INTRODUCTION TO INCORPORATION: MEMORANDUM OF ASSOCIATION

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An Overview:-

Industrial has revolution led to the emergence of large scale business organizations. These organization require big investments and the risk involved is very high. Limited resources and unlimited liability of partners are two important limitations of partnerships of partnerships in undertaking big business. Joint Stock Company form of business organization has become extremely popular as it provides a solution to (2) overcome the limitations of partnership business. The Multinational companies like Coca-Cola and, General Motors have their investors and customers spread throughout the world. The giant Indian Companies may include the names like Reliance, Talco Bajaj Auto, Infosys Technologies, Hindustan Lever Ltd., Ranbaxy Laboratories Ltd., and Larsen and Tubro etc.

Definition of a "Company"

A company is a "corporation" - an artificial person created by law.

A human being is a "natural" person. A company is a "legal" person.

A company thus has legal rights and obligations in the same way that a natural person does.

MEANING OF COMPANY:-

Section 3 (1) (i) of the Companies Act, 1956 defines a company as “a company formed and registered under this Act or an existing company”. Section 3(1) (ii) Of the act states that “an existing company means a company formed and registered under any of the previous companies laws”.

This definition does not reveal the distinctive characteristics of a company .

According to Chief Justice Marshall of USA,

“A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation of its creation confers upon it either expressly or as incidental to its very existence”.

Another comprehensive and clear definition of a company is given by Lord Justice Lindley,

"A company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising there from. The common stock contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted".

According to Haney, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership". From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

Companies and Partnerships Compared

(a) A company can be created only by certain prescribed methods - most commonly by registration under the Companies Act 1985. A partnership is created by the express or implied agreement of the parties, and requires no formalities, though it is common to have a written agreement.

(b) A company incurs greater expenses at formation, throughout its life and on dissolution, though these need not be excessive.

(c) A company is an artificial legal person distinct from its members. Although in Scotland a partnership has a separate legal personality by virtue of s.4(2) of the Partnership Act 1890, this is much more limited than the personality conferred on companies.

(d) A company can have as little as one member and there is no upper limit on membership. A partnership must have at least two members and has an upper limit of 20 (with some exceptions).

(e) Shares in a company are normally transferable (must be so in a public company). A partner cannot transfer his share of the partnership without the consent of all the other partners.

(f) Members of a company are not entitled to take part in the management of the company unless they are also directors of it. Every partner is entitled to take part in the management of the partnership business unless the partnership agreement provides otherwise.

(g) A member of a company who is not also a director is not regarded as an agent of the company, and cannot bind the company by his actions. A partner in a firm is an agent of the firm, which will be bound by his acts.

(h) The liability of a member of a company for the debts and obligations of the company may be limited. A partner in an ordinary partnership can be made liable without limit for the debts and obligations of the firm.

(i) The powers and duties of a company, and those who run it, are closely regulated by the Companies Acts and by its own constitution as contained in the Memorandum and Articles of Association. Partners have more freedom to alter the nature of their business by agreement and without formality, and to make their own arrangements as to the manner in which the firm will be run.

(j) A company must comply with formalities regarding the keeping of registers and the auditing of accounts which do not apply to partnerships.

(k) The affairs of a company are subject to more publicity than those of a partnership - e.g. companies must file accounts which are available for public inspection.

(l) A company can create a security over its assets called a floating charge, which permits it to raise funds without impeding its ability to deal with its assets. A partnership cannot create a floating charge.

(m) If a company owes a debt to any of its shareholders they can claim payment from its assets rateably with its other creditors. A partner who is owed money by the partnership cannot claim payment in competition with other creditors.

(n) A partnership (unless entered into for a fixed period) can be dissolved by any partner, and is automatically dissolved by the death or bankruptcy of a partner, unless the agreement provides otherwise. A company cannot normally be wound up on the will of a single member, and the death, bankruptcy or insanity of a member will not result in its being wound up.

Memorandum of association:-

In order to form a company, the first step is to prepare the memorandum of association. It is a document that sets out the fundamental conditions for constitution of the company and, as such it is really the foundation on which the structure of the company is based.

It defines the limitation on the powers of the company.[1]

It describes its relations with the outside world and the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what is its permitted range of enterprise.

[1] Ashbury Railway Carriage & Iron Co. Ltd. v. Ricbe (1875) L.R. 7 H.L. 635

Under section 16 of the Act a company cannot alter the conditions mentioned in its memorandum except in the cases and in the manner and to the extent provided in the Act.[2]

The memorandum of every company must state:[3]

(1) the name of the company with 'Limited; as the last word, and 'Private Limited' if the company be a private limited company;

(2) the state in which its registered office is to be situated;

(3) in the case of a company in existence before the commencement of the Companies (Amendment) Act, 1965 the objects of the company, and in the case of company after such commencement, the main objects of the company to be pursued on its incorporation and objects ancillary or incidental to attainment of such objects, and other objects, if any;

(4) the states to whose territories the objects extend where the objects of the company (other than a trading corporation) are not confined to one state;

(5) the fact that the liability of its members is limited, if it is a limited liability company;

(6) the amount of capital and the division thereof into shares of a fixed amount, unless the company is an unlimited one[4] and

(7) the association clause and subscription.[5] A company being a legal person must have a name to establish its identity.

No company can be registered with a name, which in the opinion of the Central Government, is undesirable.[6]

The name of the company should not be identical with or should not too nearly resemble the name of another registered company in existence or a registered trademark or a trademark, which is a subject of an application for registration, of any other person under the Trade Marks Act, 1999.[7]

If the liability of the members is limited, the last word of the company's name must be 'Limited', and in the case of a private limited company the word 'Private' should precede 'Limited'.[8]

[2] Ss. 16 to 19.
[3] S. 13.
[4] S. 4(a).
[5] S. 4 (c).
[6] S. 20(1).
[7] S. 20 (2).
[8] S. 13 (1) (a).

This is to ensure that all persons dealing with the company shall have a clear notice that the liability of the members is limited. Any default in this respect might involve the officers of the company in most serious consequences.

However, in exceptional cases the Central Government may, by licence, allow a company to drop the word "Limited" from its name.[9]

Also, a company can change its name by complying with the provisions of the Act.[10]

The memorandum must specify the state in which the registered office of the company is to be situated. A company may change its registered office within the territorial jurisdiction of the state of registration by complying with the provisions of the Act.[11]

But change of registered office from one state to another is a complicated affair as the Central Government has to be satisfied that the shifting of the office is necessary for any of the purposes detailed in section 17 (1), and also bound to consider the objections of a person or a class of persons whose interest will, in the opinion of the Central Government be affected by the alteration[12] . The earlier judicial practice of refusing change of registered office from one state to another on the ground of loss of revenue to the state[13] was later observed to be parochial. The new approach is to consider the question of revenue in the prospect of total revenues to the Republic of India.[14] The memorandum must state the objects for which the proposed company is to be established. The Companies (Amendment) Act, 1965 requires that in the case of companies in existence prior to the amendment, the objects clause has simply to state the objects of the company.[15]But in the case of a company to be registered after the amendment, the objects clause must be divided into two sub-clauses, namely:

1. Main objects to be pursued by the company on incorporation and objects incidental and ancillary to the attainment of the main objects;

2. other objects which are not included in the above.[16] The statement of objects, therefore, gives a very important protection to the shareholders by ensuring that the funds raised for one undertaking are not going to be risked in another.

[9] S. 25.
[10] S. 21.
[11] S. 146.
[12] S. 17 (3).
[13] Orient Paper Mills Ltd. v. State AIR 1957 Ori. 232
[14] Minerva Mills Ltd. v. Govt. of Maharashtra (1975) 45 Comp. Cas. l(Bom.) Also see Rank Film Distributors of India Ltd. v. The Registrar of Companies AIR (1969) Cal. 32
[15] S. 13 (c).
[16] S. 13 (d).

The objects clause also affords a certain degree of protection to the creditors. The creditors of a company trust the corporation and not the shareholders and they have to seek repayment out of the company's assets only.

The fact that the corporate funds cannot be spent on any project not directly within the terms of the company's objects gives the creditors a feeling of security.[17]

Thus, the funds of a company under the Act can only be applied in carrying out its authorized objects. If a director of a company makes an ultra vires payment he can be compelled to refund the money.

The directors being agents of the company can do nothing which the company itself cannot do under its memorandum of association and, therefore, any contract made by them which is ultra vires the company will be void and of no effect whatsoever.

If on the other hand, they make a contract within the powers of the company but ultra vires the powers which the company by its articles has conferred upon them, the company may ratify the contract in general meeting and thereby be bound by it.

In the absence of such ratification, the company will not be bound by the contract and the directors may be personally liable to the other party to the contract for the breach of an implied warranty of their authority. Though a contract may be ultra vires the company and, therefore, void, it may have certain indirect effects.

First, if money or property obtained under an ultra vires contract has been used to pay debts of the company, then by the principle of subrogation the creditor can, to that extent, stand in the shoes of those creditors of the company who have paid off. Secondly, if the property handed over to the company by virtue of an ultra vires contract exists in specie or if it can be traced the person handling it over can get it back.

Section 17 allows alteration of objects within certain defined limits. The limits imposed upon the power of alteration are of two kinds, namely substantive and procedural. Section 17 provides that a company may alter Memorandum so as to change the place of its registered office from one state to another or with respect to its objects only in so far as the alteration is necessary for any of the following purposes: 1. To enable the company to carry out its business more economically or more efficiently;

2. To enable the company to attain its main purpose by new or improved means;

[17] Waman Lai v. Sandia Steam Navigation Co. AIR 1944 Bombay 131. The doctrine of ultra vires has been upheld by the Supreme Court in A. Lakshamanaswamy Mudaliar v. Life Insurance Corporation of India AIR (1963) SC 1185.

3. To enlarge or change the local areas of the company's operations;

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

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

6. To sell or dispose of the whole, or any part of the undertaking of the company;

7. To amalgamate with any other company or body or persons.

The procedure of alteration of a memorandum of association to change registered office from one place to another is as follows:[18] a special resolution authorizing the alteration must be passed at a general meeting of the company. But the alteration does not take effect until it is confirmed by the Central Government on petition. Before confirming the alteration, the Central Government must be satisfied that sufficient notice has been given to every holder of the debentures of the company and to other persons whose interest, in its opinion, will be affected by the alteration. The Central Government must further be satisfied that either the consent of every creditor has been obtained to the alteration or his debt or claim has been discharged or secured to the satisfaction of the Central Government. The Central Government must cause a notice of the petition for confirmation of the alteration to be served on the Registrar, as he is also entitled to state his objections and suggestions, if any.[19]

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.[20]

Within one month the Registrar will certify the registration. Alteration takes effect when it is so registered.[21]

Change of registered office of the company from one place to another within a state can be done only with the confirmation of the Regional Director.[22]

As previously stated the memorandum must have a liability clause. This clause has to state the nature of the liability that the members incur. The company limited by shares or guarantee must also state that the liability of its members is limited.[23]

[18] S. 17(2).
[19] S. 17 (3).
[20] S. 18 (1) (b).
[21] S. 19.
[22] S. 17A.
[23] S. 13 (2).

This means that no member can be called upon to pay anything more than the nominal value of the shares or the guaranteed amount held by him or so much thereof as remains unpaid.[24]

The absence of this clause in the memorandum means that the liability of its members is unlimited. The capital clause states the amount of the nominal capital of the company and the number and value of the shares into which it is divided.[25]

The clause lays down the limit beyond which the company cannot issue shares without altering the memorandum.[26] The memorandum concludes with the subscription clause. In this clause the subscribers declare: We, the several persons whose names and addresses are subscribed are desirous of being formed into a company, in pursuance of the memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names. Each subscriber must sign the document and must write opposite his name the number of shares he takes.[27] But no subscriber shall take less than one share.[28] After incorporation no subscriber can withdraw his name on any ground whatsoever.

[24] S. 12 (2).
[25] S. 13 (4) (a).
[26] S. 94.
[27] S. 13 (4) (c).
[28] S. 13 (4) (b).