1. Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that bahalf takes delivery of them from such carrier or other bailee.
2. If the buyer or his agent in that behalf obtains delivery of the goods before their arrival at the appointed destination, the transit is at an end.
3. If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent, the transit is at an end and it is immaterial that a further destination for the goods may have been indicated by the buyer.
4. If the goods are rejected by the buyer and the carrier or other bailee continues in possession of them, the transit is not deemed to be at an end even if the seller has refused to receive them back.
5. When goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case whether they are in the possession of the master as a carrier or an agent of the buyer.
6. Where the carrier or other bailee wrongfully, refuses to deliver the goods to the buyer or his agent in that behalf, the transit is deemed to be at an end.
7. Where part delivery of the goods has been made to the buyer or his agent in that behalf, the remainder of goods may be stopped in transit, unless such part delivery has given in such circumstances as to show an agreement to give up possession of the whole of the goods (Sec.51.)

The unpaid seller may exercise his right of stoppage in transit either by taking actual possession of the goods or by giving notice of his claim to the carrier or other bailee in whose possession the goods are lying. (Sec.52).

Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case, the notice to be effectual shall be given at such time and in such circumstances that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.

Distinction between Right of Lien and Right of Stoppage in Transit

1. Nature of right: The right of lien is to retain possession, while the right of stoppage in transit is to regain or resume possession.

2. Possession of goods: The right of lien can be exercised on goods which are in actual or constructive possession of the seller, while right of stoppage in transit can be exercised when the goods are in the possession of a middleman between the seller who had parted with the possession of the goods and the buyer who has not yet acquired the possession.

3. Commencement and end: The right of lien comes to an end when the possession of the goods is surrendered by the seller, but the right of stoppage in transit commences when the goods have left the possession of the seller and continues until the buyer had acquired their possession.

4. Insolvency of the buyer: The unpaid seller's right to stop the goods in transit arises only when the buyer is insolvent but the right of lien can be exercised even when the buyer is able to pay but does not pay. This right remains in force till the right of stoppage in transit starts. Possession is the test of this right.

5. **Mode of exercising :** Right of Lien can be exercised by the seller himself. Right of stoppage in transit can be exercised by the seller through the carrier or the other bailee.

Effect of Sub-sale or pledge by buyer (Sec.53): The unpaid seller's right of lien or stoppage in transit is not affected by any sale or pledge of the goods which the buyer may have made, unless the seller has assented to it. But this right is defeated if he has transferred a document of title to goods (e.g., a bill of lading or a railway receipt) to the buyer and the buyer transfers it by way of sale to a person who takes it in good faith and for consideration.

Right of Resale

The unpaid seller has the right of resale of the goods. When the goods are of a perishable nature, the unpaid seller may resell the goods without any notice to the buyer. When the unpaid seller has exercised his right of lien or stoppage in transit, he has to give notice to the buyer of his intention to resell. Thereupon, the buyer may pay the price within a reasonable time. If the buyer does not pay, the unpaid seller can resell the goods and recover from the original buyer, damages for any loss occasioned by his breach of contract. The original buyer shall not be entitled to any profit which may occur on the sale. If however, the unpaid seller resells the goods without notice to the buyer, the unpaid seller shall not be entitled to recover damages and the buyer shall be entitled to the profit, if any , on the resale. Where an unpaid seller who has exercised his right of lien or stoppage in transit, resells the goods, the buyer acquires a good title there to as against the original buyer (Sec.54).

Unpaid Seller's Rights against the Buyer Personally

These rights refer to those, which an unpaid seller may enforce against the buyer personally, called *rights in personam.*

1. **Suit for price (Sec.55):** When property in the goods has passed to the buyer and the buyer wrongfully refuses to pay for the goods, the seller may sue him for the price of the goods {Sec.55 (1)}. Where property in the goods has not passed to his buyer and the goods have not been appropriated to the contract, if the price is payable on a certain day irrespective of delivery, the seller may sue buyer on his wrongful refusal to pay for the price {Sec.55 (2)}.
2. **Suit for damages for non-acceptance (Sec.56) :** Where the buyer wrongfully neglects or refuses to accept and pay for the goods the seller may sue him for damages for non-acceptance. Where there is no default of the seller and the buyer wrongfully refuses to take delivery of the goods within reasonable time, the seller is entitled to recover from the buyer: (i) any loss caused by the buyer's refusal to take delivery; and (ii) any reasonable charge for the care and custody of the goods (Sec.44).
3. **Repudiation of contract before due date:** Where the buyer repudiates the contract before the due date of delivery, the seller may wait till the due date of delivery or may treat the contract as rescinded and sue for damages for this breach under Section 60 of the Act. This rule is called '*rule of anticipatory breach of contract*'.

4. **Suit for interest:** Where there is specific agreement between the seller and the buyer about payment of interest of the price of the goods from the date on which the payment becomes due, the seller may charge interest from the buyer. In the absence of any such agreement, the seller may recover interest from such date as the seller may notify to the buyer.

In the absence of a contract to the contrary, *the court may award interest as such rate as it thinks fit* , on the amount of the price to the seller in a suit by him for the price from the date on which the goods are supplied or from the date on which the price is payable.

AUCTION SALES

A sale by auction is a public sale where different intending buyers try to outbid each other. The goods are ultimately sold to the highest bidder. The auctioneer who conduct the auction is an agent of the seller. The Sale of Goods Act lays down the following rules in the cases of a sale by auction (Sec.64):

1. Where goods are put up for sale in lots, each lot is *prima facie* deemed to be the subject of a separate contract of sale; [Sec. 64(1)].
2. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner; and until such announcement is made, any bidder may retract his bid. [Sec. 64(2)].

A bid by an intending buyer is construed as an offer. As an offer, it can be withdrawn any time before acceptance, which in this case occurs by the fall of the hammer, or any other customary manner. It has been held that it is customary in this country to repeat the final offer three times.

3. A right to bid may be reserved expressly by or on behalf of the seller and, where such right is expressly so reserved, but not otherwise, the seller or any one person on his behalf may, subject to the provisions herein after contain, bid at the auction; [Sec. 64(3)].
4. Where the sale is not notified to be subject to a right to bid on behalf of he seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to taken any bid from the seller or any such person; and any sale contravening this rule may be treated as fraudulent by the buyer [Sec. 64(4)];
5. The sale may be notified to be subject to a *reserve or upset price*; where the sale is not to subject to reserve or upset price the goods are to be sold to the highest bidder, whether the same bid be equivalent to the real value or not [Sec. 64(5)].;
6. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer [Sec.64(6)];
7. The auctioner cannot sell goods on credit or accept a bill of exchange.
8. A *'knock-out'* agreement between intending buyers not to bid against each other is not illegal. (*Lachman Das and others Vs. Sita Ram & Others 1975*).

Passing of Property in Sea Carriage : FOR., CF., CIF., FOB., CONTRACTS

International commerce which involves transportation of goods from far away countries is largely dependent on Sea carriage. As various merits are associated with carriage of goods by sea, the question of ownership and risk have arisen quite often. As passing of property is dependent on the terms of contract, parties to such contracts have evolved definite models for carriage of goods, such as F.O.B., F.O.R., C.I.F., and C. & F. etc. each of which have definite and internationally accepted meaning assigned for them.

F.O.R. Contracts : The word F.O.R. stands for Free on Rail. Where the seller agrees to sell the goods on FOR basis he is required to bear all expenses prior to the putting of the goods on rail. As soon as the goods are put on rail the responsibility of the seller ceases and the risk as well as property vests in the buyer as held in under *Wood Ltd. Vs.Burgh Castle Brick and Cement Syndicate (1922) 1. K B 343.* In India, the F.O.R. contracts do not imply an undertaking on behalf of the seller to procure wagons : *National Coal Co. Ltd. Vs. G.P. Park 86 Cal. L J 220.*

A Contract was made for sale of goods on "F.O.R." at the place of despatch. Purchaser complains of short delivery of goods by Railways. What are the responsibilities of the Seller?

(Ref. : to *M/s. Marwar Tent Factory Vs. Union of India Ors. AIR 1990 SC 1751.* "Seller's liability to place the goods free on rail at the place of delivery. Once that is done the risk belongs to the buyer")

Sometimes, the goods are to be delivered to the buyer through sea routes. In all such cases, the parties may enter into certain contracts, which govern the delivery of the goods through sea routes. Following are the three important and usual forms of contracts of sale which involve the carriage of goods by sea:

C & F Contracts : In a C & F contract, the insurance paid by the purchaser. In such a contract the buyer undertakes to insure the goods upon receipt of particulars of shipment while the goods are in transit. This contract is for all practical purposes an F.O.B. contract. Madras High Court held in Commissioner of Income Tax Vs. Burugh Vishwanatha Rao (Case No. 61/46) that in the case of such contracts property in the goods passed not when the goods are ascertained but subsequently. The time of shipment of the time of passing of property to the buyer as held by *Madras High Court in India C & T Distributing Co. Vs. State of Madras, AIR 1954, Mad. 1030.*

C.I.F. Contracts: The term *'C.I.F.'* means *'cost, insurance and freight'*. A **C.I.F.** contract is a contract for the sale of goods at a price which includes the cost of goods, insurance and freight charges. Thus, in such contracts, the charges of insurance during transit and the freight charges are paid by the buyer. Where the buyer orders the goods from a seller, residing abroad, under a C.I.F. contract, the seller will insure the goods and deliver them to a shipping company for transmission to the buyer; the insurance policy on the goods and the bill of lading to be delivered to the buyer along with the invoice of the goods. It may be noted that in C I.F contracts, the seller is bound to perform the following duties:

1. To load the sold goods safely on the ship named by the buyer.
2. To meet the expenses of loading the goods.

3. To enter into contract with the shipping company or ship owners for the transportation of goods and obtain a bill of lading. Such a contract should be upon reasonable terms.
4. To deliver the bill of lading to the buyer.

On the performance of the above duties, the contractual liability of the seller ceases, and the delivery of goods to the buyer is complete as far as he (i.e., seller) is concerned. Therefore, the buyer is bound to pay the price of the goods when the shipping documents are presented to him even if the goods have been lost by that time. It is also the buyer's duty to name a ship upon which the goods are to be delivered; if he fails to name a ship, he is guilty of breach of contract, and the seller can file a suit against him for the recovery of the damages.

REVIEW QUESTIONS

1. What do you mean by performance of a contract of sale?
2. What is meant by delivery of goods?
3. What are the rules as to delivery of goods under the Sale of Goods Act? Explain in detail.
4. Enumerate the remedies open to the buyer for breach of contract by the seller. Is the buyer liable for rejecting, neglecting or refusing delivery of goods?
5. What is the exact moment at which the transfer of property takes place? What is its importance?
6. 'No one can convey a better title than he himself has'. Explain the statement and state the exceptions to it.
7. What are the rights and duties of a buyer in a contract of sale?
8. What are the remedies for a breach of contract of sale (a) by the buyer and (b) by the seller?
9. Who is an unpaid seller? State and explain the rights of an unpaid seller against (a) the goods and (b) the buyer (personally).
10. Distinguish between unpaid seller's right of lien and stoppage in transit.
11. Write short notes on :

    (a) Right of resale (b) Auction sales (c) Right of stoppage in transit (d) CIF contract (e) FOB Contract.

PRACTICAL PROBLEMS

Attempt the following problems, giving reasons:

1. A sells of B a horse which is to be delivered to B the next week. B is to pay the price on delivery. A asks his servant to keep the horse separate from other horses. The horse, however, dies before it is delivered and paid for. Who shall bear the loss?

   {*Hint.* It is a contract of sale of specific goods in a deliverable state and, therefore, the property in the horse passes to B at once at the time of contract. Hence B should bear the loss.}
2. On 6th May, A entered into a contract for the sale of 100 bags of wheat to B and received Rs.2,500 in part payment of the price. The goods were not with the seller at that time but had been despatched from Nagpur on 4th May. A had received the R/R which he endorsed in favour of B on 6th May while in transit. The goods never reached the destination as they were burnt on 7th May while in transit. Who shall bear the loss?

   {*Hint.* B has to bear the loss as the property in the goods has passed to him at once at the time of endorsement of the R/R in his name, i.e., on 6th May while the loss occurred on 7th May}.
3. X sells a car by auction to Y, who is the highest bidder.Y offers to pay for the car by a cheque and he is allowed to do so provided he signs a document stating that the property in the car would not pass to

him until the amount of the cheque has been credited to the seller's account. The cheque is subsequently dishonoured. X asks Y to return back the car as he has not become the owner of the car because the cheque given by him been dishonoured. Is X's contention justified?

{*Hint.* No X's contention is not justified. The property in the car had passed on the fall of hammer, a subsequent agreement that the property would not pass until the cheque is realised is of no effect and therefore X having lost his title to price. Delivery and payment are concurrent condition. X was, therefore, entitled to refuse delivery of car until paid and could have exercised his 'right of lien' as an unpaid seller. But once he has given the delivery of car, his 'right of lien' is lost, since lien is lost once possession is lost.}

4. A sells to B the whole content of a certain heap of wheat, which according to A contains 10 quintals. B gets the wheat weighed for his own satisfaction. When the wheat is being weighed, there is a fire and the whole of the wheat is destroyed. Can A recover the price of wheat from B?

{*Hint.* Yes, A can recover the price from B. It is a contract of sale of specific goods in a deliverable state (as nothing remained to be done by the seller to ascertain the price), and, therefore, the property passes to the buyer as soon as the contract is made. When the buyer gets something done for his own satisfaction, the passing of property is not affected by that and Sec.20 applies to such a case all right}

5. A gives some diamonds to B on sale or return basis. On the same day B gives those diamonds to C on sale or return and from him they are lost. Who shall bear the loss?

{*Hint.* B must bear the loss because by transferring the diamonds further he has adopted the transaction and the property in them has, therefore, passed to him}.

6. A sells to B 100 bags of wheat which are locked up in a godown. A hands over to B the key of the godown. Does it constitute delivery of the goods to B?

{*Hint.* Yes, this is a delivery to B, being a symbolic delivery.}

7. X of Kochin agreed to sell 400 tons of rice to Y of Kolkata to be shipped in November or December 2002. X puts the rice on ship on 20 October 2002. Is the buyer bound to accept the consignment?

{*Hint.* The buyer is not bound to accept the consignment because the seller has not complied with the stipulation as to time and time being of the essence of all mercantile contracts, an essential term of the contract has been taken.}

8. P of Delhi writes to R of Mumbai to send him a book by parcel post. R accordingly sends the book by parcel post. The parcel is lost on the way. Can R recover its price from P?

{*Hint.* Yes, R can recover the price of the book from P because as per Section 39 of the Sale of Goods Act, delivery to the carrier (i.e., the post office) is delivery to the buyer and the buyer becomes the owner, thereafter, who should bear the loss.}

9. P sold barely to B by sample, delivery to be made at T railway station. B sold the barely to X. The barely was delivered to be made at T railway station and B, after sample, whereupon B seeks to reject the goods. Will B succeed?

{*Hint.* B cannot reject the barely, as by reselling those goods to X and ordering to send them to X, he had in law 'accepted' the goods.}

10. A sells goods to B. B pays to A through a cheque. Before B could obtain the delivery of goods, his cheque has been dishonoured by the bank. A, therefore, refuses to give delivery of the goods until paid. Is A's action justified?

{*Hint.* Yes A's action is justified, because the right of lien is linked with possession and not with title or passing of property.}

11. A sells goods to B and transfers him the document of title to the goods. B pays A through a cheque. In fulfilment of a contract of sale B transfers that document of title to C. Before C could obtain the delivery

of goods. B's cheque has been dishonoured by the bank. Hence A gives instructions to stop delivery of the goods to C until paid. Is A's action justified?

{*Hint.* No, A's action is not justified. An unpaid seller's right of lien if defeated against transferee who takes a document of title in good faith and for consideration (Sec.53).}

12. A sells and consigns to B goods of the value of Rs.10,000 on credit. B assigns the railway receipt to C to secure a specific advance of Rs. 5,000 on the railway receipt before the goods reach the destination B becomes insolvent. A gives notice to stop the goods in transit but C claims them. Can A stop the goods in transit?

{*Hint.* Yes, A can stop the goods in transit but subject to the pledge of C.C can recover the amount of pledge from the goods or from A. Hence A can stop the goods in transit only when he pays Rs.5,000 to C (Sec.53).}

13. P sells to R a quantity of wheat lying in P's warehouse. It is agreed that three months credit shall be given to R. R allows the wheat to remain in P's warehouse. Before the expiry of the three months R. R allows the wheat to remain in P's warehouse. Before the expiry of the three months R becomes insolvent and the Official Assignee demands delivery of the wheat from P without offering to pay the price. Is P entitled to retain the goods until paid?

{*Hint.* Yes, P is entitled to retain the goods as security for the price until he is paid. In the case of buyer's insolvency the lien exists even though goods had been sold on credit and the period of credit has not yet expired, provided the goods are still in possession of the seller (Sec.47).}

14. A sells certain goods to B, the property in the goods is to pass to B on delivery which is to take place on 1st August, and the payment to be made by B on Ist June. B refuses to pay the price on the due date on the plea that the property in the goods has not passed to him. Can A sue B for the price before the delivery of the goods takes place?

{*Hint.* Yes, A can sue B for the price. Where the sale price is payable 'on a day certain', the seller can sue the buyer on his default, irrespective of passing of property and delivery of goods (Sec. 55).}

15. A attended an auction sale and made a bid of Rs. 600 for a typewriter but withdrew the offer before the fall of the hammer. One of the conditions of the sale, which A had read was that biddings once made, shall not be withdrawn. A was sued for Rs.600 his being the highest bid. Decide.

{*Hint.* A is liable to pay Rs. 600 because as per the conditions of the auction no bid can be withdrawn. The auctioneer has the right to make the auction subject to any condition he likes (*The Coffee Board vs Famous Coffee and Tea Works (1965).*}

16. At an auction sale, A makes the highest bid for a flower vase. Purporting to accept the bid the auctioneer strikes the hammer, but strikes the vase and breaks it. Who is to bear the loss? Would your decision differ if the auctioneer had struck the table, on which the vase was kept, with the hammer and the vase fell down and broke into pieces?

{*Hint.* The loss in both the cases is to be broke by the owner of the flower vase, because at the time of the completion of the contract, namely, striking the hammer, the goods forming the subject matter of the contract have perished, and as such impossibility of performance at the time of contract renders the agreement *void ab-initio.*}

⊕ ⊕ ⊕

CHAPTER - 21

CONTRACT OF PARTNERSHIP

CHAPTER OUTLINE

THE INDIAN PARTNERSHIP ACT, 1932

DEFINITION OF PARTNERSHIP, FIRM ETC

ELEMENTS OF PARTNERSHIP

CLASSIFICATION OF PARTNERSHIP

PARTNERSHIP DEED

REGISTRATION OF FIRMS

RELATION OF PARTNERS TO ONE ANOTHER

RIGHTS AND DUTIES OF A PARTNER

RELATION OF PARTNERS TO THIRD PARTIES

- IMPLIED AUTHORITY OF A PARTNER

RECONSTITUTION OF A FIRM

- ADMISSION OF A PARTNER
- RETIREMENT OF PARTNER
- EXPULSION OF A PARTNER
- INSOLVENCY OF A PARTNER
- DEATH OF A PARTNER

DISSOLUTION OF A FIRM

SETTLEMENT OF ACCOUNTS

The law relating to partnership is contained in the Indian Partnership Act, 1932, which came into force on 1st October, 1932. Prior to the enactment of this Act, it was embodied in Chapter XI of the Indian Contract Act. 1872. A contract of partnership is a special contract. Where the Partnership Act is silent on any point, the general principles of the law of contract apply (Sec.3). The Act contains 74 sections and extends to the whole of India except the State of Jammu and Kashmir.

Section 4 of the Indian Partnership Act defines the term '*partnership*' as under: "*Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all*". Persons who have entered into a partnership with one another are individually called as '*partners*' and collectively as '*a firm*', and the name under which their business carried on is called the '*firm name*'.

Elements of Partnership: 1. Partnership is an association of two or more persons. 2. There must be an agreement entered into by all the persons concerned. 3. The partnership is organised to carry on some business. 4. The persons concerned must agree to share the profits of the business. 5. The business is to be carried on by all or any of them acting for all. All these elements must be present before partnership can be said to come into existence. If any one of these elements is not present, there cannot be partnership. Each of these elements are explained below in detail..

Minimum and maximum number: The minimum number of persons required to constitute a partnership is two. Reduction in the number of partners to one shall bring about compulsory dissolution of the firm. As regards the maximum number, Section 11 of the Companies Act, 1956 states that the number of persons (partners) carrying on business in banking must not exceed 10 and in other business 20. If the number exceeds this limit, the partnership will become an illegal association of persons unless it is registered as a company under the Companies Act, 1956.

Mutual agency

The partnership business may be carried on by all the partners or any of them acting for all. This is the most essential or cardinal principal of partnership. Each partner is the agent of the firm as well as of the other partners. He can act on behalf of the firm and can bind it by his acts done in the usual course of business. Similarly, each partner is a principal for all other partners and may be bound by the law of agency and the partners are largely regulated by the law of a principal and an agent.

Mutual agency is the true test: The true test, therefore, in determining whether a partnership exists or not is to see whether the relation of principal and agent exists between the parties and not merely whether the parties share in the profits or the business is carried on for the benefit of all. It is this relation of an agency among partners which distinguishes a partnership from a single co-ownership on the one hand and the agreement to share profits on the other. The existence of this relation of agency can be gathered from the relation of the parties and the circumstances of the case. The question of intention must be decided on the basis of the conduct of parties and of all the surrounding circumstances.

Firm Name: A firm name shall not contain any of the following words, namely, 'Crown', 'Emperor', 'Imperial' , 'King', 'Queen', 'Royal', 'Government' or words expressing or implying the sanction, approval, partonage etc., except when the State Government signifies its consent to the use of such words as part of the firm name by order in writing. It may also be noted that the

name used by the firm should not be confusing with the name of an already existing firm. Where a name, which is same or similar to the name of existing firm, is used with fraudulent intention, the courts may restrain the use of such names.

Legal status of a firm : A firm is merely a collection of partners. It has *no separate legal entity apart from its partners (Malabar Fisheries Co. Vs. Commissioner of I.T Kerla 1980).* As a matter of fact, the assets of the firm are the joint property of the partners. Moreover, the partners are also personally liable for all the business obligations of the firms,. Thus, the legal position of the firm is that it has no independent existence apart from its partners. However, in mercantile or commercial usage, a firm is considered to have an existence separate from its partners. The business generally talks of the assets, liabilities and goodwill of the firms as if it where something separate from its partners. Under the Income Tax Act, also , the position is somewhat different. The firm is assessable as a separate unit and the partners are also assessed separately.

CLASSIFICATION OF PARTNERSHIP

A partnership may be classified on the following basis namely: (i) on the basis of duration, (ii) on the basis of extent of business, and (iii) on the basis of liability.

1. **Partnership at will:** It is partnership in which its duration is not fixed but can be dissolved by any one of the partners at his will at any time. Thus. a partnership is at will in the following two cases, (a) Where the partnership is not for a fixed period of time, or (b) Where no provision is made as to when and how the partnership will come to an end. Such a partnership is called a *partnership at will* because it is carried on at the willingness and desire of the partners, and can be put to an end at the will of any of the partners. As there is no provision regarding the dissolution of the firm, it may be dissolved by any partner at any time by giving, in writing, a notice to all the partners. Where a date of dissolution is mentioned in the notice, the firm is dissolved from that date. Where no date of dissolution is mentioned, the firm stands dissolved from the date of communication of notice.
2. **Partnership for a fixed period:** It is a partnership in which its duration is fixed and cannot be dissolved by any partner at his will. Such a partnership is dissolved on the expiry of the fixed period.
3. **Partnership on the basis of extent of business:** The partners are also liberty to carry on one or more adventures or undertaking in a business. On this basis, the partnership may be of the following two kind: 1. *Particular partnership* : It is partnership which is formed for the purpose of carrying on a particular adventure or understanding e.g., a partnership for the construction of particular building, bridge etc. 2. *General Partnership*: It is a partnership which is formed for the purpose of carrying on business in general.

Classification of Partners and Their Liability

1. **Actual or Active Partner:** Actual partner is one who becomes partner by agreement and takes active part in the conduct of the partnership business. He is also called *ostensible* or *working partner.*
2. **Dormant or Sleeping Partner:** A dormant partner is one who is neither active nor known to the outsiders. He is also called a *sleeping* or *secret partner.* In reality he is a silent partner in the firm and also contributes his share in the business. But he does

not take active part in the conduct of the partnership business.

3. **Nominal partner :** A nominal partner is one who has no real interest in the business. He is entitled to share the profits of the business. A a matter of fact, a nominal partner only lends his name to the firm and his name is used in the firm as if he is an actual partner. It may be noted that a nominal partner does not contribute any capital and also does not take part in the conduct of the partnership business. However, he is liable for all acts of the firm as if he was its actual partner.
4. **Partner by estoppel or holding but :** A partner by estoppel is one who represents himself to be a partner in the firm, but in reality he is not so. Sometimes , a person who is not really a partner, represents himself to be a partner and the persons dealing with the firm believe him to be a partner. In such cases, he is estopped (i.e., prevented) from denying that he is not a partner. Such a person is called a *partner by estoppel or by holding out.*
5. **Sub-Partner :** A sub-partner is one who shares the profits of another partner. Sometimes, a partner of a firm agrees to share his own share of profits with an outsider. In such cases, a sub-partnership comes into existence between the contracting partner and the outsider. And such an outsider is called a *sub-partner.* In fact, a sub-partner is not a partner in the original firm. He has no right against the original firm. However, he can claim an agreed share of profits from the contracting partner only.
6. **Minor Partner:** A minor partner is one who is below the age of 18 years. It may, however, be noted that a minor cannot be a full-fledged partner in a firm. He can be admitted to avail the benefits of an already existing firm.

Admission of a minor (Sec.30) : Since a minor's contract is considered being void, he cannot become a partner in a firm, because partnership is founded on contract. Though a minor cannot be a partner in a firm, he can, " be admitted to the benefits of a partnership". When this has been done, his rights and liabilities are as follows: 1. A minor may be admitted to the benefits of an already existing partnership with the consent of the other partners. (Sec.30(1)). 2. Such a minor will have a right for the profits of the firm. 3. He may have access to and inspect and copy of any accounts but not books of the firm. (Sec 30(2)). 4. Minor's share is liable for all acts, but the minor is not personally liable. {Sec.30(3)}. 5. He cannot sue for an account or payment of his share, unless he is severing his connections with the firm. {Sec(30)}. 6. At any time, within 6 months of his attaining majority or of his obtaining the knowledge thereof, whichever is later, he may give a public notice denoting his willingness or otherwise of continuing as a partner. Where he fails to give such notice, he becomes a full partner thereon. {Sec.30 (5)}. 7. According to Indian Law, he becomes liable for all acts done since he was admitted to the benefits of the partnership (Not from the date of his attaining majority, or the date of election to remain in the firm. 8. Where he is not willing to continue, (a) his right and liabilities shall continue to be those of a minor upto the date on which he gives public notice; (b) his share shall not be liable for acts done subsequent to the date of notice; (c) he can sue for his share of the property and profits.

PARTNERSHIP DEED

The Partnership is created by agreement. The agreement may be oral or in writing; the agreement can be inferred from the conduct of the parties. In India this agreement may be oral or in writing. It is in the interest of the partners as well as business itself, that the agreement should be in writing. Through this agreement, the rights and duties of the partners are determined. This agreement is known as *Partnership Deed.*

When the partners have decided to enter into a deed of partnership, it would be stamped according to the provisions of the Indian Stamp Act. 1894. The deed of partnership (or deed of partnership need not be registered. It is not a public document like a Memorandum of Association of a company and only binds third parties so far as they have notice of it.

The partnership deed contains various provisions relating to various matters such as: (a) Name of the firm, (b) Names and addresses of all partners, (c) Nature and place of business, (d) Date of commencement of partnership, (e) Duration of partnership, (f) Amount of capital of each partner, (g) Profit sharing ratio, (h) Interest on Capital, (i) Interest on Drawings, (j) Interest on loan advanced by a partner to the firm, (k) Salary or commission payable to any partner, (l) Method of valuation of goodwill and other assets and liabilities in case of admission or retirement or death of a partner, (m) Settlement of accounts in case of retirement/death of a partner or dissolution of firm.

Notes : The partnership deed must not contain any term which is in contravention with the provisions of the Indian Partnership Act. The terms laid down in the partnership deed may be varied by the consent of all the partners.

REGISTRATION OF FIRMS

Partnership is the result of an agreement between two or more persons. It need not necessarily be registered. Registration does not create partnership. It only provides proof of the existence of the partnership firm, and afford protection to outsiders. Registration of the partnership is not compulsory. It is optional and there is no penalty for non-registration. Yet Section 69 imposes serious limitations on the capacity of an unregistered firm. These disabilities compel a firm to get itself registered sooner or later.

Time of registration: The Act does not mention anything about the time for registration. Registration may take place at any time during the continuance of the parntership firm. It is not essential that the firm should be registered. The Court will dismiss the suit (of the firm) on the plea of non-registration. The defect of non-registration cannot be rectified subsequent to registration. A fresh suit will have to be filed after registration, provided it is still within the period of limitation. Thus, a fresh suit by the partner on the same cause of action after withdrawal of a suit by the partners for want of registration will not be barred.

Procedure for registration: Registration are appointed in all States for the purpose of registering parntership firms. The procedure of registration is very simple. Section 58(1) states that the registration of a firm may be effected at any time be sending by post or delivering to the Registrar of Firms for the area in which any place of the business of the firm is or proposed to be situated, as statement in the prescribed from and accompanied by the prescribed fee. The application must state the following particulars: (a) The name of the Firm; (b) The place of business of the Firm; (c) The name (s) of any other place (s) where the Firm carries on business; (d) The

date when each partner joined the firm; (e) The names in full and permanent address of the partners; (f) The duration of the firm.

The application forms should be signed and verified by each partner. Where the Registrar is satisfied that the provisions of the Act have been duly complied with, he shall record an entry of the statement in the Register called the *Register of Firms*. He then issues a *Certificate of Registration*. This completes the procedure of registration. It may be noted that the registration is complete, when the statement is delivered to the Registrar.

Effects of Non-Registration (Section 69)

1. ***No civil suits by partners***
2. **No civil suit by a firm**
3. ***No right of set-off***

Exception to the effects of Non-Registration: Non -registration of a firm, does not affect the following rights:

1. **Suit for the dissolution firm:** An unregistered firm and its partners can sue for the dissolution of the firm or accounts of the dissolved firm, or any right or power to realise the property of the dissolved firm. This exception is based on the principle that registration is designed primarily for the protection of outsiders and the absence of registration need not prevent the disappearance of unregistered or improperly registered firm.
2. **Suit for set-off :** Non-registration of a firm does not affect a suit or claim to set-off the value of which does not exceed Rs. 100. Similarly it will not affect proceeding in execution or other proceeding incidental to or arising from a suit or claim, not exceeding Rs. 100 in value.
3. **Right of third parties:** Non-registration of a firm does not affect the rights of a third party to sue firm or its partners. A third party can always sue the firm whether registered or not.
4. **Power of official receiver and assignee:** An Official Receiver or Assignee of a court acting for an insolvent partner of an untergistered firm may bring a suit for the realisation of the property of an insolvent partner.
5. **Firms having no place of business in India:** Non-registration will not affect the right of a firm or partners of a firm having no place of business in India.
6. **Non-contractual rights:** Non-registration will not affect the enforcement of rights arising otherwise than out of a contract, e.g., for an injunction against wrongful infringement of a trade mark, trade name or patent rights of the firm. Similarly, one partner can bring a suit for damages for misconduct against another partner.
7. **To realise the property of dissolved firm:** Any right or power to realise the property of a dissolved firm, so that the partners of a dissolved firm can sue a third party to realise the property of the firm even though the firm was never registered.
8. **Jurisdictional exemption:** The rights of firms or partners of firms which are situated in an area exempted by the State Government under Sec.56 of the Act from the applicability of the provision of the Act relating to registration of firms are not affected by non-registration.

RELATION OF PARTNERS TO ONE ANOTHER

The relations of the partners of a firm to one another are usually governed by the agreement among them. Such an agreement may be expressed or may be implied from the course of dealings among them. It may be varied by consent of all of them and such consent may be expressed or may be implied by a course of dealing (Sec. 11(1)). Where there is no specific agreement or where the agreement is silent on a certain point, the relations of partners to one another as regards their rights and duties are governed by Sec. 9 to 17 of the Partnership Act.

Rights of a Partner

1. Right to take part in business
2. Right to be consulted
3. Right of access to accounts
4. Right to share in profits
5. Right to interest on capital
6. Right to interest on advances
7. Right to be indemnified
8. Right to the use of partnership property
9. Right of partner as agent of the firm
10. No new partner to be introduced
11. No Liability before joining
12. Right to retire
13. Right not be expelled

Duties of a Partner

Partnership is a contract of utmost good faith. The partner must act with utmost good faith as the very basis of partnership is mutual trust and confidence. According to Sec.9, which deals with the general duties of partners, partners are bound (a) to carry on the business of the firm to the greatest *common advantages*, (b) to be *just and faithful* to each other, and (c) to *render true accounts and full information* of all things affecting the firm to any partner or his legal representative. The other duties under Partnership Act are summed up as under.

1. To carry on business to the greatest common advantages
2. To observe faith
3. To indemnify for fraud
4. To attend to duties diligently
5. Not to claim remuneration
6. To share losses
7. To indemnify for wilful neglect
8. To hold and use property of the firm exclusively for the firm
9. To account for personal profits

firm operates as notice to the firm except in the case of a fraud on the firm committed by a third party with the consent of the partner. This follows from the general rule that a notice to an agent of matters relating to his agency is notice to the principal.

4. **Liability of a partner for acts of the firm (Sec.25) :** Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner. The significance of joint and several (independent) liability is that for every act of the firm partner can be sued individually and also jointly with other partners.
5. **Liability of the firm for wrongful acts of a partner(Sec.36) :** Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of the firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefore to the same extent as the partner.
6. **Liability of firm for misapplication (Sec.27) :** A firm is liable to make good the loss where :
   (a) a partner acting within the scope of his apparent authority receives money or property from a third party and misapplies it; or
   (b) the firm in the course of its business receives money or property from a third party, and the same is misapplied by any of the partners which it is in the custody of the firm.

RECONSTITUTION OF A FIRM

The reconstitution of a firm takes place when there is any change in the composition of the partnership. The various ways in which a firm is reconstituted are shown below.

ADMISSION OF A PARTNER [Section 31]

Subject to provisions of Section 30 (regarding minor partner), a person may be admitted as a partner either-

(i) with the consent of all the existing partners, or

(ii) in accordance with a contract already entered into between the existing partners for the admission of a new partner.

Liability of an Incoming Partner: An incoming partner is not liable for all the acts of the firm done before his admission. This general rule has two exceptions which are as follows:

(i) An incoming partner is liable for the acts done before his admission if (a) the new firm assumes the liabilities of the old firm, and (b) the creditors accept the new firm as their debtor and discharge the old firm from its liability.

(ii) A minor who, on attaining majority decides to become a partner, is liable for all acts of the firm done since he was admitted to the benefits of partnership.

An incoming partner is liable for all the acts of the firm done after his admission.

RETIREMENT OF A PARTNER

A partner may also retire from an existing firm. The partner who retires from an existing firm is known as a *'retiring partner'* or an *'outgoing partner'*. A partner may retire from the firm in any one of the following three modes:

1. By consent
2. By agreement
3. By notice

Liability of a Retiring Partner

1. Liability for the acts of the firm done before retirement
2. Liability for the acts of the firm done after retirement

Right of a Retiring Partner

1. Rights to carry on competing business
2. Right to share subsequent profits

EXPULSION OF A PARTNER

A partner cannot be ordinarily expelled from the firm. However, in certain exceptional cases, he can expelled by following prescribed procedure: (a) The power of explusion should be given to the partners by an express contract between them. (b) The power of explusion should be exercised by majority of the partners. (c) The power of expulsion should be exercised in absolute good faith.

All the above conditions must be satisfied before a partner is expelled from the firm. If these conditions are not satisfied, then the expulsion of the partner is not proper, and is without any legal effect. It may be noted that in case of improper or wrongful expulsion, the expelled partner does not cease to be a partner of the firm. But he is entitled to be reinstated in his position. However, he cannot recover damages for wrongful expulsion. The liabilities and rights of an expelled partner are the same as those of a retiring partner.

INSOLVENCY OF A PARTNER

When a partner is adjudicated an insolvent, he ceases to be a partner in the firm from the date of the order of adjudication, whether or not the firm is thereby dissolved. As a general rule, the adjudication of a partner as an insolvent causes a dissolution of the firm. But by the agreement between themselves, the partners can provide that the firm will not be dissolved by the insolvency of any partner. Thus the insolvency of a partner severs his connection with the firm.

The estate of the insolvent (which vests in the Official Assignee) is not liable for any act of the firm done after the date of adjudication. Similarly the firm is not bound by the act of such a partner after the date of adjudication.

DEATH OF A PARTNER (Section 35)

Ordinarily a firm is dissolved on the death of a partner. But if there is a contract to the contrary, a firm is not dissolved by the death of a partner. Section 35 deals with the case where the firm continues after the death of a partner. It lays down that the estate of a deceased partner is not liable for any act of the firm done after his death. In order that the estate of the deceased partner may not be liable for the future obligations of the firm, it is not necessary to give any public notice.

***Example** : Goods are ordered before but delivered after the death of one of the partners. The debt accrues after the delivery of the goods. Held that the estate of the deceased partner is not liable for the price even though the seller had no notice of the death.*

RIGHTS AND DUTIES OF PARTNERS AFTER A CHANGE IN THE FIRM

Change in Constitution : Section 17(a) provides that where a change occurs in the constitution of a firm, the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before such change. This rule is, however, subject to the contrary.

Firm continuing business after the expiry of its term : Section 17(b) provides that where a partnership constituted for a fixed term continues to carry on business after the expiry of that term, their rights and duties of the partners remain the same as they were before the expiry, so far as they may be consistent with the partnership at will.

Where additional undertakings are carried out : Section 17(c) provides that where a firm constituted to carry out one or more adventures or undertakings carries out other adventures or undertakings, the original agreement will govern the mutual relations between the partners.

Revocation of continuing guarantee (Section 38) : A continuing guarantee given to a firm, or to a third party in respect of the transactions of a firm, is, in the absence of contract to the contrary revoked as to future transactions from the date of any change in the constitution of the firm.

DISSOLUTION OF FIRM (Sections 39 to 47)

Meaning of Dissolution : The terms 'dissolution' stands for discontinuation. Under the Indian Partnership Act, 1932, the dissolution may be either of partnership or of a firm.

Section 39 of the Act provides that " the dissolution of partnership between all the partners of a firm is called the *dissolution of a firm* ". It implies the complete breakdown of partnership between all the partners. *Dissolution of partnership* merely involves a change in the relation of partners, whereas the dissolution of firm amounts to a complete closure of the business.

Distinction between Dissolution of Partnership and Dissolution of a Firm

	Basis of distinction	*Dissolution of partnership*	*Dissolution of firm*
1.	Termination of old partnership and formation of new partnership.	Old partnership comes to an end and a new partnership comes into existence.	Old partnership comes to an end but no new partnership comes into existence.
2.	Continuation of business under firm name	The business continues under firm's name.	The business does not continue under firm's name
3.	Revaluation Vs. Realisation.	Revaluation account is prepared.	Under firm's dissolution Realisation account is prepared.

Modes of Dissolution of a Firm : Section 40 to 44 the Partnership Act deals with the various modes in which a firm may be dissolved. a firm may be dissolved either with or without the intervention of the Court.

Dissolution Without the Intervention of the Court : (a) Dissolution by agreement between all the partners (Section 40). (b) Compulsory dissolution or dissolution by operation of law (Section 41.) (c) Dissolution of the happening of certain contingencies (Sec.42). (d) Dissolution of partnership at will by notice (Section 43).

Dissolution by Agreement (Section 40) : A firm may be dissolved (i) with the consent of all the partners, or (ii) in accordance with a contract between the partners. The consent required for dissolution should be the consent of all the partners. So, a majority of the partners have no power to dissolve the firm against the wishes of the minority.

Compulsory Dissolution (Section 41) : Compulsory dissolution of the firm means that the firm ceases to exist in the eyes of law. A firm is compulsorily dissolved, (i) when all or *all partners but one are adjudged insolvent* or (ii) when the *business of the firm becomes unlawful.* When a partner is insolvent, he cases to be partner from the date of adjudication. It follows that if all the partners are adjudged insolvent, or if all but one partner are declared insolvent, the firm cases to exists, for a firm must consist at least of two persons partners.

A firm is also compulsorily dissolved on the happening of any event which makes it, unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership. Section 41 (b) does not apply to a case where the partnership is illegal *ab initio:* such partnership would be void and no question of dissolution would arise. It refers to firm which has validly come into existence but has *subsequently become illegal* by the happening of a certain event. Where a firm is carrying on more than one adventure or undertakings, the illegality of one or more shall not itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

Dissolution on the happening of certain contingencies: A firm is dissolved - (a) by the *expiry of the term fixed*; (b) by the *completion of the adventure* or undertaking; (c) by the *death* of a partner; and (d) by the *insolvency* of a partner (Section 42).

The above provisions are subject to contract to the contrary. In other words, the partners may agree that even on the happening of the said contingencies, the firm shall not be dissolved

Dissolution by Notice of Partnership at Will (Section 43) : Partnership at will may be dissolved by any partner giving notice in writing to all other partners of his intention to dissolve the firm. An oral notice to only some of the partners will not be sufficient. It must not be vague. Once a notice is given it cannot be withdraw unless all the partners consent to such withdrawal.

The date of dissolution in the case of a partnership at will shall be (a) the date mentioned in the notice; or (b) if no such date is mentioned in the notice, when the notice is communicated to all the other partners.

Dissolution by the Court (Section 44)

Dissolution by the court may take place on any of the following grounds: (i) a partner becoming of *unsound mind*: (ii) permanent *incapacity* of a partner; (iii) misconduct of partner affecting the business; (iv) a partner committing wilful or *persistent breach of agreement*; (v) a partner selling or *transferring his interest.* (iv) when the business of the firm cannot be carried on *save at a loss*; (vii) for *any other reason* for which, in the opinion of the court, *dissolution is just and equitable*,

Section 44 enumerates the various ground on which a court may dissolve a partner ship. The power of the court to dissolve a firm is not subject to the contract between the partners. It rests with the discretion of the court to order dissolution. As the grounds mentioned above upon which a partner may apply for dissolution are not exhaustive, the Act in sub-section (g) permits a partner to seek dissolution on any other ground which would satisfy the Court that dissolution is just and equitable.

12. What are the statutory restrictions on the implied authority of a partner? Will the third party be affected by restrictions placed on the implied authority of a partner? Explain in detail.
13. What is meant by dissolution of a firm? When can a partnership be dissolved compulsorily by the court?
14. What are the different modes of dissolution of a firm?
15. How will you distingunish between 'dissolution of a firm' and 'dissolution of a partnership'?
16. What are the consequences of the dissolutions of a firm?
17. What are liabilities and rights of partners after dissolution of the firm? Does the partner's authority continue after the dissolution ? If yes, for what purposes?
18. State the rules governing settlement of accounts of the firm, and sale of goodwill, after dissolution.
19. Explain the different ways of reconstitution of a firm.
20. Write short notes on
    (i) Incoming and outgoing partners
    (ii) Retirement of a Partner
    (iii) Expulsion of a Partner
    (iv) Insolvency of a Partner
21. When and how, should a Public Notice be given under the Indian Partnership At? What are the consequences if such a notice is not given in the case of dissolution of the firm?

PRACTICAL PROBLEMS

Attempt the following problems, giving reasons for your answers :

1. A and B, two chartered accountants, agree to carry on practice in common at the office of A under the name " A and B" for a period of seven years. The terms of agreement entered into between them provide that B should manage the office and supervise the clerical work and that he should draw a fixed allowance of Rs. 15,000 per month in lieu of profits. It is further agreed that losses, if any, shall be borne by A alone, and that after seven years A would be entitled to the office and all the other equipments, and B would not have any right, or claim, in respect of them. Are A and B partners?

   {*Hint.* Yes, A and B are partners. In a partnership, partners are free to agree to any terms as regards sharing of profits. Again, sharing of losses is not necessary for becoming a partner. So also, partners may agree that on the dissolution of their partnership all the assets will belong to one partner only.}

2. A is the sole proprietor of a firm. He admits B as partner on the following terms: (i) B is not to bring any capital, (ii) B is not to be responsible for any loss, (iii) B is to receive Rs.10,000 per annum in lieu of profits, (iv) B is not to enter any contracts on behalf of the firm. Discuss the legal position of B.

   {*Hint.* B is a partner with A because to constitute to constitute a partnership neither contribution of capital nor active participation in management of the business is essential.}

3. M, a clerk in K's business entered into a verbal agreement with K for a share of profit and loss in the proportion of one-sixth to M and five-sixth to K. It was further agreed that the buildings in which the business was carried on should remain the property of K.M alleges that he is a partner and claims dissolution of the firm and an account of assets. K denies the partnership, and alleges that M is only a clerk. Decide.

   {*Hint.* In view of the surrounding circumstances of the case it is evident that M is only a clerk. It is an established fact that sharing of profits is not the sole test of partnership.}

4. A and B, two Kartas of two joint Hindu families consisting of M,N O and P,Q,R, as the member of the two families respectively, enter into a partnership for the benefit of their respective families and contribute from the family funds towards the capital of the partnership. Are M,N,O,P,Q and R partners?

{*Hint.* No,M,N,O,P,Q and R are not partners. In the eye of law it is a partnership between A and B, the two Kartas, each Karta being counted as one person, and the other members of the two families do not *ipso facto* become partners.}

5. P,Q,R,S and T, all adult members of a joint Hindu family convert their family business into partnership. Is the partnership valid?

{*Hint.* Yes, the partnership is valid, The law permits the members of a joint Hindu family to covert their family business into a contractual partnership.}

6. A introduces B to C his partner, when in fact he is not so, and B keeps silence. On the faith of the representation C gives credit to A. A becomes insolvent. Can C make B liable?

{*Hint.* Yes. C can make B liable on the principal of 'estoppel or holding out?'}

7. A and B are partners in a firm. X informs Y that he is also a partner in the firm of A and B. Y conveys this information to his friend C. C, believing X to be a partner of the firm of A and B, supplies goods on credit to the firm. Can C make X liable for the payment of the price of the goods remaining unpaid?

{*Hint.* Yes, C can make X liable for the payment of the price under the doctrine of 'holding out' because C has acted on the faith of the representation while giving credit to the firm. For making the doctrine of 'holding out' applicable it is not necessary that the representation must be made directly to the person so giving credit.}

8. P enters into a partnership with R, a minor, for the benefit of R.Is the partnership valid?

{*Hint.* No, the partnership is not valid. There must a partnership in existence before a minor, can be admitted to the benefits.}

9. R, a minor, was admitted to the benefits of a firm consisting of A,B and C, three adult partners. Within six months after attaining majority R gives public notice that he has become a regular partner. But A and B refuse to take him. Is A and B's refusal justified?

{*Hint.* No, A and B's refusal is not justified. R becomes a full-fledged partner as he has elected to become a partner within six months of his attaining majority, and other partners cannot refuse to take him as a partner.}

10. A and B were partners in an unregistered firm carrying on business of sugar manufacturing. C was advanced Rs. 1,000 by the firm in lieu of his promise to supply sugarcane. There was short supply of sugarcane and Rs. 700 were due from C to the partnership firm. The firm was afterwards dissolved and on division of assets of partnership this debt of Rs. 700 was allotted to A. Can A sue C to recover the amount?

{*Hint.* Yes, A can sue C to recover the amount of Rs. 700 because the unregistered firm or its partners are allowed to file a suit for the realisation of the assets upon the dissolution of the firm. The disability to sue disappears with the dissolution of the firm.}

11. A and B purchased a taxi to ply it in partnership. They had done business for about a year when A, without the consent of B, disposed of the taxi. B brought an action to recover his share in the sale proceeds. A's only defence was that the firm was not registered. Will B succeed in his suit?

{*Hint.* Yes, B will B succeed in his suit. As the business had been closed on the sale of the taxi, the suit in the question is for claiming share of the assets of a dissolved firm. Section 69(3) (a) specially protects the right of a partner of an unregistered firm to sue for the realisation of the property of a dissolved firm.}

12. X and Y are partners in a cloth business. X orders in firm's name and on the firm's letter-head to be supplied with two bags of wheat at his residence. Is the firm liable to pay the debt?

{*Hint.* No, the firm is liable to pay because X's act in question is beyond the scope of his implied authority for which the firm cannot be bound.}

13. A, B, C and D established a partnership for refining sugar. A was considered expert in the job of buying sugar. Thus A was entrusted with the duty of purchasing sugar for the firm. A himself was a wholesale dealer

CHAPTER - 22

THE NATURE OF A COMPANY

CHAPTER OUTLINE

THE COMPANIES ACT, 1956

DEFINITION OF A COMPANY

CORPORATION OR BODY CORPORATE

CHARACTERISTICS OF A COMPANY

LIFTING OF CORPORATE VEIL

KINDS OF COMPANIES

- CHARACTERED COMPANIES
- STATUTORY COMPANIES
- REGISTERED COMPANIES
- PUBLIC AND PRIVATE COMPANIES
- HOLDING AND SUBSIDIARY COMPANIES
- FOREIGN COMPANIES
- ONE MAN/FAMILY COMPANY
- PRODUCER COMPANY

DISTINCTION BETWEEN PARTNERSHIP AND COMPANY

The Company Legislation in India has developed on the lines almost parallel to the English Company Law. The Companies Act, passed from time to tome in India have been following the English Companies Act with certain modifications to suit Indian conditions. The English Companies Act of 1844 is treated to be the first enactment on modern system of joint stock enterprises. On that very line, the first Indian Companies Act providing for the registration of joint stock companies was passed in the year 1850.

THE COMPANIES ACT, 1956

The Indian Companies Act, 1913 was repealed by the present Companies Act of 1956 which came into force on 1st April, 1956. The present Companies Act is based largely on the recommendations of the Company Law Committee (Bhabha Committee) which submitted its report in March, 1952. This Act is the largest statute ever passed by our Parliament. It consists of 658 sections and 12 schedules. The Act was amended several times since 1956. The latest amendments were effected in 2000 and 2001.

Applications of the Act

The Act applies to the following companies :

1. The Companies formed or registered under the Act;
2. Companies formed or registered under previous companies laws i.e., existing companies (Sec. 561);
3. Companies formed or registered under any previous companies laws to the extent and the manner declared in part IX of the Act (Sec. 562).
4. Unlimited Companies registered as limited companies in pursuance of any previous companies laws (Sec. 563);
5. Unregistered companies for the purpose of winding up under Part X of the Act (Sec. 582, 592 and 589);
6. Foreign Companies (Sec. 592 and 602);
7. Insurance Companies except in so far as the provisions of the Companies Act 1956 are inconsistent with the provisions of Insurance Act, 1938 (IV of the 1938);
8. Banking Companies except in so far as the provisions of the Companies Act, 1956 are inconsistent with the provisions of the Banking Companies Act, 1959 (X of 1949).
9. Companies engaged in the generating or supply of electricity except in so far as the provisions of the Companies Act 1956 are inconsistent with the provisions of the Indian Electricity Act, 1910 or the Electricity Supply Act, 1948;
10. Such body corporate incorporated by any Act for the time being in force, as the Central Government may, by notification in Official Gazette.
11. Government Companies (Section 617);
12. Nidhis or mutual benefit societies declared as such by the Central Government by notification in the Official Gazette [Sec. 620-A(2)(b)].

The Act does not apply to

1. Companies established under the special Acts of Parliament such as the Reserve Bank of India, Life Insurance Corporation of India, State Transport Corporation etc.
2. Partnership firms.
3. Co-operative societies.
4. Societies which are governed by the Societies Registration Act, 1860.
5. Trusts which are governed by the Indian Trust Act, 1882.

Definition of Company

According to *Section 3(1)(i) of the Companies Act, 1956* a company means, "*A company formed and registered under this Act or an existing company*". An existing company means a company formed and registered under any of the previous Companies Law.

According to ***Lord Justice Lindley*** a company is, *"An association of many persons who contribute money or money's worth to a common stock and employed for a common purpose. The common stock so contributed is denoted in money and is 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*".

A company, thus may be defined as an incorporated association, which is an artificial person, having an independent legal entity, with a perpetual succession, a common seal, a common stock capital comprised of transferable shares and carrying limited liability in relation to its members.

Corporation or Body Corporate

A *corporation sole* is a corporation and constituted in a single person who, in right of some office or function, has corporate status. Examples of corporate sole are to be found in perpetual offices such as the President, Governors, Crown, Ministers, a public trustee. A corporation sole is not a "body corporate" for the purposes of the Companies Act 1956. It is still a legal person and as such can be member of a company. A *corporation aggregate* consists of a group of persons contemporaneously associated so that they form a single person, e.g., a limited company, a municipality, or a municipal corporation.

CHARACTERISTICS OF A COMPANY

1. ***Separate Legal Entity :*** A company formed and registered under the Companies Act is a distinct legal entity. It is a creation of law and is sometimes called *artificial person* being invisible and intangible. It is a fiction of law with legal, but no natural or physical existence. The principle that a company is a legal entity separate from the individuals who compose it is very clearly illustrated in the leading case of ***Saloman Vs. Saloman & Co. Ltd. (1897).*** Saloman had a boot business. He sold the business to a company named Saloman & Company Ltd., which he formed. There were seven members-his wife, daughter and four sons who took one share each and Saloman himself who took 20,000 shares. The price paid by the company to Saloman was £30,000; but instead of paying him cash, the company gave him £20,000 fully paid shares of each one £ and £10,000 in debentures. Owing to strike in the boot trade, the company was wound up. The assets of the company amounted to £ 6,000 only. Debts amounted to £ 10,000 due to Saloman and secured

by debentures and a further £ 7,000 due to unsecured creditors. The unsecured creditors claimed that as Saloman & Company Ltd. was really the same person as Saloman, he could not owe money to himself and that they should be paid their £ 7,000 first. It was held by the House of Lords that Saloman was entitled to £ 6,000 as the company was an entirely separate person from Salomia. The unsecured creditors got nothing.

Thus, Saloman's case established beyond doubt that in law, a registered company is an entity distinct from its members, even if one person holds all the shares in the company. There is no difference in principle between a company consisting of only two shareholders and a company consisting of two hundred members. In each case the company is a separate legal entity.

Lee Vs. Lee's Air Farming Co. Ltd. (1960) Of the 3,000 shares in a company, L held 2,999. He voted himself as the governing director and chief pilot at a salary. L was killed in an air crash while working for the company. His widow claimed compensation for the death to her husband while in the course of his employment. It was argued that no compensation was due because L and Lee's Air Farming Ltd. were the same person. The Privy Council applied Saloman's case and said that L was a separate person from the company he formed and compensation was payable.

2. ***Perpetual succession*** : Unlike a natural person a company never dies. It is an entity with a perpetual succession. Its existence is not affected by the death, lunacy and insolvency of its members.

3. ***Limited liability*** : Limited liability of members is another most important characteristic of a company. Their liability is limited to the face value of shares subscribed to by them. If the shares are fully paid up, their liability is nil. Where the assets of the company are insufficient to meet the claims of the creditors of the company, the members cannot be asked to pay anything more than what is due on the shares of the company held by them.

4. ***Common seal*** : As a company is an artificial person it cannot sign its name on a contract. Common seal is used as a substitute for its signature. Every company must have a seal with its name engraved on it. Anything done under an agreement between the company and the third party requires recognition of the company in the form of an official seal.

Every company must have a *common seal* and the name of the company must be engraved in legible characters on its seal; the penalty for contravention is Rs.500 (Section 147 of the Companies Act). The seal is used for execution of all important documents. "A company may be bound by a deed even when it has not affixed its seal if it acted on the deed and taken the benefits of the covenants therein". *(Mcdonold Vs.Johan Twiname Ltd. 1953. (A.E.I.R. 589)].*

Though the Companies Act or the model regulations in *Table A* of *Schedule I* do not provide for the form and manner in which the common seal of a company should be kept, i.e., whether a metallic one or a rubber stamp, the Department of Company Affairs, vide its Circular No.8/ 70 (147) 64-P.R, dt.8.12.64 observed that the working of Section 147 (1)(b) suggests that the view that only a metallic seal should be used is correct. Thus, in view of the above, *common seal of the company should be a metallic seal and not a rubber stamp.*

5. ***Transferability of shares*** : The shares of a company are freely transferable and can be sold or purchased in the share market. Section 82 of the Companies Act recognises the right of transferability of shares and provides that, "*the shares or other interest of any member shall be movable property transferable in the manner provided for in the articles of the company*".

6. ***Capacity to sue and be sued*** : On incorporation, a company acquires a separate and independent legal personality. As a legal person, it can sue and be sued in its own name.

7. ***Not a citizen*** : Although a company is a legal person having both nationality and domicile, it is not a citizen. As such, a company cannot, therefore, claim the protection of those fundamental rights which are explicitly guaranteed to citizens only, namely, the right of franchise.

8. ***Company's actions limited*** : A company cannot go beyond the powers of its charter-the memorandum of association. But once the powers have been laid down, it cannot go beyond unless the memorandum of association is itself altered prior to doing so.

9. ***Separate property*** : As a legal person, a company can own, enjoy and dispose of any property in its own name. No member can claim himself to be the owner of the company's property. The property of the company is not the property of the shareholders; it is the property of the company.

Consequences of the principle of separate corporate personality

- The shareholders shall have no insurance interest in the property of the company, (*Macaure Vs. Northern Assurance Co. Ltd.*)
- The persons who own its capital may also be its creditors or employees.
- When the shareholder dies, the company continues to exist. His shares, and not the assets of the company, vest in his personal representatives.
- The nationality of the company does not depend on the nationality of the shareholder. (*Janson Vs. Driefontein Mines Ltd.*)
- The property of the company is not the joint property of its shareholders.
- A company can also be prosecuted for wrongs done in its name. Being an artificial person, it can, however, be only fined, it cannot be imprisoned.

LIFTING THE CORPORATE VEIL

The general rule is that a *company is a legal person and is distinct from its members.* The principle is regarded as a curtain, a veil, or shield between the company and its members, thus protecting the latter from the liability of the former. But when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will regard the company as an association of persons. These cases are *exceptions to the principle in Saloman Vs Saloman &Co. Ltd.* In these exceptional cases, the law either goes behind the corporate personality to the individual members or ignores the separate personality of each company in favour of the economic reality constituted by a group of associated concerns. When this protection is taken away, the veil is said to have been lifted or pierced. The corporate veil is lifted in the following cases :

1. ***Determination of the Character*** : In times of war the court will lift the veil to see whether a company is controlled by enemy/aliens. Consequently, a company registered in England may be *'alien enemy'* if its agents or the persons who infact control its affairs, are alien enemies. [*Daimler Company Ltd. Vs. Continental Tyre & Rubber Ltd. (1960)*].

2. ***Where company is a mere cloak or sham*** : The court will lift the veil where the company is a mere cloak or sham i.e. where the device of incorporation is used for some illegal or improper purpose. [*(Jones Vs. Lipman (1962)*].
3. ***Where the company is acting as an agent of the shareholders:*** Where a company is acting as an agent for its shareholders, they will be liable for its acts. Whether it is acting as an agent is a question of fact in each case.
4. ***Protection of revenue*** : The courts may disregard the corporate entity of a company where it is used for tax evasion or to circumvent tax obligation. Further, where it is desired to establish the residential status/character of a company for tax purposes the court will lift the veil and find out where is central management its, and the place determines its residence.

Statutory Exceptions

1. ***Number of members below statutory minimum*** : If at any time the number of members of a company is reduced below two in the case of a private company or below seven in the case of a public company and it carries on business for more than six months while the number is so reduced, every member, who knows of this fact, will become liable to an unlimited extent for the payment of the whole debts of the company contracted during the time (section 45).
2. ***Company name not mentioned on a bill of exchange etc.:*** Where an officer of the company or any person signs on behalf of the company, a bill of exchange, promissory note, cheque or order for money or goods, wherein the name of the company is not mentioned, he is personally liable unless the amount is paid by the company. (Section 147).
3. ***Group accounts*** : The principle of separate legal entity may be disregarded where a company has subsidiaries and group accounts must be laid before the company in general meeting when the company's own Profit and Loss Account and Balance Sheet is so laid. (Section 212).
4. ***Fraudulent trading*** : If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors, the court may declare that any person(s) who were knowingly parties to the carrying on of such business are to be personally liable for the debts and other liabilities of the company. (Section 542).
5. ***Investigation into related companies*** : An inspector appointed under Section 239 by the Central Government may lift the veil of incorporation if he thinks it necessary for the purpose of investigation into the affairs of its subsidiary or holding company.

KINDS OF COMPANIES

1. Chartered Companies

The Crown, in the exercise of the royal prerogative, has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Such companies or corporations are known as *Chartered Companies*. Examples of this type of companies are Bank of England,

East India Company, Peninsular and Oriental Steam Navigation Company (1840) etc. The powers and the nature of business of a chartered company are defined by the charter which incorporates it.

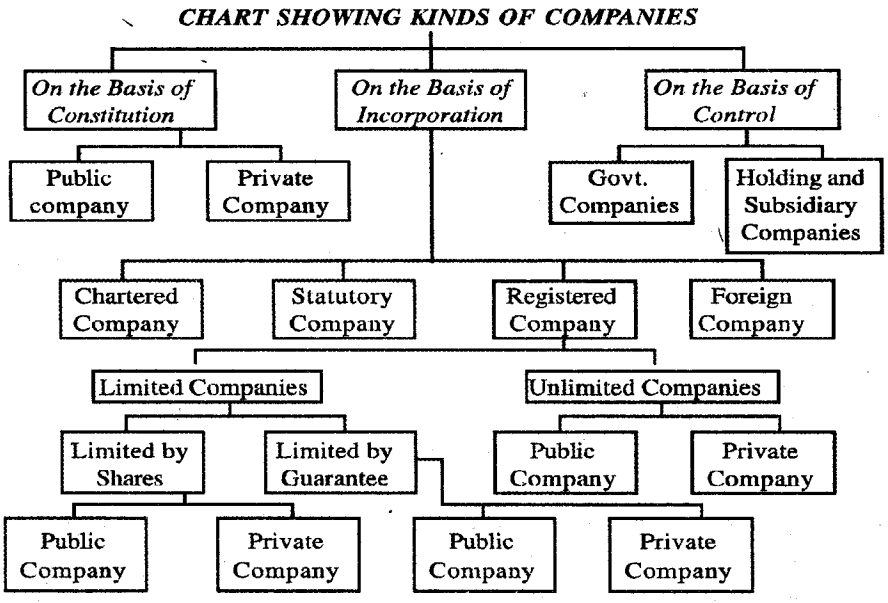
2. Statutory Companies

A company may be incorporated by means of a special Act of the Parliament or any State legislature. Such companies are called *Statutory Companies*. They are generally formed to carry out some special public undertaking. For example railway, waterworks, gas, electricity generation etc. Instances of statutory companies, (which are also known as *Public Corporations*) in India are Reserve Bank of India (RBI), The Life Insurance Corporation of India (LIC), The Food Corporation of India (FCI), Unit Trust of India (UTI), State Trading Corporation (STC) etc.

Statutory companies are governed by the Acts creating them. They are not required to have any memorandum or articles of association. Changes in their structure are possible only by amendment in the Acts creating them. The annual report on the working of each statutory company is required to be placed before the Parliament or the State Legislature as the case may be. A statutory company though owned by the Government has a separate legal entity. It cannot be regarded as a department of the Government. The provisions of the Companies Act, 1956 apply to the statutory companies except where the said provisions are inconsistent with the provisions of the Act creating them.

3. Registered Companies

Companies registered under the Companies Act, 1956, or the earlier Companies Act are called *registered companies*. Such companies come into existence when they are registered under the Companies Act and a certificate of incorporation is granted to them by the Registrar. Section 12(2) provides that a company registered under the Act may be (a) a company limited by shares, (b) a company limited by guarantee, and (c) an unlimited company.



(i) ***Companies limited by Shares :*** Companies limited by shares are the most common type of companies. This is a company where the liability of its members is limited to the amount fixed by the memorandum of the company, if any, unpaid on the shares respectively held by them. The liability can be enforced during the existence of the company as well as during the winding up. Where the shares are fully paid up, no further liability rests on them.

(ii) ***Companies limited by Guarantee :*** This is a company where the liability of its members is limited to such amounts as they may respectively undertake as fixed by the memorandum to contribute to the assets of the company in the event of its being wound up. In the case of such companies, as in the case of companies limited by shares, the liability of its members is limited, but it is limited to the amount of guarantee undertaken by them. For example, the Madras Stock Exchange is a company limited by guarantee. A company limited by guarantee may or may not have a share capital. If it has a share capital, the liability of the members is twofold; (i) liability to pay the share amount and (ii) the amount guaranteed. A guarantee company may not be suitable for ordinary business purposes. Clubs, trade associations, research associations and societies for promoting various objects are the examples of guarantee companies. Many such companies obtain permission of the Central Government to dispense with the word 'limited'.

(iii) ***Unlimited Companies :*** It is a company where the liability of its members is not limited at all. In such a company, the liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim rateable contribution from other members. The articles shall state the number of members with which the company is to be registered and if the company has a share capital, the amount of share capital with which the company is to be registered. An unlimited company may be converted into a limited company either limited by shares or limited by guarantee.

PUBLIC AND PRIVATE COMPANIES

Public Company : A public company means a company which is not a private company. There must be at least seven persons to form a public company. However, there is no maximum limit as to its number of shareholders or members. It is the essence of a public company that its articles do not contain provisions restricting the number of its members or excluding generally the transfer of its shares to the public or prohibiting any invitation to the public to subscribe for its shares or debentures. Generally speaking any member of the public may acquire shares in a public company on payment of the share money. The articles of a public company may, however, contain restrictions on the issue or transfer of shares. The company remains a public company despite such restrictions. Only the shares of a public company are capable of being dealt in on a stock exchange.

Private Company : A private company means a company which by its articles (i) restricts the rights to transfer its shares, (ii) limits the number of its members to fifty (excluding members who are or were in the employment of the company), and (iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company. [Section 3(1)(iii)].

Where two or more persons hold one or more shares in a company jointly, they shall be treated as a single member. There should be at least two persons to form a private company and the maximum number of members in a private company cannot exceed 50. A private limited company

is required to add the words "*Private Limited*" at the end of its name. The Companies Act does not specify in what manner the right to transfer shares must be restricted in the articles. The restriction as to transfer of shares must be made applicable in respect of all shareholders. There cannot be any discrimination. If a private company fails to comply with any of the restrictions contained in the articles, it ceases to be entitled to some of the privileges of a private company.

Sec. 3(1) (iii) of the Amendment Act, 2000 further provided (prohibited) that a *private company* should include following restrictions in its Articles i.e.,

(d) *Prohibit an invitation or acceptance of deposits* from persons other than its members, directors or their relatives.

Note : Question may arise as to whether the articles of existing companies need be amended to include this condition. Even if the articles are not amended, the provisions of section 9 will apply wherein it is stated that the provisions of the Act will supercede the provisions of the articles. However, it is desirable advisable as a good secretarial practice to alter the articles. It these restrictions are not there, the company will be treated as public company. Therefore, the articles of Association should be amended immediately by passing *Special Resolution* under section 31 to provide for restriction, in particular item (d) above.

(ii) It may be noted that after the above amendment no private limited company can take any loan/deposit or retain any loan/deposit taken from any outsider (other than its members, director's or their relatives.) Therefore, all private limited Companies will have to regularise this matter immediately.

(iii) Every private company should have paid up capital of Rs. One lac. Existing companies will have to issue new shares to ensure paid up capital of Rs. 1 lac within 2 years of commencement of Amendment Act. Such capital may be Equity or Preference

(iv) If paid up capital is not increased to Rs. 1 lac within 2 years the company will be deemed to be a defunct company under section 560, name of such a company will be struck off by Register of Companies.

Privileges of a Private Company : The Provisions of the Companies Act apply to public and private companies alike. But certain provisions of the Companies Act do not apply to a private company but are applicable to public companies. These may be regarded as the *privileges or advantages of a private company* which are as under :

1. A private company may consist of *two members only.*
2. A private company is *entitled to commence business immediately on incorporation.*
3. A private company may allot shares *without issuing a prospectus or delivering to the Registrar a statement in lieu of prospectus.*
4. A private company is not required to hold a *statutory meeting* or file a statutory report with the Registrar.
5. A private company can have a *minimum of two directors.*
6. The provisions of section 81 as regards *further issue of capital* do not apply to a private company.
7. A private company may issue not only equity and preference shares but also deferred shares or any other kind of *shares with disproportionate voting rights* as it may think fit.

8. A private company can give *financial assistance for purchase of its shares* or its holding company's shares.
9. Copies of Balance Sheet and Profit and Loss Account filed with the Registrar cannot be *inspected by* the public.
10. A director of a private company need not hold *the share qualification.*
11. Restrictions in regard to *overall managerial remuneration* imposed by Section 309 do not apply to a private company.
12. An *interested director* can participate in the Board proceedings and exercise his vote.

The privileges mentioned above are not available to a private company which is a subsidiary of a public company. It also applies to a private company which becomes a deemed public company by virtue of Section 43-A. Further, a private company ceases to be entitled to privileges mentioned above if, having made provisions required of a private company in its articles, the company makes a default in complying with any one of those provisions.

Distinction between Public Company and Private Company

1. ***Minimum number of members*** : The minimum number of persons required to form a public company is *seven*, whereas in private company it is only *two.*
2. ***Maximum number of members*** : There is *no limit* as to the maximum number of members of a public company, but a private company cannot have more than *fifty* members excluding past and present employees.
3. ***Commencement of Business*** : A private company can commence its business as soon as it is incorporated. But a public company shall not commence its business immediately unless it has been granted the *certificate of commencement of business.*
4. ***Invitation to public*** : A public company by *issuing a prospectus* may invite public to subscribe to its shares/debentures whereas a private company cannot extend such invitation to the public.
5. ***Transferability of shares*** : There is no restriction on the transfer of shares in the case of a public company whereas a private company by its articles must restrict the right of members to transfer the shares.
6. ***Number of directors*** : A public company must have at least *three* directors whereas a private company may have *two* directors.
7. ***Statutory Meeting*** : A public company must hold as statutory meeting and file with the Registrar a statutory report. But in a private company there are no such obligations.
8. ***Restrictions on appointment of directors*** : A director of a public company shall file with the Registrar a consent to act as such. He shall sign the memorandum and enter into a contract for *qualification of shares.* He cannot vote or take part in the discussion on a contract in which he is interested. Two-thirds of the directors of a public company must *retire by rotation.* These restrictions do not apply to a private company.
9. ***Managerial remuneration*** : Total managerial remuneration in the case of a public company cannot exceed 11% of the net profits, but in the case of inadequacy of profits, a minimum of Rs. 50,000 can be paid. These restrictions do not apply to a private company.

10. ***Further issue of capital*** : A public company proposing further issue of shares must offer them to the existing members. A private company is free to allot new issues to outsiders.

Conversion of Private Company into Public Company

Conversion by choice : A private company may deliberately choose to become a public company. If a private company deletes from its articles the requirements of section 3(i)(iii) by *passing a special resolution*, the company will cease to be a private company from date of the alteration of the articles. When a private company chooses to become a public company, it will have to comply with all the provisions of the Companies Act, applicable to a public company. Within 30 days of its becoming a public company, it shall *file with the Registrar a prospectus* or *a statement in lieu of prospectus.*

Conversion by default : A private company is entitled to certain privileges and exemptions. It can enjoy those privileges as long as it complies with the requirements of its definition as given in Section 3(i)(iii). Where any default is made in complying with these provisions (viz, restriction on transfer of shares, limitation of the number of members to 50 and prohibition of invitation to public to buy shares and debentures), the company loses the privileges and the exemptions and the provisions of the Act apply to the company as if it was not a private company. However, the company may be relieved of the consequences on an application made to the court, and the court is satisfied that the failure to comply with the conditions is not wilful or that it is just and equitable to grant relief. (Sec. 43).

Conversion by the operation of law : Private companies are exempted from the operation of several provisions of the Act and enjoy certain privileges principally on the ground that they are family concerns in which the public is not directly interested. As public money is invested in such companies, there is no reason for treating such companies as private companies. The law tries to tackle the problem by creating another type of company viz., *Deemed Public Company.* Actually it is a private company which, under certain circumstances, can be treated by the laws as the public company. Firstly where a private company is a subsidiary of a public company, it is dealt with as a public company for all purposes of the Act.

A private company shall also be deemed as a public company in the following cases : (a) Where it *invites public deposits* through an advertisement; (b) it *holds 25% or more of the paid up share capital of a public company*; (c) it has public company(ies) or deemed public company(ies) as its shareholders *holding in aggregate 25% or more of its paid up share capital*; (d) its average annual turnover for the last three consecutive financial years is ***Rs. 25 crores or more***. A private company which has become a public company by virtue of these provisions shall continue to be so until it has, with the approval of the Central Government and in accordance with the provisions of the Act, again become a private company. Provisions regarding 'deemed public companies' are deleted by the Companies Amendment Act, 2000.

Conversion of public company into private company : A public company may be converted into a private company by altering the articles incorporating the three restrictions mentioned in Section 3(i)(iii). Such alteration of articles will be made by a *special resolution* and the *approval of the Central Government* is necessary for such alteration. A copy of the special resolution has to *be filed with the Registrar within 30 days* and when the approval of the Central Government for conversion of a public company into private company is obtained, a copy of such approval

languages. It shall also have the name of the company and the country of incorporation stated in English on *business letters, bill heads, and letter papers and on all notices and other official publications of the company.*

4. **Winding up :** All foreign companies carrying on business in India may be wound up by an order of the Court as unregistered companies. It can also be wound up even if it has been dissolved or cease to exit according to its own law of incorporation (Section 584).

One-man Company and Family Company

These are companies in which one man holds virtually the whole of the share capital with a few extra members holding the remainder, who may be his relations or nominees. Being the largest holder, such a person is generally the sole or the managing director and enjoys complete control over the company. This is done with a view to fulfil the statutory requirement of at least seven members in the case of a public company and at least two members in the case of a private company. He is, thus, in a position to enjoy the profits of the business with limited liability. Such types of companies are perfectly valid and not illegal. As already established in *Saloman Vs. Saloman & Co. Ltd.,* such companies are legal entities distinct from the members.

Licensed Companies (or Companies not for Profit)

Section 25 of the Companies Act relates to licensed company. These licensed companies are *formed for a non-trading object or for a noble cause*, like the promotion of art, science, education, commerce, etc. Charitable associations, sports clubs, trade associations, chambers of commerce, etc, are examples of companies not for profit. Such companies can be formed only on obtaining the license from the Central Government or State Government i.e. they can be registered only after such licence. The Government has power to revoke the licence granted to such companies if it thinks fit on giving the company notice and after an opportunity to object.

Illegal Associations

Section 11 of the Act provides that *no company, association or partnership consisting of more than 10 persons in case of banking business and of more than 20 persons in the case of any other business* which has for its objects the acquisition of gain, can be legally formed unless it is registered under the Companies Act or is formed in pursuance of some other Indian law. If they are not so registered, they would be considered as illegal associations. The law does not recognise them being illegal.

Effect of an Illegal Association : An association or partnership which is not registered under Section 11 can have *no legal recognition as a separate legal entity.* The result of this is (a) Such an association cannot enter into any binding contract. (b) It cannot sue or be sued. But such an association may get itself registered and enforce its claims. (c) Such an association cannot be dissolved under the Act either at the instance of a creditor, a member, or the association itself. Every member of such an association shall be *personally liable for all liabilities incurred* in such business and shall also be liable to a fine which may extend upto Rs. 1,000.

Distinction Between Partnership and Company

1. ***Registration :*** Registration of a firm is not compulsory even under the Partnership Act, 1932 whereas incorporation/registration of a company is compulsory under the Companies Act, 1956.
2. ***No. of Members :*** Minimum two persons may constitute a partnership. Maximum membership in case of partnership doing banking business is ten persons and for other business is twenty persons, while minimum two and maximum fifty constitute private limited company and minimum seven and no maximum (unlimited) constitute a public limited company.
3. ***Legal Status :*** A firm has no individual legal status while a company has a separate legal existence of its own, and is considered a separate person from its members.
4. ***Property :*** Property of the firm is the property of the partners. On the country, in case of company property always belongs to the company.
5. ***Contracts :*** A partner cannot contract with the firm whereas a shareholder can contract with the company.
6. ***Management :*** Management in case of partnership vests in the hands of the active partners whereas in case of a company, management vests in the Board of Directors elected by the shareholders.
7. ***Life Duration :*** Partnership unlike company has no perpetual existence.
8. ***Liability :*** Partners of the firm are liable to an unlimited extent, i.e., in partnership there is an unlimited liability whereas the liability of shareholders is usually limited.
9. ***Creditors :*** Creditors of the firm are also creditors of the partners individually, whereas in the case of company, creditors are only the creditors of company and not of the individual shareholders.
10. ***Dissolution on Death :*** Death of partner may mean dissolution of partnership while the death of a shareholder or even of a director does not affect the existence of a company.
11. ***Agency Relationship :*** Every partner is an agent of the other partner, whereas the shareholder of a company is not an agent of the company.
12. ***Transfer of interest :*** A partner cannot transfer his interest in the firm without the consent of the other partners. A transferee becomes a partner of the firm only with the consent of the other partners whereas in case of a company shares are easily transferable and the transferee of a share becomes a members of the company without any difficulty.
13. ***Statutory obligations :*** Partnership has less statutory obligations under the Partnership Act, 1932 whereas a company is regulated strictly under the Companies Act, 1956.

REVIEW QUESTIONS

1. Define the term company. What are its characteristics?
2. "The company is a legal entity distinct from its members". In what cases do the courts disregard this principle?
3. Define a Private company. Distinguish it from a Public Company.
4. Discuss the privileges enjoyed by a private company over a public company. How can a private company be converted into a public company and vice versa?

Documents to be Filed : The application for registration of a company should be presented to the Registrar of Companies of the State in which the business office of the company is to be situated. The application shall be accompanied with the following documents.

1. The Memorandum of Association
2. The Articles of Association, if any, duly signed by the subscribers of the Memorandum.
3. A statement of the nominal or authorised capital.
4. A notice of address of the registered office of the company. This may be done within 30 days of registration if it cannot be filed at the time of registration.
5. A list of directors and their consent to act as such, signed by each.
6. An undertaking in writing signed by each such director to take and pay for their qualification shares.
7. A declaration that all the requirements (provisions) of the Companies Act have been complied with. Such a declaration may be signed by an *advocate* of the Supreme Court or High Court, an *attorney* or *pleader* entitled to appear before a High Court, or a *Chartered Accountant* practising in India, who is engaged in the formation of the company, or by a person named in the articles as *director, manager or secretary of the company.*

Items number 5 and 6 listed above are not required to be filed in the case of a private company.

If the Registrar is satisfied that all the requisite documents delivered to him are in order, he shall register the Memorandum and the Articles, if any, provided he is satisfied on the following points : (a) the relevant provisions of the Act have been complied with, (b) the objects of the company are lawful. (c) the requisite number of persons required under the Act have subscribed and duly signed, (d) the Memorandum and the Articles comply in all respects with the provisions of the Act, (e) the name selected by the company is acceptable; and (f) the statutory declaration has been properly made. If the Registrar of Companies is satisfied that all the aforesaid requirements have been complied with, he will register the company and place its name on the register of companies. It is clear that once the statutory requirements have been complied with, the Registrar has no option but no register it. On refusal to register a company on improper grounds, he may be compelled by a *Writ of Mandamus.*

Certificate of Incorporation

On registration, the Registrar will issue a certificate of incorporation whereby he certifies that the Company is incorporated. From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from its shareholders and secures a perpetual succession. Hence it is the *birth certificate* of the company. The certificate of incorporation prevents the reopening of matter prior to the registration and places the existence of the company as a legal person beyond doubt. Consequently, even if the seven signatures to a memorandum were written by one person or were all forged, the certificate would be conclusive that the company was duly registered. Similarly, if the signatories were all infants, the certificate would still be conclusive.

Certificate of Commencement of Business

A private company may commence its business immediately on incorporation but a public company cannot commences business immediately after incorporation, unless it has obtained a

certificate of commencement of business (also known as *Trading Certificate*) from the Registrar. If the company has a share capital and has issued a prospectus inviting the public to subscribe for its shares or debentures it cannot commence business until (a) shares payable in cash have been allotted to the extent of the minimum subscription : (b) every director has paid in cash the application and allotment money on the shares taken by him; (c) no money is liable to be repaid to the applications for failure to apply or obtain permission for the shares or debentures to be dealt in on any recognised stock exchange. (d) a statutory declaration duly verified by one of the directors or the secretary in the prescribed form that the above conditions have been complied with has been filed with the Registrar [Section 149(1)].

On the above requirements being duly fulfilled, the Registrar shall certify that the company is entitled to commence business. *This certificate is a conclusive evidence that the company is so entitled. [Section 149(3)]. Contracts made by the company before it has obtained the certificate of commencement are provisional* only and do not become binding on the company until it has become entitled to commence business. [Section 149(4)]. Where a company is wound up before it becomes entitled to commence business, anybody who has supplied goods cannot have any claim against the company. *A company is bound to commence business within a year of its incorporation or else it is liable to be would up by the Court.* [Section 433(c)].

PROMOTER

A promoter is one "*who undertakes to form a company with reference to a given object and to set it going and who takes the necessary steps to accomplish that purpose*" The promoters of a company decide the scope of its business activities. They negotiate, if necessary, for the purchase of an existing business. They instruct the solicitors to prepare the necessary documents and secure the services of directors. They provide the registration fees and carry out other duties involved in the formation of a company. They also make arrangements for advertising and circulating the prospectus, and placing the capital.

A promoter is not an agent for the company which he is forming because a company cannot have an agent before it comes into existence. For the same reason, he cannot be the trustee of the company. However, from the moment he acts with the company in mind, a *promoter stands in fiduciary position towards the company.*

Liabilities of promoters : A promoter can be compelled by the company to hand over any *secret profit* which he has made without full disclosures to the company. The company can also sue for the recession of the contract of sale by the promoter where the promoter has not disclosed his interest therein.

A promoter is liable for any *untrue statement in the prospectus* to a person who has subscribed for any shares or debentures on the faith of the prospectus. Such a person may sue the promoter for compensation for any loss or damage sustained by him.

Remuneration of promoters : The nature of the promoters work in the formation of a company calls for considerable skill for which he should be adequately remunerated. A promoter has no right against the company for his remuneration unless there is a contract to that effect. In the absence of such a contract, he cannot even recover from the company payments he has made in connection with the formation of the company.

Preliminary or Pre-Incorporation Contracts

Preliminary contracts are purported to be made on behalf of a company before its incorporation. Prior to this, a company has no capacity to contract. A contract entered into by promoters on behalf of a proposed company is void so far as the company is concerned. The promoters cannot be the agents for a principal of a which has not yet come into company existence. In such a case the company cannot sue or sue on it. The company has no legal existence until it is incorporated. The preliminary contracts made by promoters generally provide that if the company adopts the agreement, the promoters' liability shall cease and if the company does not adopt the agreement within a certain time either party may rescind the contract. In such a case the promoters, liability would cease after the lapse of the fixed time.

Provisional Contracts : Pre-incorporation contracts must be distinguished from contracts entered into by a company after incorporation, but before it becomes entitled to commence business. Contracts entered into by a company after its incorporation and before it is entitled to commence business are provisional only and are not binding on the company until the trading certificate is issued. Consequently, should the company go into liquidation, without commencing business, such contracts cannot be enforced at all.

Before 1963 (i.e. before passing of specific Relief Act) : A pre-incorporation contract never binds company, since a person (legal or artificial) cannot contract before his or its existence, and the company before incorporation has no legal existence. Even where articles purport to enforce such a contract, the company cannot be bound because ratification is not possible as the ostensible principal did not exist at the time the contract was made (*Kelner Vs. Baxter*).

After 1963 (i.e After passing of the Specific Relief Act, 1963) : Until the passing of the Specific Relief Act, 1963 the promoters found it very difficult to carry out the incorporation. Since contracts prior to incorporation were void and also could not be ratified, people hesitated to either supply any goods or work for the cause of incorporation. Promoters also felt shy of accepting personal responsibility. *The Specific Relief Act, 1963* came as a sigh of relief to the promoters. Secs 15 (h) and 19 (e) of the Act provide that when the promoters of a company have before its incorporation entered into a contract for the purposes of the company and such a contract can be enforced by or against the company. Thus, contracts like a contract for the preparation and printing of the Memorandum or Articles of association is the contract envisaged under this Act.

Distinction between Pre-incorporation and Provisional Contracts

	Pre-incorporation Contracts	*Provisional Contracts*
1.	Contracts which are entered into before the company comes into existence	Provisional Contracts are entered by a company after its incorporation but before commencement of its business.
2.	No effect so far as the company is concerned. to commence business.	Not binding until the company is entitled
3.	Can be enforced against the company only if warranted by terms of incorporation.	Cannot be enforced should liquidation without commencing business.

MEMORANDUM OF ASSOCIATION

Meaning : Memorandum of Association is one of the core documents which has to be filed with the Registrar of Companies at the time of incorporation of a company. It is a document which sets out the constitution of the company and is really the foundation on which the structure of the company is based. It contains the fundamental conditions upon which alone the company is allowed to be incorporated. A company may pursue only such objects and exercise only such powers as are conferred expressly in the memorandum or by implication therefrom i.e. such powers as are incidental to the attainment of the objects. A company cannot depart from the provisions contained in its memorandum, however, great the necessity may be. If it does, it would be *ultra vires* the company, and therefore wholly void. It defines its relation with the outside world and the scope of its activities. The purpose of the memorandum is to enable shareholders, creditors and those who deal with the company to know what is the permitted range of the activities of the enterprise.

Contents of Memorandum

According to Section 13, the Memorandum of Association of every company must contain the following clauses : 1. The *Name* of the company with 'Limited' as the last word of the name in the case of a public limited company and with 'Private Limited' as the last word in the case of a private limited company. 2. The State in which the *registered office* of the company is to be situated. 3. The *objects* of the company to be classified as (i) the main objects of the company to be pursued by the company on its incorporation and objects incidental to the attainment of the main objects, and (ii) Other objects not included above. 4. The *Liability* of members is limited if the company is limited by shares or by guarantee. 5. In the case of a company having a share capital, the amount of *share capital* with which the company proposes to be registered and its division into shares of a fixed amount. An unlimited company need not include items 4 and 5 in its memorandum. A brief discussion of the various clauses is as follows :

Name clause : A company may be registered with any name it likes. But no company shall be registered by a name which in the opinion of the Central Government is undesirable and in particular which is identical or which too nearly resembles the name of an existing company. Every public company must write the word 'limited' after its name and every private limited company must write the 'private limited' after its name. A company cannot adopt a name which violates the provisions of the *Emblems and Names (Prevention of Improper Use) Act 1950.* Every company is required to publish its name outside its registered office, and outside every place where it carries on business, to have its name engraved on a seal and to have its name on all business letters, bill heads, notices and other official publications of the company (Section 147).

Registered Office clause : This clause states the name of the State where the registered office of the company is situated. The registered office clause is important for two reasons. Firstly, it ascertains the domicile and nationality of a company. This domicile clings to it throughout its existence. Secondly, it is the place where various registers relating to the company must be kept and to which all communications and notice must be spent.

Objects clause : The objects clause is the most important clause in the memorandum of association of a company. It is not merely a record of what is contemplated by the subscribers, but it serves a two-fold purpose - (a) It gives an idea to the prospective shareholders the purposes

for which their money will be utilised. (b) It enables the persons dealing with the company to ascertain its powers. In case of companies which were in existence immediately before the commencement of the Companies (Amendment) Act 1965, the objects clause has simply to state the objects of the company. But in the case of a company to be registered after the amendment, the objects clause must state separately.

(i) ***Main Objects :*** This sub-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.

(ii) ***Other objects :*** This sub-clause shall state other objects which are not included in the above clause.

Liability Clause : This clause states that the liability of the members of the company is limited. In the case of a company limited by shares, a member is liable only to the amount unpaid on the shares taken by him. In the case of a company limited by guarantee, the members are liable to the amount undertaken to be contributed by them to the assets of the company in the event of its being wound up. However, this clause is omitted from the memorandum of association of the unlimited companies.

Capital Clause : The memorandum of a company limited by shares must state the authorised or nominal share capital, the different kinds of shares, the nominal value of each share. The chief point to consider in regard to this class is what funds are necessary to set the business going or, if it is proposed to by an existing concern, what sum is needed to pay its price and what, in addition, is wanted to keep the business going. It is generally advisable to have a reasonable amount of more capital and have some shares in reserve as unissued so that further capital may be raised as and when required.

Association or Subscription clause : This clause provides that those who have agreed to subscribe to the memorandum, must signify their willingness to associate and form a company. According to Section 12 of the Act, atleast *seven persons are required to sign the memorandum in the case of pubic company, and at least two persons in the case of private company.* The memorandum has to be signed by each subscriber in the presence of at least one witness who must attest the signatures. Each subscriber must write opposite his name the number of shares he shall take. No subscriber of the memorandum shall take less than one share. This clause need not be numbered.

ALTERATION OF MEMORANDUM

The Memorandum of association of a company being its charter, the right of the company to alter its contents is rigidly limited by the provisions of the Act. Section 16 of the Act provides that a company shall not alter the conditions contained in its memorandum except in the cases, in the manner and to the extent provided in the Act.

Change of Name

A company can change its name. For this purpose it must first pass a *special resolution* and then obtain *approval of the Central Government* in writing. However, no such approval is necessary for merely including or deleting the word 'Private' consequent on the conversion of the public company into private company and vice versa. (Section 21).

The Registrar shall enter the new name the register in place of former name and shall issue a fresh certificate or incorporation. Necessary alteration shall also be made in the memorandum by the Registrar. The change of name shall be complete and effective only on the issue of such a certificate. The rights and obligations of a company will not be affected on the change of its name (Section 23).

Change of Registered Office

A company can shift its registered office from one place to another within the same city, town or village, provided a *notice of change is given to the Registrar within 30 days of such change*. But, where the registered office is to be changed outside the local limits of any city, town or village in the same State, *special resolution* to that effect must be passed. However, the alteration of the change of the place of the registered office of a company from one state to another shall take effect only on the *confirmation by the National Company Law Tribunal (NCLT)* on petition. A notice of such change shall also be given to the Registrar within 30 days of the change. These two changes in the registered office do not involve alteration of memorandum.

Procedure for shifting Registered office from one State to another

A company can change its registered office from one State to another only for purpose specified in Section 17 (1) of the Companies Act, 1956 and for no other purpose.

1. *Resolution of the Board of Directors:* The first step in changing registered office is that the board of directors must adopt a resolution to that effect.
2. *Special resolution*: A special resolution must be passed by the company in the general body meeting of share holders/members (Sec.17(1).
3. *Confirmation by the NCLT:* the change shall not take effect unless and until it is confirmed by the NCLT on a petition by the company .(Sec17(2). Consequent to the Companies (Amendment) Act, 1996, the change of registered office requires no confirmation by NCLT.
4. *Notice to affected parties*: Before confirming the change the NCLT shall ensure that sufficient notice has been given to every person whose interest will be affected by the change and that the consent of the creditors of the company has been obtained or their debts or claims have been discharged or secured. (Sec.17(3)
5. *Notice to Registrar:* The NCLT shall cause notice of the petition for confirmation of the change to be served on the Registrar. The Registrar shall also be given a reasonable opportunity to appear before the CLB and state his objections and suggestions, if any, with respect to the confirmation of the alteration. (Sec.17(4).
6. The NCLT as it may think fit impose such terms and conditions.
7. *Copy of the order to be filed with ROC's*: A certified copy of the order confirming the alternation, together with a printed copy of altered memorandum shall be filed by the company with the registrar of each of the states who shall registrar the same. All the records of the company shall be transferred.

The aforesaid copy of the order must be filed within three months from the date or the order. The NCLT before confirming a resolution will satisfy itself that sufficient notice has been given to every creditor and all other persons whose interest are likely to be affected by the alternation

to every creditor and all other persons whose interest are likely to be affected by the alternation including the Registrar of Companies and the Government of the State in which registered office is situated. In *Orient Paper Mills Ltd. Vs. State of AIR (1957) Ori.232*, it was observed that a State whose interests are affected by the change of the registered office to a different States High Court declined to confirm of the shifting of the registered office from Orissa to West Bengal on the ground that the State has the right to protect its revenue and therefore the interest of the State must be taken into account.

But in *Minerva Mills Ltd. Vs. Govt. of Maharashtra* , the Bombay High Court held that the CLB cannot refuse confirmation of the shifting of the registered office on the ground of loss of revenue to a state or would adversely affect on the general economy of the State. Similar view was expressed in *Rank Film Distributors of India Ltd Vs. Registrar of Companies, West Bengal.*

Change of Registered Office within a State

(1) No company shall change the place of its registered office from one place to another within a State unless such change is confirmed by the Regional Director.

(2) The company shall make an application in the prescribed form to the Regional Director for confirmation under sub-section .

(3) The confirmation referred to in sub-section (1), shall be communicated to the company within four weeks from the date of receipt of application for such change.

Explanation - For the purposes of this section, it is hereby declared that the provisions of this section shall apply only to the companies which change the registered office from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same state.

(4) The company shall file, with the Registrar a certified copy of the confirmation by the Regional Director for change of its registered office under this section, within two months from the date of confirmation, together with a printed copy of the memorandum as altered and the Registrar shall register the same and certify the registration under his hand within one month from the date of filing of such document.

(5) The certificate shall be conclusive evidence that all the requirements of this Act with respect to the alteration and confirmation have been complied with and hence forth the memorandum as altered shall be the memorandum of the company".

Change of the Objects clause

Section 17 of the Act only gives a limited right to the company to alter its objects clause. This section provides specific purposes that the objects clause can be altered only if the change enables the company : (a) to carry on its business more economically or more efficiently; (b) to attain its main object by new or improved means; (c) to enlarge or change the local area of its operation; (d) to carry on some business, which under existing circumstances may be conveniently or advantageously combined with the business of the company; (e) to restrict or to abandon any of the objects specified in the memorandum; (f) to sell or dispose of the whole or any part of the undertaking of the company; (g) to amalgamate with any other company or body of persons.

The company can alter its objects clause only to the above named purposes. The Company Law Board has no jurisdiction to confirm any alteration which is not covered by Section 17(i).

The alteration must leave the business of the company substantially the same what it was before with only such changes in the mode of conducting it as will enable it to be carried on more economically or more efficiently. The additions or alterations should be a step in aid to improve efficiency and generate more resources.

Procedure : Before the company can alter object clause, it shall pass a *special resolution*, sanctioning the alteration. A copy of the special resolution shall be filed with the Registrar within 30 days of its passing. But the alteration shall not take effect unless it is *confirmed by the Company law Board on petition*. Before confirming, the National Company Law Tribunal shall see that sufficient notice of the petition has been given to all persons whose interests are likely to be affected by the proposed alteration. It may confirm the alteration either wholly or in part and on such terms and conditions as it may think fit. *A certified copy of the order of the Company Law Board together with a printed copy of the altered memorandum must be filed with the Registrar within three months of the order,* who shall register the same and issue a certificate of registration within one month. (Section 18). If the copy of the order is not registered within the prescribed period, the proceedings connected with the order will become void and inoperative. However, the Board may revive the order on an application made within one month of its lapse. (Section 19).

Change of Liability clause

Ordinarily the liability clause cannot be altered so as to make the liability of members unlimited. Any alteration in the memorandum will be void if the effect of the alteration is the enhancement of the liability of members. This provision, however, will not apply to a case where the members agree in writing to be bound by the alteration. (Section 38). A limited company, if authorised by its articles by a special resolution, may alter its memorandum to make the liability of its directors or manager unlimited. This rule applies to future appointees only. Such alteration will however not affect the existing directors and managers unless they have accorded their consent. (Section 323).

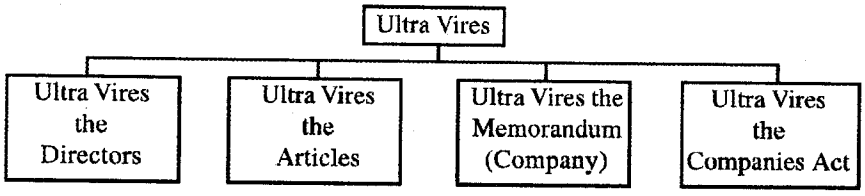
Change of the Capital clause

A limited company, having a share capital may alter its capital clause subject to the provisions of its articles by a resolution in the general meeting. The confirmation of the court is not required if alteration is made for any of the following purposes : (i) to increase its share capital. (ii) to consolidate and divide its capital into shares of larger amount. (iii) to convert its fully paid shares into stock and reconvert the stock into fully paid up shares. (iv) to subdivide its shares into shares of smaller amount, and (v) to cancel its shares. *But for reduction of share capital, special resolution and confirmation by the court are necessary.* For detailed discussion on the above, see chapter, *"Shares and Debentures"*.

DOCTRINE OF ULTRA-VIRES

A company has power to carry out the objects set out in the memorandum and also everything which is reasonably necessary to enable it to carry out those objects. Any activities not expressly or impliedly authorised by the memorandum are ultra-vires to the company. An act is said to be *ultra-vires* (beyond the powers) when it is performed which, though legal in itself, is not authorised by the objects clause in the memorandum of association or the statute.Such an act is *void and cannot be ratified* even by an unaniminous resolution of all the shareholders.

The doctrine of ultra vires was put in its modern form in the famous case of ***Ashbury Railway Carriage and Iron Co. Ltd. Vs. Riche***. There may be certain acts which are ultra-vires the directors or ultra-vires the articles but which are intra-vires the company. If an act is *ultra-vires the directors* only and the shareholders have ratified it, the company would be bound by it. Where an act is *ultra-vires the articles*, it can be ratified by altering the articles through a *special resolution*. Further, it an act is within the powers of the company, any irregularities seen can be cured by the consent of all the shareholders.



Effects of Ultra-vires Acts : An act which is ultra-vires the company is *absolutely void*. A company is not bound by and cannot enforce an ultra-vires contract. The effects of an ultra-vires are as follows.

1. As such a company may be *restrained by an injunction* to do an act if it is ultra-vires of its objects.
2. If the money borrowed has been used to pay-off debts which could have been enforced against the company, the lender may *sue the company being subrogated* to the rights of the creditors who were paid-off.
3. If the lender can identify his money, or other property purchased with it, he is entitled to what is known as a *tracing order* and can *recover*.
4. The lender may *hold the directors personally liable* for contracting an ultra-vires loan of the company. The directors are *liable for damages to the lender* for the breach of the implied warranty of authority.
5. If any money is unlawfully disbursed, the directors shall be personally liable to make good the amount.
6. Where the officers of a company persuade a third party to enter into a transaction which is ultra-vires the company, an action may lie against them in *breach of warranty of authority*.
7. An ultra-vires contract *cannot become intra-vires by reason of estoppel, lapse of time, ratification or delay*.
8. A company can *protect its property* acquired by an ultra-vires expenditure.
9. A company will be *liable for torts or crimes committed* in the pursuit of its stated objects.

ARTICLES OF ASSOCIATION

Meaning : The word *'Articles'* means the Articles of association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act. The Articles of association are the rules and regulations of a company framed for the purpose of internal management of its affairs. It deals with the rights of the members of the company

inter-se. The articles are framed for carrying out the aims and objects of the Memorandum of Association. The articles of association of a company are subordinate to and are controlled by the Memorandum of Association.

It is not obligatory to register Articles in the case of a public company limited by shares. In such a case, *model articles contained in 'Table A' of Schedule I of the Act* will apply. However, a private company, a company limited by guarantee and an unlimited company must register their articles alongwith the Memorandum. (Section 26). In the case of an unlimited company, the Articles shall state the number of the numbers, with which the company is to be registered, and if it has a share capital, the amount of share capital with which it is to be registered. [Section 27(1)]. In the case of a company limited by guarantee, the Articles shall state the number of members with which the company is to be registered. [Section 27(2)].

In the case of a private company, the Articles must contain provisions which (a) restrict the right to transfer its shares; (b) limit the number of its members to fifty excluding past and the present employees of the company; (c) prohibit any invitation to the public to subscribe for any shares in or debentures of the company. [Section 27(3)].

The Articles must be printed and divided into paragraphs, numbered consecutively. The articles must be signed by each subscriber of the memorandum in the presence of at least one witness who will atleast the signature and likewise add his address, description and occupation, if any. [Section 30].

Contents of Articles

1. Exclusion wholly or in part of *Table A*. 2. Adoption of preliminary contracts. 3. Number and value of shares. 4. Allotment of shares. 5. Calls on shares. 6. Lien on shares. 7. Transfer and transmission of shares. 8. Forfeiture of shares. 9. Alteration of share capital. 10. Share certificates. 11. Conversion of shares into stock. 12. Voting rights and proxies. 13. Rules of conducting Meetings. 14. Directors, their appointment etc. 15. Borrowing powers. 16. Accounts and audit. 17. Dividends and reserves. 18. Winding up.

Alteration of Articles

Companies have wide powers to alter their Articles. Any restriction on the exercise of their powers will be invalid. Articles of Association may be altered by a company by passing a *special resolution* to that effect. The altered Articles will bind the members in the same way as did the original Articles. The company must *file with the Registrar a copy of the special resolution within one month from the date of its passing.*

Section 31 of the Companies Act, 1956 vests companies with powers to alter or add to its Articles. A company cannot divest itself of these powers (*Andrews Vs. Gas Meter Co.(1897) I Ch.361*}. Matters as to which the Memorandum is silent can be dealt with by the alteration of Articles (Section 31(1)}. The alteration must be effected subject to the following limitations:

(i) the alteration must not exceed the powers given by Memorandum or conflict with the provisions thereof.

(ii) It must not be inconsistent with any provisions of the Companies Act or any other statute.

(iii) It must not be illegal.

(iv) It should not be in fraud of a minority or inflict a hardship on a minority subject to an important provision that whatever is done in the interest of the company can never be regarded as oppressive to the minority, however, hurtful it may be to the minority. *(Brown British Abrasive Wheel Co. (1919) 1 Ch.290: Side bottom Vs. Kershaw Least and Co.Ltd. 1 Ch.154.)*

(v) The alteration must not be inconsistent with an order of the Court. Where a company is compelled by a Court's order to change its Articles in cases of oppression or mismanagement any subsequent alteration thereof which is inconsistent with such an order can be made by the company only with the leave of the Court.

(vi) It may be regarded as having a retrospective effect so long as it does not affect the things already done by the company *(Allen Vs.Gulf Line (1909) S. C.732.)*

(vii) If a public company is converted into a private company then the approval of the Central Government is necessary {Section 31 (1) Provision}. Printed copy of altered articles shall be filed with the Registrar within one month of date of the Central Government's approval {Section 31(2)}.

It may further be noted than an injunction cannot be granted to prevent the adoption of new articles which constituted a breach of contract. But if the company acts on them it may be liable to damages*/Shirtlaw Vs.Southern Foundries Ltd.1940 A.C. 701(760)*

(viii) An alteration that has the effect of increasing the liability of a member to contribute to the company is not binding on a present member unless he has agreed there to in writing (Section 38.)

(ix) A reserve liability once created cannot be undone but may be cancelled on a reduction of capital (*Midland Railway Carriage Wagon Co.(1907) W.N.175*; (Section 99).

(x) Any irregular alternations which have been made and acted upon for many years are binding.

DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

1. **Contents and scope :** Memorandum of Association is the charter of the company and defines the scope of its activities. Articles of Association of the company is a document which regulates the internal management of the company. These are rules made by the company for carrying out the objects of the company as set out in the Memorandum.
2. **Relationship between company, members and outsiders:** Memorandum of Association defines the relation of the company with the outside world, whereas Articles of Association deals with the rights of the members of the company *inter-se* and also establishes the relationship of the company with the members.
3. **Alteration :** Memorandum of Association cannot be altered except in the manner and to the extent provided by the Act, whereas the Articles being only the byelaws of the company, can be altered by a special resolution.
4. **Supremacy :** Memorandum is a supreme document of the company, whereas Articles are subordinate to the Memorandum. They cannot alter or control the Memorandum.
5. **Adoption :** Every company must have its own Memorandum. But a company limited by shares need not register its Articles. In such a case *Table 'A'* applies.

6. **Ultra-vires Acts :** A company cannot depart from the provision contained in its Memorandum, and if it does, it would be ultra-vires the company. Anything done against the provisions of Articles, but which is intra-vires the Memorandum, can be ratified.

LEGAL EFFECT OF MEMORANDUM AND ARTICLES

The Memorandum and the Articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants by the company and each member to observe all the provisions of the Memorandum and the Articles [Section 36(1)].

The effect of these provisions is to constitute through the Memorandum and the Articles of Association of a company a contract between each member and the company. The effect and the implications of this section may be appreciated by considering, how far the memorandum and the articles bind. (i) The members to the company, (ii) the company to the members. (iii) the members inter-se and (iv) the company to the outsiders.

Members to the Company : As between the members and the company, each member of the company is bound to observe the various provisions of the Memorandum and Articles of association as if he had actually signed the same.

Company to the Members : The company is bound to the members by the various provisions contained in the Memorandum and the Articles of association in the same way as the members are bound to the company. The company can, therefore, exercise its rights as against any members only in pursuance of and in accordance with the Articles and the Memorandum. Any member is entitled to sue the company to prevent any breach of the Articles which would affect his right as a member of the company. Thus, where a right is conferred by the Articles on a shareholder to record his vote at a company meeting, the chairman of the meeting cannot deprive him on this right.

Members Inter-se : The Articles and the Memorandum do not constitute express agreement between the members of the company. Yet each member of the company is bound by the Memorandum and Articles on the basis of an implied contract to the other members. The articles regulate the rights of the members inter-se but such rights can be enforced only through the company.

Company to the Outsiders : Articles do not constitute any contract between the company and an outsider. This is because the outsider is not a party to the contract, and therefore, cannot sue on it. An outsider is not entitled to enforce the Articles against the company for any breach of right that is conferred on him by the Articles. Thus, a provision in the Articles to pay remuneration to the promoters constitutes no contract between them and the company on which they can sue the company for damages, if the remuneration is not paid to them. The term 'outsider' means a person who is not a member of the company. Even a member will be regarded as an outsider and he will not be in a position to enforce a right against the company if he enjoys the right in the capacity of a solicitor or a director and not in the capacity of a member.

CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES OF ASSOCIATION

The Memorandum and Articles of association of every company are required to be registered with the Registrar of Companies. *On registration they become public documents, and are open for public inspection on payment. Everyone dealing with the company, whether a shareholder or*

an outsider, is presumed to have read the two documents. He will be presumed to know the contents of these documents. This deemed knowledge of the two documents and their contents is known as the constructive notice of Memorandum and Articles. Accordingly, where a person deals with a company in a manner which is inconsistent with the provisions of the Memorandum or Articles, he must take the consequences in respect of such dealing.

Moreover, *the parties dealing with the company must be taken not only to have read these documents but also to have understood according to their proper meaning.*

Doctrine of Indoor Management (Rule in *Turquand* Case)

The Doctrine of Indoor Management is an exception to the rule of constructive notice. A person dealing with a company is deemed to have knowledge of the Memorandum and the Articles of Association of the company. So, if he enters into a transaction with the company which is ultra-vires of the Memorandum or Articles, he cannot treat the transaction as binding on the company. On the other hand, if the transaction appears to be proper one, when compared with the Memorandum and Articles, it would be grossly unfair if the company could escape liability under it by showing that there was some irregularity in the conduct of the company's affairs leading upto the transaction, when the other party did not know of the irregularity and had no means of discovering it.

The doctrine of indoor management is eminently practical and is based on business convenience, for business could not be carried on smoothly if a person dealing with the company was compelled to call for evidence that all internal regulations have been duly observed. The doctrine is not only convenient, it is also just. The lot of creditors of a company is not a particular happy one; it would be unhappier still if the company could escape liability by denying the authority of the officials to act on its behalf. The Memorandum and the Articles of a company are *public documents* and accessible to all who are to consult them; but the details of the internal procedures are not registered and not accessible to all.

The doctrine is however, subject to the following ***exceptions*** :

1. **Knowledge of irregularity :** A person, who deals with the company and who has knowledge in its internal management in connection with the subject-matter of his dealings, cannot claim the benefit of the rule in Turquand's case.
2. **Negligence :** A person cannot claim the benefit of the rule in Turquand's case in circumstances under which he would have discovered the irregularity if he had made proper inquiries.
3. **Forgery :** The rule in Turquand's case will not apply where a document on which the person seeks to rely is a forgery.
4. **Acts outside the apparent authority :** The rule in Turquand's case does not apply where a person acting on behalf of the company exceeds any actual or ostensible authority given to him.
5. **No Knowledge of the contents of the articles :** A person who has not actually read the Memorandum and Articles of a company and who was not at the time, he entered into the contract, aware of their contents, cannot seek to rely on statement contained therein. The doctrine of indoor management is based on the principle of estoppel, and therefore, it cannot be invoked in favour of a person who has not consulted the company's Memorandum and Articles of association.

REVIEW QUESTIONS

1. Describe the procedure relating to the formation of companies under the Companies Act 1956. Enumerate the various documents to be filed with the Registrar in connection with it.
2. What is the effect of issuing a certificate of incorporation? Can a court annual a certificate of incorporation which has been improperly issued?
3. Explain the term *promoter* and describe his legal status vis a-vis the company.
4. Discuss the duties and liabilities of a promoter. How can he realise the remuneration for the services which he renders to the company?
5. Discuss the steps that are to be taken before a company can commence its business.
6. 'The Memorandum of Association is the charter of the company'. Comment.
7. Discuss the contents of the Memorandum of Association.
8. By what method and to what extent may a company alter its Memorandum of Association?
9. Explain fully the doctrine of ultra-vires in relation to companies? What are the liabilities of a company and its agents for ultra-vires acts?
10. Define Articles of Association and give its contents.
11. Distinguish between Memorandum and Articles of Association.
12. What do you understand by the doctrine of indoor management? State the exceptions to it.
13. Explain the legal effects of Memorandum and Articles of Association of a company.
14. Write short notes on

    (a) Alteration of Object clause in a Memorandum (b) Constructive Notice (c) Doctrine of Indoor Management.

PRACTICAL PROBLEMS

1. The promoters of a company, before its incorporation, enter into an agreement with P to buy a sugar-mill on behalf of the company. After incorporation, the company refuses to buy the said sugar-mill. Has P any remedy either against the promoters or against the company?

   (*Hint* : P can sue the promoters in their personal capacity only.)
2. 'S' on the instructions of promoters of a company prepared Memorandum of Association and Articles of Association, paid the registration fees and got the company incorporated, 'S' claims his costs and charges from the company, but the company refuses to pay. Will 'S' succeed?

   (*Hint*: No. 'S' shall not succeed against the company but against the promoters personally. Based on the views held in the case of Re. English and Colonial Produce Company).
3. The Memorandum of Association and the Articles of Association of a company were delivered to the Registrar on June 10, for registration. On June 15, Registrar issued the Certificate of Incorporation but dated June 10. The company made allotment of its shares on June 12. The allotment is challenged on the ground that it was made before the actual date of incorporation Is the allotment of shares valid?

   (*Hint* : Yes. Allotment of shares is valid by virtue of Section 35 of the Act which declares that the certificate, once issued, is conclusive evidence that the company has been duly registered..)
4. A debt was contracted by the promoter for and on behalf of a public company before the date at which the company was entitled to commence its business. The promoter applied for shares in the company and debt was set off against payment in cash for allotted shares, Discuss the validity of the set-off.

   (*Hint* : The set-off is valid provided it is in good faith and bonafide. On the one hand cash was to be received and on the other, paid back to the company. Thus, a mere formality is absent.)

A public company may raise its capital by issuing shares or debentures. The public is invited to subscribe for its shares or debentures. The invitation containing the offer states the prospectus of the company and the purposes for which the capital is required. The document inviting the public to purchase the shares or debentures of the company is called a *Prospectus.*

Definition of Prospectus *:* Section 2(36) defines a prospectus as *"any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offer from the public for the subscription or purchase of any shares in, or debentures of, a body corporate".*

A prospectus is usually a circular or newspaper advertisement published by the promoters after the formation of the company to induce the public to take up shares in the company. The invitation must be sent to the public if the document is to be a prospectus.

FORMALITIES IN ISSUING A PROSPECTUS

1. Every prospectus issued by or on behalf of a company must be *dated* and that date shall unless the contrary is proved, be regarded as the date of its publication.
2. A copy of the prospectus *signed by every director* or proposed director or by his agent must be delivered to the Registrar on or before the date of publication. The prospectus issued to the public should mention that a copy of the prospectus along with the specified documents have been filed with the Registrar.
3. SEBI's Consent or authorisation i.e. acknowledgment from *Securities Exchange Board of India.*
4. *Every form of application* for subscribing the shares or debentures of a company shall not be issued, unless *it is accompanied by a copy of the prospectus.*
5. A prospectus must *contain the necessary information* to enable the public to decide whether or not to subscribe for its shares or debentures. Every prospectus shall state the particulars specified in part I and II of Schedule II.

CONTENTS OF A PROSPECTUS

The Government has revised the format of prospectus given in Schedule II of the Companies Act, 1956 w.e.f. 1-11-99. This has been done to provide for greater disclosure of information regarding the company, its management, the project proposed to be undertaken by the company, the *financial performance* of the company for the last five years and *management perception of risk factors* so as to enable the investors to take an informed decision regarding investment in shares or debentures offered through public issue. The company will also be required to furnish particulars in regard to *other listed companies under the same management* within the meaning of section 370(1B) of the Companies Act, which have made any capital issue during the last three years. The company will inform whether they have obtained *credit rating for* debenture/ preference share issue. A declaration will also have to be furnished to the effect that all the relevant provisions of the Companies Act, 1956 and the *guidelines issued by the government have been complied with* and no statement made in prospectus is contrary to the provisions of Companies Act, 1956 and rules made thereafter.

The Government has also prescribed rules on similar lines regarding salient features of the prospectus for the purpose of Sub-section (3) of Section 56 (*abridged prospectus*) of the Companies Act, 1956 and has prescribed new Form 2A in this regard.

Keeping in view the requirement of Schedule II of the Companies Act, 1956 and the SEBI guidelines for disclosure and investor protection, the prospectus to be issued by companies should provide for the following matters:

1. General Information

(a) *Name and address of registered office* of the company;

(b) *Details of letter of intent/industrial licence* obtained and disclaimer clause of SEBI about non-responsibility for financial soundness or correctness of statements;

(c) *Names of stock exchanges* where listed (if applicable) and where listing applications have been made for the issue;

(d) Provisions of Section 68A(1) of Companies Act, 1956 regarding fictitious applications.

(e) *Declaration regarding minimum subscription* and *refund of application money* in terms of Schedule II of Companies Act, 1956 and SEBI guidelines;

(f) *Dates of opening, closing and earliest closing of the issue*;

(g) *Names and addresses of lead managers, co-managers, trustees* (if applicable), legal advisors to the company, auditors, bankers to the issue, brokers to the issue and the secretary.

(h) Whether or not *credit rating* from any other recognised agency has been obtained for the proposed debenture issue should be mentioned. If rating is obtained, it should be indicated, preferably with implications of the rating symbol. In terms of SEBI guidelines, rating of a credit agency is mandatory for debentures with maturity period of more than 18 months.

(i) *Underwriting arrangements* made for the issue, names of underwriters, amount underwritten and declaration by Board of directors and the lead managers that in their opinion the resources of the underwriters are sufficient to discharge their underwriting obligations.

2. Capital Structure of the company and issue details

(a) Authorised, issued, subscribed and paid-up capital of the company.

(b) Size of the issue with break up of reservation for *preferential allotment* to promoters, shareholders of group/associate companies, financial institutions, mutual funds. NRI, permanent employees, etc. The *lock-in-period* in respect of shares/debentures to be allotted to promoters and shareholders of group and associate companies/employees/financial institutions should be mentioned. The maximum number of shares/debentures that can be allotted to each employee and the number of permanent employees in the company should be mentioned.

(c) Paid-up capital after the present issue and after conversion of debentures, if applicable.

3. Details of the issue

(a) Authority for the issue and details of resolutions passed for the issue.

(b) Terms of Payment : The amount payable on application, allotment and on calls should be stated. Further, in case of premium issues, the appropriation of application, allotment and call money towards capital and premium should be indicated. For debenture issues

(h) *Changes in directors* and auditors in the last three years, if any, and reasons therefore.

(i) *Procedure for making application* and availability of forms, prospectus and mode of payment.

(j) Procedure and time schedule for *allotment and issue of certificates.*

7. Financial Information

A report from the auditors on:

(a) *Profits and losses of the company* (where there is no subsidiary company) and the combined profits and losses of the subsidiaries or individual profits and losses of each subsidiary for each of the five financial years preceding the issue of prospectus (where there are subsidiaries);

(b) *Assets and liabilities of the company* (where there is no subsidiary company) at the last date to which the accounts are made up and the combined assets and liabilities of the subsidiaries or individually with the assets and liabilities of each subsidiary (where there are subsidiaries);

(c) *Rates of the dividends paid by the company* in respect of each class of shares for each of the five financial years preceding the issue of prospectus.

If no accounts have been made up in respect of any part of the period of five years ending three months before the date of issue of prospectus, the report should contain a statement of the fact. Further, a statement of accounts of the company should be made in respect of a part of the said period upto a date not earlier than six months of the date of issue of prospectus and the assets and liabilities position as at the end of that period. There should be a *certificate from the auditors that such accounts have been examined and found correct by them.*

The report should distinguish items of a nonrecurring nature and indicate the nature of provisions or adjustments made or are yet to be made.

8. Statutory and other information

(a) Minimum subscription, as laid down in the SEBI guidelines.

(b) Expenses of the issue giving separately fees payable to advisers, registrars to the issue, managers to the issue and trustees for debenture holders.

(c) Underwriting commission and brokerage.

(d) Previous issue for cash or consideration otherwise than for cash.

(e) Details of public or right issue during the last five years.

(i) Date of allotment and refund;

(ii) Date of listing on the stock exchange;

(iii) Amount of premium or discount, if applicable.

(f) Details of premium received in respect of any issue of shares made in the two years preceding the date of issue of prospectus or to be made stating the proposed date of the issue, the reasons for differentiation of premium for different categories, if applicable and the disposal of premia received or to be received.

(g) Commission or brokerage paid on previous issue.

(h) Debentures and redeemable preference shares and other instruments outstanding on the date of prospectus and the terms of their issue.

(i) Option to subscribe;

(j) Particulars of property purchased or proposed to be purchased from vendors to be paid for wholly or partly out of the proceeds of the issue and the interest of the promoters or directors in any transaction relating to the property within the last two years.

(k) Details of directors, proposed directors, whole-time directors, their remuneration, appointment and remuneration of the managing director(s).

(l) Interests of directors, their borrowing powers and qualification shares.

(m) Any amount or benefit paid or given within the two preceding years or intended to be paid or given to any promoter or officers and consideration for the payment or giving of the benefit.

(n) The dates of, parties to, and general nature of (i) every contract of appointment or remuneration of a managing director or manager; (ii) every other material contract, not being a contract entered into in the ordinary course of business of the company or entered into more than two years prior to the date of prospectus; Reasonable time and place for inspection of the contract should be provided for.

(o) Full particulars of the nature and extent of interest of every director or promoter. (i) in the promotion of the company; or (ii) in any property acquired by the company within two years of the date of the prospectus or proposed to be acquired by it.

(p) Rights of members regarding voting, dividend, lien on shares, modification of rights and forfeiture of shares/debentures.

(q) Restriction on transfer and transmission of shares/debentures and on consolidation/ splitting.

(r) Revaluation of assets, if any, during the last 5 years.

ADDITIONAL DISCLOSURES TO BE MADE IN PROSPECTUS

SEBI has directed that *lead managers* should ensure proper disclosures to the investors, keeping in mind their increased responsibilities consequent upon the notification of the Merchant Bankers Rules and regulations. The lead managers should, therefore, not only furnish adequate disclosures but also ensure due compliance with the *Guidelines for Disclosure and Investor Protection* issued by SEBI, both in letter and in spirit.

Lead Manager should ensure inclusion of the following information in the offer documents:

(i) *Disclaimer clause :* (To be printed in both in the offer document in Part I after Issue Details under the head "*General Information*"). "It is to be distinctly understood that the vetting of the draft prospectus/letter of offer by SEBI should not in any way be deemed/construed as approval from SEBI for the proposed Issue. SEBI does not take any responsibility for the financial soundness of any scheme or project of for the statements made or opinions expressed in the offer document. SEBI merely ensures, on the basis of information furnished to it, that adequate disclosures have been made in the offer document to enable the investors to take informed investment decisions".

(ii) *Reservation for Non-Resident (NRIs) Overseas Corporate Bodies (OCBs) in Public Issues:*

(a) "Name and address of at least one source in India from where individual NRI applicants can obtain the application forms" - at the appropriate place.

(b) "NRI applicants may please note that only such applicants as are accompanied by payment in free foreign exchange will be considered for allotment under the reserved category. Such NRIs who wish to make payment through Non-Resident Ordinary (NRO) accounts shall not use the forms meant for reserved category but must use the form meant for Resident Indians" - at the appropriate place.

(iii) *Stockinvest :* Manner of obtaining Stockinvest and disposal of applicants accompanied by Stockinvest as also a paragraph, on the following lines, at the appropriate place.

"Registrars to the issue have been authorised by the Company (through Resolution of the Board passed on ...) to sign on behalf of the Company to realise the proceeds of the Stockinvest from the issuing bank or to affix non-allotment advice on the instrument or cancel the stockinvest of the non-allotees or partially successful allottees who have enclosed more than one stockinvest. Such cancelled stockinvest shall be sent back by the Registrars directly to the investors".

(iv) *Buy-back arrangement for purchase of non-convertible portion (khokha) of partly convertible debentures:*

(a) Full information relating to the terms of offer or purchase including the name(s) of the party offering to purchase the Khokhas, the discount at which such offer is made and the ultimate price that would work out to the investor including the discount portion.

(b) Where no such arrangement has been disclosed in the offer document, the Lead Manager may not allow such offer being made during the period he is associated with the issue.

(v) *Performance vis-a-vis promises relating to previous issues :* In case of issuer has come out with a public or rights issue within the previous 3 years of the proposed issue, details relating to the objects of the previous issues, schedule of implementation thereof and the status against the same should be disclosed under the head.

(vi) *Deployment of proceeds of the issue :* The offer document shall give details of avenues of investment in which the management proposes to deploy issue proceeds pending utilisation in the proposed project.

(vii) *Stock market data :* Along with high/low and average prices of shares of the Company, during preceding 3 years details relating to volumes of business transacted should also be stated for respective periods.

(viii) *Statement relating to allotment and refund :* Lead manager shall ensure that the offer document does not contain statements to the effect that "... or in the event of unforeseen circumstances within such further time as may be allowed by the Stock Exchange Extension, if any, granted by the Stock Exchange would be without prejudice to the Company's liability to pay interest under Section 73 of the Companies Act, 1956".

The SEBI has also in its recent guidelines for disclosure and investor protection stated that every prospectus submitted to it shall, in addition to the requirements of Scheduled II of the Companies Act, contain/specify the followings information. Some of them to mention are:

An index of the contents of the prospectus, details of actual project expenditure, and its financing, details of bridge-loan, bifurcated details of turnover (separately) into products manufactured traded, not normally traded in, statement of assets and liabilities after providing for revaluation, a statement by directors regarding last financial statements affecting materially the profitability of the company if any, details of shareholding by the promoter group, stock market data, management perception of internal and external risk factors, discussion of the financial condition and results of the operations, details regarding major shareholders etc.

Legal significance : It was stated in earlier pages of this book that a company cannot normally vary at any time the terms of a contract in the prospectus and that it can do so only with the approval and authority obtained from its general meeting [Section 61]. Suppose, there is a condition in the prospectus, which requires or binds an applicant for shares or debentures to waive compliance with any of the requirements relating to statutory matters and reports. In such a case it will be void. Similarly, if there is a condition which has the effect of affecting him with the notice of any contract, document or a matter not specifically referred to in the prospectus, then such a condition shall be void [Section 56(2)].

Suppose, the requirement of Section 56 have not been complied with but the application for shares has been accepted by the company. Can the applicant ask for the rescission of the contract or rectification of the register? The answer is "no". But he can sue the person responsible for the issue of the prospectus for any damages he may have suffered *[South of England Natural Gas and Petroleum Co. (1911)].*

STATEMENT IN LIEU OF PROSPECTUS, (SECTION 70)

In some cases, companies are able to raise the original capital without inviting the public to subscribe. In such cases, the company need not issue a prospectus. Where a public company, which has a share capital does not issue a prospectus on its formation, it cannot allot any shares without first filing with the Registrar a document called *'Statement in lieu of Prospectus'*. This document must be in the form set out in Schedule III and must contain practically the same information as is required in the prospectus.

The document shall be delivered to the Registrar at least *three days before the first allotment of shares.* The statement must be *signed by every director* or proposed director or his agent. If a company fails to deliver a statement in lieu of prospectus, it cannot allot any shares or debentures. An allotment, if made, is *voidable if the allottee notifies the company within 2 months after the statutory meeting* or in case where there is no such meeting within two months after allotment.

If a company fails to fulfill the above conditions, the company and every director who has been knowingly a party to this contravention shall be *liable for fine upto Rs. 1,000.* If a statement in lieu of prospectus delivered to the Registrar contains an untrue i.e., a misleading statement, every person who authorised the delivery of the statement shall be *liable to imprisonment for two years and fine of Rs. 5,000.*

OFFER FOR SALE AND DEEMED PROSPECTUS (SEC. 64)

The provisions relating to a prospectus (as regards registration, contents and full disclosure) are very stringent and the duty of preparing and filing a prospectus in accordance with the law is extremely onerous. These requirements used to be evaded by companies in the past by allotting the whole of an issue of shares or debentures to an *Issuing House* at a certain price. The Issuing House then published an advertisement in the nature of an offer for sale inviting public to buy the shares or debentures from it at a higher price. *Sec. 64 now specifically provides that a document by which an 'offer for sale' is made to the public is within the definition of the prospectus.*

When applications are received by the Issuing House, it renounces its interest in the shares or debentures to the extent of the number of shares or debentures allotted in favour of the applicant. When this is done, the applicant becomes an allottee of the company. By this method of allotment, stamp duty is saved.

SHELF PROSPECTUS

(1) Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file as *shelf prospectus.*

(2) A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus.

(3) A company filing a shelf prospectus shall be required to file an *information memorandum* on all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, within such time as may be prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.

(4) An information memorandum shall be issued to the public along with shelf prospectus field at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities under that prospectus:

Provided that where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

Explanation - For the purpose of this section--

(a) "*financing*" means making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructure financing or, such other company as the Central government may notify in this behalf;

(b) "*Shelf prospectus*" means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

INFORMATION MEMORANDUM (Sec. 60B)

(1) A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.