetical circumstances. The additional business need not be even akin to the existing business but it must not be destructive of or inconsistent with or detrimental

\textsuperscript{393} (1973) 43 comp cases 353 (P&H)
\textsuperscript{394} (1969) 39 comp. cases 974
to the existing business. It must leave the existing business substantially what it was before.

(ii) The question whether any additional business is one which may be conveniently or advantageously combined with the business of the company carried on at the time when the special resolution is passed, is essentially a business proposition and must be determined by the persons engaged in the business of the company.

(iii) The court/CLB (now the Central Government) can confirm the alteration either wholly or in part subject to such terms and conditions as it may deem fit on being satisfied that the alterations sought to be confirmed are not beyond the scope of section 17(1) and do not adversely affect the rights and interests of the members of the company and/or of its creditors. No hard and fast rule can be laid down as to the quantum of evidence necessary for the satisfaction of the Court/CLB (now the Central Government). The fact that the company is in a sound financial position and that the shareholders unanimously or by majority decision seek alterations of the memorandum of association is a factum in favor of confinement thereof.

3. In Patent Tyre Co. Re\textsuperscript{395}, it was held that the new business may be quite a different business if it can be conveniently and advantageously combined with the existing business of the company.

Lawrence J. stated: “It is essentially a business proposition whether an additional business can or cannot be conveniently carried on under existing circumstances with the business of the company. The additional business of course, must not be destructive of or inconsistent with the existing business, it must leave the existing business substantially what it was before; but the additional business may be one which is different from the original business and yet may well be conveniently carried on”.

4. In Cyclists Touring Club, Re\textsuperscript{396}, a club was formed for protecting cyclists on public roads. The club was not allowed to alter the objects so as to include the protection of the motorists, as cyclists had to be protected against motorists.

\textsuperscript{395} (1923) 2 Ch. 222
\textsuperscript{396} (1907) 1 Ch. 269
5. In New Asarwa Manufacturing Co. Ltd., Re, it was held that confirmation of alteration of object clause is not to be refused only because new business is wholly different from existing business.

FACTS- The petitioner company, New Asarwa Manufacturing Company was a registered company. The company was more or less a one-object company and its object clause provided the objects of the company as “To purchase the factory known as… and to expand the business of weaving cloth etc”, and activities of allied nature. The company at its extraordinary general meeting passed a special resolution for alteration of its objects. The main object of the future business of the company was intended as “To acquire and take over from Echem Investment Private Limited as a going concern the business of cinema exhibition carried on by the said Echem Investment Pvt. Ltd in the name and style of Shital Theatres at Gomtipur road, Ahemdabad”. The company also intended to carry on incidentally the business of spinning and weaving and all other incidental activities in relation thereto, and it has been mentioned under the heading “other objects” of the company. The company therefore approached the court for sanction to the alteration under section 17 of the companies Act 1956.

ISSUE INVOLVED
Whether such alteration of the object can be confirmed by the Court?

DECISION
The court rejected the objection raised by the registrar of companies, that the business which the company was intending to carry on was entirely a new business, which could not be incidental or ancillary or even akin or alike to the then existing business of the company. The court held that “it is an established legal position that in deciding as to whether sanction to the alteration of a memorandum should be granted or not, the court should not reject an application ex-facie merely because the new business is wholly different from or bears no relation to the existing business of the company. All that should be essential and borne in mind is that it should be capable of being conveniently and advantageously combined with the existing business”.

The court held that the new business intended by the company having regard to the changed circumstances, namely, that the original undertaking of the company

397 (1975) comp. cases 151 (Guj.)
had been sold away for a sum of Rs. 40 Lac, whereby the company had received such a big amount, could conveniently with its business of some manufacturing activities as well as its business of dealing in cotton, be put to profitable use by investing the same in some lucrative line. No circumstances had been pointed out by the Registrar nor brought on record by any other affected party that it would not be convenient or advantageous for the company to engage itself in the main business of exhibition of films with the existing business of the company.

Held, that it is no doubt true that the court may refuse to confirm an alteration unconnected with the existing objects or where the change has altered the basis of the company, but it could not be said that the proposed alteration would change the basis of the company to destroy the then existing business of the company. The alteration of the objects was confirmed.398

6. In United Collieries Ltd. Re,399 it was held that when business of a company is nationalized, and can no longer be carried on, it can be allowed to venture in to entirely new fields and allowed to alter its memorandum of association.

7. In Juggilal Kamlapat Jute Mill Co. Ltd. V Registrar of Companies400, it was held that the expression “some business” in section 17 (1) (d) may include new business, but it should not be destructive or inconsistent with the existing business. Where there is no scope for expansion or making improvements in the existing plant or under existing circumstances, it is advisable to reduce existing business, and opening of a new business can amount to reducing business, and opening of a new business can amount to combination thereof with existing one. In this case the company originally formed for “business in jute” was allowed to include in the “business of rubber”.

8. In Amala Electric Supply Co. Ltd. Re,401 a company formed for generating power was allowed to change the objects to include cold storage and other allied business.

398 Ibid
399 (1975) Comp Cases 226 (Cal)
400 (1967) 37 Comp. Cases 20 All
401 (1963) 33 Comp. Cases 585 (Punj)
9. *In Modi Spinning & Weaving Mills Ltd. Re*\(^402\), the Appellant Company was allowed to change the objects to include manufacture of industrial and power alcohol.

10. *In J.K. Jute Mills V Registrar of Companies*\(^403\), it was held that the Court/CLB may take a lenient view of the financial position if the company is sound and the alteration is not objected to by creditors and shareholders. It was further held in this case that the court/company law board has “a discretion to be exercised judiciously, in the interest of the members of the company and its creditors, not to confirm the alteration or confirm the same in whole or in part, or subject to such terms and conditions as it deem fit.

D. PROCEDURE FOR ALTERATION OF OBJECT CLAUSE

Since the amendment of section 17, by virtue of Companies Amendment Act 1996, the prescribed procedure for altering objects is only the requirement of a special resolution and its filing with the Registrar. The requirement of seeking confirmation of the Company Law Board has been dispensed with. The alteration of the objects has become an internal matter. No outside confirmation is necessary. The only restraint now is that the special resolution of the company should be within the scope of the permissible range of alteration as outlined in section 17(1). The matter being wholly internal, only the shareholders can object to any change which is extraneously to the substantive limits stated in section 17(1). The memorandum of association is a contract between the company and its members. This contract operates within the frame work of the companies Act. Members can prevent through a civil court action, violation of the companies Act by their company. Lending institutions and creditors would not be able to object. It would, however, be better to inform them and to take their approval because they can think in terms of withdrawing loan facilities where such facilities were extended on the basis of objects as they then stood. They may not like to risk their financial resources in new and adventurous objects.\(^404\)

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\(^{402}\) (1964) 34 Comp. Case 86
\(^{403}\) (1967) 37 Comp. Case 20 All
\(^{404}\) Supra Note 279 Page 77
The Company Law Board was also required to have regard to the rights and interests of the members of the company. If there are any dissentient members, the board may order that an arrangement be made for the purchase of the interests of such members.\textsuperscript{405}

The company law board had the discretion to refuse to confirm the alteration or to confirm it either wholly or in part or subject to such conditions as may be deemed fit as provided under section 17 (5). In a case before the Allahabad High Court, an alteration was confirmed only in part and that too subject to the condition that a separate profit and loss account in respect of new business should be maintained for a period of five years.\textsuperscript{406}

Under English Law the confirmation of the court was not necessary except when an application had been lodged against the alteration within 21 days of the passing of the special resolution. The application had to be filed by the holders of not less than 15% in nominal value of the company’s issued share capital or any class thereof. If the company was limited by shares, the application had to be filled by at least 15% of the company’s members. Fifteen percent of the company’s debentureholders could also proceed under the section of English Law which saved a good deal of time and expense. Explaining the reason, why the same had not been adopted in India, a learned judge said:

“It may be that the Indian parliament in its wisdom might have thought that the shareholders in India have neither the sense of responsibility, nor the maturity of business experience of English shareholders to be left free to judge by themselves the ultimate desirability of altering so important a feature of the company as the objects clause of the memorandum.”\textsuperscript{407}

But now, since the above noted amendment of 1996, the procedure in India is also very liberal. No outside approval is necessary. Only the members can restrain their company by civil proceeding from altering objects outside the scope of limits as specified in section 17 (1).\textsuperscript{408}

\textsuperscript{405} In Sipani Automobiles Ltd. Re, (1993) 78 Comp. Case 557
\textsuperscript{406} Motilal Padampat Sugar Mills Co. Re, 1964 34 Comp. Case 86 All
\textsuperscript{407} Bhutoria Bros, Re , AIR 1957 Cal 593
\textsuperscript{408} Supra note 404, page 78
E. REGISTRATION OF THE ALTERATION OF OBJECTS CLAUSE

In the case of alteration of objects, a copy of the resolution should be filed with the registrar of companies within one month from the date of the passing of the resolution. In the case of inter-state shifting of the registered office a certified copy of the central government’s order and a printed copy of the altered memorandum must be filed with the registrar within three months of the order. The documents have to be filed with the registrar of the place from where the office is to be shifted and also with the registrar of place at which the new office is to be established.\textsuperscript{409}

Within one month, the registrar will certify the registration. Alteration takes effect when it is so registered\textsuperscript{410}.

If an application for registration is not made within the above time, the whole proceedings of alteration will lapse. The company may however seek from the Central Government an order for revival of the lapsed proceedings, provided an application is made within the further period of one month and is based upon a sufficient cause. In computing the time of three months, the time taken for drawing up of the Central Government’s order as well as time taken for obtaining a copy thereof is to be excluded. The Central Government has the power to extend time for registering an alteration, when there is sufficient cause to excuse the delay.\textsuperscript{411}

\textsuperscript{409} Ishita Properties Ltd. Re, (2002) 112 Comp. Case 547 CLB
\textsuperscript{410} Section 19 of Companies Act 1956
\textsuperscript{411} Section 18(4) of companies ACT 1956