INTRODUCTION TO COMPANY LAW

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1. History and Origin of Company Law in India

As we all know that India has drawn a lot of legislation from England. Similarly, in the case of Companies law, India enacted company law based upon the company law enacted in England. The three phases which influenced the Company legislations may be divided as:

i. Colonization era;
ii. Period after World War II;
iii. The Opening up of Indian markets in the year 1990.

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<u>Legislation Enacted</u>

In the year 1850, the first Company enactment for the registration of the joint-stock company was introduced in India. This enactment as mentioned before was based upon the English Companies Act, 1844.

Later in the year 1857, the concept of limited liability was recognised in the companies legislation but the said limited liability was not extended to the banking company. The concept of limited liability into the Companies Act was introduced earlier in the English Companies Act of 1856. But by the year of 1858, the concept of limited liability was extended to banking company even in India.

In the year 1866 Companies Act was yet again passed for consolidating and amending the laws relating to incorporation, regulation and winding up of trading companies and other associations. This Act was based upon the Companies Act 1862 of England. This Act was recast in the year 1882 and was in use until 1913.

In the year 1913 another Indian Companies Act was enacted based upon English Companies Consolidation Act, 1908. Companies Act of 1913 was amended in the year 1914, 1915, 1920, 1926, 1930 and 1932. But the major amendment to the Companies Act of 1913 who was made in the year 1936 this amendment was based upon the English Companies Act. 1929. The act of 1913 regulated the Indian business company until 1956.

By the end of 1950, Bhabha committee was set up under the chairmanship of H. C. Bhabha. For the difference of Indian Companies Act with reference to the development of Indian trade and industry.

The committee submitted its report on 1952, this report of Bhabha committee was accepted Companies (Amendment) Act, 1956. This legislation was made keeping in mind the English legislation of Companies Act in 1948.

<u>Origin of the Act of 1956</u>

The period of the Second World War and the post-war years witnessed an upsurge of Industrial and commercial activity on an unprecedented scale in India and large profits were made by businessmen through incorporated companies. The Government of India took up the revision of Company Law immediately after the termination of the last war. Two company lawyers, one

from Bombay and the other from Madras, were successively appointed to advise Government on the broad lines on which, the Indian Companies Act, 1913, should be revised and recast in the light of the experience gained during the war years. Their reports were considered by Government and a memorandum embodying its tentative views was circulated towards the end of 1949 for eliciting an opinion.

On 28th October 1950, the Government of India appointed a Committee of twelve members representing various interests under the chairmanship of Shri H. C. Bhabha, to go into the entire question of the revision of the Companies Act, with particular significance to the development of trade and industry of India. This Committee, popularly known as the Bhabha Committee, submitted its report in March, 1952, recommending comprehensive changes in the Companies Act of 1913. The report of the Bhabha Committee was again the subject of discussion and comment by Chambers of Commerce, Trade associations, professional bodies, leading industrialists, shareholders and representatives of labour. The Bill, which eventually emerged as the Companies Act, 1956, was introduced in Parliament on 2nd September 1953. IT was a comprehensive and consolidating as well as amending piece of legislation. The Bill was referred to a Joint Committee of both Houses of Parliament in May, 1954. The Joint Committee submitted its report in May, 1955, making some material amendments to the Bill. The Bill, as amended by the Joint Committee, underwent some further amendments In Parliament and was passed in November, 1955. The new Companies Act (I of 1956) came into force from 1st April, 1956.

Major Changes brought forth by the Companies Act 1956 over the Companies Act, 1931

1. Promotion and growth of Companies;
2. Capital structure of the Companies;
3. Company meetings and procedures;
4. Company accounts and its presentation & powers and duties of the auditors of the company;
5. Inspection and investigations of the affairs of the Company;
6. The constitution of the Board of Directors, Powers and functions of directors, Managing Directors and Managers; and
7. Administration of the Company Law.

Opening of the market gates to the Globe - 1990

The Era of liberalisation, privatization and globalisation saw the anachronistic Companies legislation made in time of closed market and hence inadequate to handle the global entry. This non-conducive legislation would have obstructed the Indian Corporate Sector. In pursuance to this necessity the Companies Bill, 1993 was formed but was later withdrawn. The Depositories Act, 1996 was introduced in India and later a working Group was constituted to rewrite the

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Companies Act, 1956. In pursuance to above made effort the Companies Bill, 1997 was introduced in Rajya Sabha on August 14, 1997 in order to replace the prior legislation.

The President of India promulgated the Companies (Amendment) Ordinance, 1998 on October 31, 1998. But this promulgated the Companies (Amendment) Ordinance, 1998 was soon replaced by the Companies (Amendment) Act, 1999.

The objectives of the Companies (Amendment) Act, 1999:

1. To surge the capital market by boosting the morale of the National business houses.
2. Fostering the FITs and Foreign Direct Investments in the country.

The changes brought by the Companies (Amendment) Act, 1999 are:

- A facility was introduced to allow the Corporate Sector to buy-back company's own share;
- Provisions relating to investments and loans were liberalised and rationalised;
- Requirement of prior approval of the Central Government on investment decisions was done away with and companies were allowed to issue "sweat equity" in lieu of the intellectual property;
- The compliance of the Indian Accounting Standard was made mandatory and the National Committee on Accounting Standard was also incorporated;
- The benefit of the investors was looked into by setting up "Investor Education and Protection Fund";
- Introduction of the nomination to shareholders, debenture holders, etc.

Later, the Companies (Amendment) Act, 2000 was enacted, which was followed by the Companies (Amendment) Act, 2001 wherein the Section 77A was introduced in relation to buy-back of the shares. This amendment allowed the Board of Directors to buy-back the shares upto 10% of the paid-up capital and free reserves provided not more than one such buu-back is made during the period of 365 days. Then, the Companies (Amendment) Act, 2002 was enacted which was followed by the Companies (Second Amendment) Act, 2002. The first amendment introduced the setting-up and regulation of the Cooperatives as a body corporate under the Companies Act, 1956 to be called 'Producer companies'. The Second Amendment was to expedite the winding-up process of the companies to facilitate rehabilitation of the sick companies and protection of workers interest.

The Companies (Amendment) Act, 2006, was brought into force on 1.11.2006 wherein it introduced the Director Identification Number (DIN) and also introduced electronic filing of various returns and forms.

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The New Enactment of the New Society

The Companies Act, 2013 replaced the Companies Act, 1956. The legislators introduced ideas of the likes of:

- Corporate Social Responsibility (CSR)
- Class action suits
- Fixed term for the Independent Directors
- The provision of raising money from the public was made little stringent
- Prohibition on insider trading by company directors or key managerial personnel by declaring such activities as a criminal offence
- It permits shareholder agreements providing for the 'Right of First Offer' or 'Right of first Refusal' even in the case of Public Companies

The Companies (Amendment) Act, 2015: It received the presidential assent on May, 2015 and became operate on 29th May, 2015. It is designed to address the issues of the stakeholders such as Chartered Accountants and other professionals.

Key Amendments brought in by the Companies (Amendment) Act, 2015 may be explained as follows:

I. No minimum Paid-up share Capital

No minimum paid-up share Capital requirements will now apply for incorporating private as well as Public Companies in India.

II. Relaxation in relation to related Party Transaction

In the case of related party transactions which requires stake-holders approval relaxation has been given wherein earlier required special resolution has been replaced by the ordinary resolution.

III. Inspection of the resolution filed with the Registrar

This Act has limited public access of such resolutions relating mainly to the strategic business matters. Such documents will no longer be available for the public to review or permitted to take copy of.

IV. Common Seal Optional

Under the Act of 2013 it was required to affix common seal on certain documents but, now after the Act of 2015, the use of the common Seal has been made optional although the common seal is one of the integral characteristics of a Company.

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V. Violations of Acceptance of Deposits

Companies Act of 2013 provisions in relation to the Acceptance/ renewal/ repayment of deposits. However no specific penalty prescribed for the new compliance with the relevant provision i.e. Section 13 and Section 76.

A new Section 76A has been introduced for these non-compliances. The defaulting company will be liable for a minimum fine of INR 1 crore and maximum amount of INR 100 crore in addition to the amount of deposit or part thereof along with interest.

VI. Dividend

The Companies Act, 2015 has introduced a proviso which states that a company must set-off the losses and depreciation carried over from past years against the profits of the company before declaring dividend for a financial year.

The Companies (Amendment) Act, 2017

The Companies (Amendment) Bill, 2016 was intended to be passed by the legislature, but after referring it to the Committee this Bill went through a lot of corrections and metamorphosed into The Companies (Amendment) Bill, 2017 which was then passed as the **Companies (Amendment) Act, 2017**. The salient features of the amendments brought by this Act are:

1. Synergy with SEBI and RBI Rules: For the first time, several provisions have been amended to align the Act with various rules and regulations of the SEBI (Security Exchange Board of India) and the RBI (Reserve Bank of India). For example, Sections 194 and 195 of the Act, which was dealing with the offence of insider trading and forward dealing, have now been omitted since the SEBI regulations were succinct to cover all.
2. The instances of such frauds: Further disclosures to be made in the prospectus have also been aligned with the SEBI's power to regulate IPOs (Initial Public Offering). The definition of 'debenture' has been amended to permit RBI to disqualify certain instruments as debentures.
3. Proportionality of penalties: The quantum of penalty will now be levied taking into consideration the size of the company, nature of business, injury to public interest, nature and gravity of default, repetition of default, etc which is one of the most appreciated amendments. Two new provisions regarding the determining of the level of punishment have been freshly introduced and lesser penalties for one person companies and small companies were inserted. Provisions for small companies and penal vigour has been reduced.
4. Placement process made easier in Private Sector: The placement process is rationalised by doing away separate offer letter details to be kept in the records of the Company and hence reducing the number of filings to Registrar. The company is not allowed to use money from private placement unless allotment made and the return of the same filed with the registrar To make sure that an investors

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are informed, the disclosures are made under Explanatory Statement as provided in Rule 13(2)(d) of Companies (Share Capital and Debenture) Rules, 2014, embodied in the Private Placement Application Form. Change in definition of private placement is proposed to umbrella all securities offers and invitations other than rights. The Companies would be allowed to make an offer of multiple security instruments simultaneously.

5. Standards for Independent Director: Section 149 of the Act deals with the qualifications and disqualifications of independent directors. Sub-Section (6) provides for various disqualifications for becoming an independent director, one of which is, such a person having "pecuniary relationship" with "the company, its holding, subsidiary or associate company, or their promoters, or directors". The amendment clarified that 'pecuniary relationship' excluded the remuneration of director having transaction not exceeding 10% of his total income or such amount as may be prescribed.

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<u>The Companies (Amendment) Act, 2019</u>

The Companies (Amendment) Act, 2019 received the assent of the President on the 31st July, 2019. While introducing the Bill in the Lok Sabha, the Hon'ble Finance and Corporate Affairs Minister, Nirmala Sitharaman said, "the Bill seeks to ensure more accountability and better enforcement to strengthen the corporate governance norms and compliance management in corporate sector as enshrined in the Companies Act, 2013".

In order to review the Companies Act and to gain better compliance, the Government of India constituted a Committee in July, 2018. The said Committee, after taking the opinions of several stakeholders of the Company, submitted its Report in August, 2018. The Committee recommended that serious offences must face rigour of law but technical mistake be given in-house adjudication for speedy redressal. Accordingly, proposal to amend certain provisions of the Companies Act, 2013 was made, however, in view of the urgency, the Companies (Amendment) Ordinance, 2018 was promulgated on November, 2018. To replace the aforesaid Ordinance, the Amendment Bill was introduced in Lok Sabha and passed, but Bill was not taken up in Rajya Sabha. Therefore, to continue the effect of prior ordinance the President promulgated the Companies (Amendment) Ordinance, 2019 on the 12th day of January, 2019 and the Companies (Amendment) Second Ordinance, 2019 on the 21stday of February, 2019. Then the Companies (Amendment) Bill, 2019 was passed by both the houses of parliament and became the law.

The Major reforms undertaken by the Ordinance of 2018 and 2019 include the following:

1. Re-categorisation of offences which are in the category of compoundable offences to an in-house adjudication framework. However, no change has been made for any of the non-compoundable offences.

2. Ensuring compliance of the default made and prescribing deterrent penalties in case of repeated defaults.

3. Delegation and De-clogging the NCLT by:

i. Enlarging the jurisdiction of Regional Director ("RD") by increasing the pecuniary limits up to which compounding of offences under Section 441 of the Act can take place.

ii. Vesting in the Central Government the power to approve the alteration in the financial year of a company under Section 2(41).

iii. Vesting the Central Government the power to approve cases of conversion of public companies into private companies so as to reduce the burden on the government and developing the sector.

iv. Other reforms include re-introduction of declaration of commencement of business provision; greater accountability with respect to filing documents related to creation, modification and satisfaction of charges; non-maintenance of registered office to trigger de-registration process; holding of directorships beyond permissible limits to trigger disqualification of such directors.

2. Definition

Section 3 (1) (i) of the Companies Act, 1956 defines a company as "a company formed and registered under this Act or an existing company". Section 3(1) (ii) Of the act states that "an existing company means a company formed and registered under any of the previous companies laws". This definition does not reveal the distinctive characteristics of a company. According to Chief Justice Marshall of USA, "A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation of its creation confers upon it either expressly or as incidental to its very existence".

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

According to Haney, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership".

From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

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3. Characteristics of a Company

The main characteristics of a company are:

i. Incorporated Association

A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

For forming a public company at least seven persons and for a private company at least two persons are persons are required. These persons will subscribe their names to the Memorandum of association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability [Sec 12 (1)].

ii. Artificial Legal Person

A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders. It was rightly pointed out in Bates V Standard Land Co. that : "The board of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them".

But for many purposes, a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name, and can sue and be sued in its own name.

However, it is not a citizen as it cannot enjoy the rights under the Constitution of India or Citizenship Act. In **State Trading Corporation of India v C.T.O** [1963 SCJ 705], it was held that neither the provisions of the Constitution nor the Citizenship Act apply to it. It should be noted that though a company does not possess fundamental rights, yet it is person in the eyes of law. It can enter into contracts with its Directors, its members, and outsiders.

Justice Hidayatullah once remarked that if all the members are citizens of India, the company does not become a citizen of India.

iii. Separate Legal Entity

A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of

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the company and nor for the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act. Where a company is required to pay Income-tax on its profits and when these profits are distributed to shareholders in the form of dividend, the shareholders have to pay income-tax on their dividend of income. This proves that a company that a company and its shareholders are two separate entities.

iv. Perpetual Existence

A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s). Law creates it and law alone can dissolve it. Members may come and go but the company can go on for ever. "During the war all the member of one private company , while in general meeting, were killed by a bomb. But the company survived; not even a hydrogen bomb could have destroyed i". The company may be compared with a flowing river where the water keeps on changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership.

v. Common Seal

As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself. It acts through natural person who are called its directors. But having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company. A company may have its own regulations in its Articles of Association for the manner of affixing the common seal to a document. If the Articles are silent, the provisions of Table-A (the model set of articles appended to the Companies Act) will apply. As per regulation 84 of Table-A the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorized by it in that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may appoint for the purpose, and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

vi. Limited Liability

A company may be company limited by shares or a company limited by guarantee. In company limited by shares, the liability of members is limited to the unpaid value of the shares. For example, if the face value of a share in a company is Rs. 10 and a member has already paid Rs. 7 per share, he can be called upon to pay not more than Rs. 3 per share during the lifetime of the company. In a company limited by guarantee the liability of members is limited to such

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amount as the member may undertake to contribute to the assets of the company in the event of its being wound up.

vii. Transferable Shares

In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires. However, in the case of a private company, the articles shall restrict the right of member to transfer their shares in companies with its statutory definition.

In order to make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares.

viii. Separate Property

As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

ix. Delegated Management

A joint stock company is an autonomous, self-governing and self-controlling organization. Since it has a large number of members, all of them cannot take part in the management of the affairs of the company. Actual control and management is, therefore, delegated by the shareholders to their elected representatives, known as directors. They look after the day-to-day working of the company. Moreover, since shareholders, by majority of votes, decide the general policy of the company, the management of the company is carried on democratic lines. Majority decision and centralized management compulsorily bring about unity of action.

4. Distinction between Company and Partnership

S.No.	**Basis**	**Company**	**Partnership**
1.	*Mode of creation*	By Registration by Statute.	By Agreement.
2.	*Legal Statute*	Legal entity distinct from members, perpetual succession.	Firm and partners are not separate; no separate entity; uncertain life.

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3.	*Liability*	Limited liability of members.	Unlimited joint and several liability of partners.
4.	*Authority*	Divorce between ownership and management. There is Representative Management.	Right to share management, common and ownership and Management. There is Mutual Agency hence Implied Authority.
5.	*Transfer of Shares*	Public Company: Freely transferable; transferee gets all the rights of the transferor.	Ordinarily no right of transfer of share by a partner-limited rights of transferee.
6.	*Number of Members*	Private Company: Minimum 2 and Maximum 50. Public Company: Minimum 7 and Maximum unlimited.	Minimum 2 and Maximum 20.
7.	*Resources*	Large and unlimited resources.	Personal resources of partners are limited.
8.	*General Powers*	Memorandum defines and confines the scope of the company. Alteration is difficult.	Easy to change the agreement and so also the powers of the partners.
9.	*Legal Formalities*	Statutory books, Audit, Publication Registration, filing, etc. lots of legal formalities.	No legal formalities Registration not compulsory. No audit, no publication of accounts etc.
10.	*Dissolution*	Only according to the provisions of law, usually by an order of the court. Death of a share- holder does not affect the existence of a company.	Dissolution by agreement, by notice, by court. Death of a partner may mean dissolution of partnership.

5. Lifting of Corporate veil

Corporate veil is a legal concept that separates the personality of a corporation from the personalities of its shareholders, and protects them from being personally liable for the company's debts and other obligations.

At times it may happen that the corporate personality of the company is used to commit frauds and improper or illegal acts. Since an artificial person is not capable of doing anything illegal or fraudulent, the façade of corporate personality might have to be removed to identify the persons who are really guilty. This is known as 'lifting of corporate veil'.

It refers to the situation where a shareholder is held liable for its corporation's debts despite the rule of limited liability and/of separate personality. The veil doctrine is invoked when shareholders blur the distinction between the corporation and the shareholders. A company or corporation can only act through human agents that compose it. As a result, there are two main ways through which a company becomes liable in company or corporate law: firstly through direct liability (for direct infringement) and secondly through secondary liability (for acts of its human agents acting in the course of their employment).

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There are two existing theories for the lifting of the corporate veil. The first is the "alter-ego" or other self-theory, and the other is the "instrumentality" theory.

The alter-ego theory considers if there is in distinctive nature of the boundaries between the corporation and its shareholders.

The instrumentality theory on the other hand examines the use of a corporation by its owners in ways that benefit the owner rather than the corporation. It is up to the court to decide on which theory to apply or make a combination of the two doctrines.

Concept of limited liability:

One of the main motives for forming a corporation or company is the limited liability that it offers to its shareholders. By this doctrine, a shareholder can only lose what he or she has contributed as shares to the corporate entity and nothing more. This concept is in serious conflict with the doctrine of lifting the veil as both these do not co-exist which is discussed by us in the paper in detail.

Development of the Concept of "Lifting the Corporate Veil"

One of the main characteristic features of a company is that the company is a separate legal entity distinct from its members. The most illustrative case in this regard is the case decided by House of Lords- **Salomon v. A Salomon & Co. Ltd**.

In this case, Mr. Solomon had the business of shoe and boots manufacture. 'A Salomon & Co. Ltd.' was incorporated by Solomon with seven subscribers-Himself, his wife, a daughter and four sons. All shareholders held shares of UK pound 1 each. The company purchased the business of Salomon for 39000 pounds, the purchase consideration was paid in terms of 10000 pounds debentures conferring charge on the company's assets, 20000 pounds in fully paid 1 pound share each and the balance in cash.

The company in less than one year ran into difficulties and liquidation proceedings commenced. The assets of the company were not even sufficient to discharge the debentures (held entirely by Salomon itself) and nothing was left to the insured creditors. The House of Lords unanimously held that the company had been validly constituted, since the Act only required seven members holding at least one share each and that Salomon is separate from Salomon & Co. Ltd.

The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are distinct and separate from those of its members; it can sue and be sued exclusively for its purpose; liability of the members are limited to the capital invested by them.

Further in **Lee v. Lee's Air Farming Ltd.**, it was held that there was a valid contract of service between Lee and the Company, and Lee was therefore a worker within the meaning of the Act. It was a logical consequence of the decision in Salomon's case that one person may function in the dual capacity both as director and employee of the same company.

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In **The King v Portus; ex parte Federated Clerks Union of Australia**, where Latham CJ while deciding whether or not employees of a company owned by the Federal Government were not employed by the Federal Government ruled that the company is a distinct person from its shareholders. The shareholders are not liable to creditors for the debts of the company. The shareholders do not own the property of the company.

In course of time, the doctrine that a company has a separate and legal entity of its own has been subjected to certain exceptions by the application of the fiction that the veil of the corporation can be lifted and its face examined in substance.

Thus when "Tata Company" or "German Company" or "Government Company" is referred to, we look behind the smoke-screen of the company and find the individual who can be identified with the company. This phenomenon which is applied by the courts and which is also provided now in many statutes is called "*lifting of the corporate veil"*. As a consequence of the lifting of the corporate veil, the company as a separate legal entity is disregarded and the people behind the act are identified irrespective of the personality of the company. So, this principle is also called *"disregarding the corporate entity"*.

Meaning of the Doctrine

Lifting the corporate refers to the possibility of looking behind the company's framework (or behind the company's separate personality) to make the members liable, as an exception to the rule that they are normally shielded by the corporate shell (i.e. they are normally not liable to outsiders at all either as principles or as agents or in any other guise, and are already normally liable to pay the company what they agreed to pay by way of share purchase price or guarantee, nothing more).

When the true legal position of a company and the circumstances under which its entity as a corporate body will be ignored and the corporate veil is lifted, the individual shareholder may be treated as liable for its acts.

The corporate veil may be lifted where the statute itself contemplates lifting the veil or fraud or improper conduct is intended to be prevented.

"It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of public interest, the effect on parties who may be affected, etc.". This was iterated by the Supreme Court in **Life Insurance Corporation of India v. Escorts Ltd.**

The circumstances under which corporate veil may be lifted can be categorized broadly into two following heads:

1. Statutory Provisions
2. Judicial interpretation

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Statutory Provisions

Section 5 of the Companies Act defines the individual person committing a wrong or an illegal act to be held liable in respect of offenses as 'officer who is in default'. This section gives a list of officers who shall be liable to punishment or penalty under the expression 'officer who is in default' which includes a managing director or a whole-time director.

Section 45: Reduction of membership below statutory minimum: This section provides that if the members of a company is reduced below seven in the case of a public company and below two in the case of a private company (given in Section 12) and the company continues to carry on the business for more than six months, while the number is so reduced, every person who knows this fact and is a member of the company is severally liable for the debts of the company contracted during that time.

In the case of **Madan lal v. Himatlal & Co**. the respondent filed suit against a private limited company and its directors for recovery of dues. The directors resisted the suit on the ground that at no point of time the company did carry on business with members below the legal minimum and therefore, the directors could not be made severally liable for the debt in question. It was held that it was for the respondent being *dominus litus,* to choose persons of his choice to be sued.

Section 147: Misdescription of name: Under sub-section (4) of this section, an officer of a company who signs any bill of exchange, hundi, promissory note, cheque wherein the name of the company is not mentioned is the prescribed manner, such officer can be held personally liable to the holder of the bill of exchange, hundi etc. unless it is duly paid by the company. Such instance was observed in the case of Hendon v. Adelman.

Section 239– Power of inspector to investigate affairs of another company in same group or management: It provides that if it is necessary for the satisfactory completion of the task of an inspector appointed to investigate the affairs of the company for the alleged mismanagement, or oppressive policy towards its members, he may investigate into the affairs of another related company in the same management or group.

Section 275- Subject to the provisions of Section 278, this section provides that no person can be a director of more than 15 companies at a time. Section 279 provides for a punishment with fine which may extend to Rs. 50,000 in respect of each of those companies after the first twenty.

Section 299- This Section gives effect to the following recommendation of the Company Law Committee: "It is necessary to provide that the general notice which a director is entitled to give to the company of his interest in a particular company or firm under the proviso to sub-section (1) of section 91-A should be given at a meeting of the directors or take reasonable steps to secure that it is brought up and read at the next meeting of the Board after it is given. The section applies to all public as well as private companies. Failure to comply with the requirements of this Section will cause vacation of the office of the Director and will also subject him to penalty under sub-section (4).

Sections 307 and 308- Section 307 applies to every director and every deemed director. Not only the name, description and amount of shareholding of each of the persons mentioned but also the nature and extent of interest or right in or over any shares or debentures of such person must be shown in the register of shareholders.

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Section 314- The object of this section is to prohibit a director and anyone connected with him, holding any employment carrying remuneration of as such sum as prescribed or more under the company unless the company approves of it by a special resolution.

Section 542- Fraudulent conduct: If in the course of the winding up of the company, it appears that any business of the company has been carried on with intent to defraud the creditors of the company or any other person or for any fraudulent purpose, the persons who were knowingly parties to the carrying on of the business, in the manner aforesaid, shall be personally responsible, without any limitation of liability for all or any of the debts or other liabilities of the company, as the court may direct. In *Popular Bank Ltd., In re* it was held that section 542 appears to make the directors liable in disregard of principles of limited liability. It leaves the Court with discretion to make a declaration of liability, in relation to 'all or any of the debts or other liabilities of the company'. This section postulates a nexus between fraudulent reading or purpose and liability of persons concerned.

Judicial Interpretations

By contrast with the limited and careful statutory directions to 'lift the veil' judicial inroads into the principle of separate personality are more numerous. Besides statutory provisions for lifting the corporate veil, courts also do lift the corporate veil to see the real state of affairs. Some cases where the courts did lift the veil are as follows:

1. ***United States v. Milwaukee Refrigerator Transit Company****:* In this case, the U.S. Supreme Court held that "where the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will disregard the corporate entity and treat it as an association of persons."

   Some of the earliest instances where the English and Indian Courts disregarded the principle established in Salomon's case are:

2. ***Daimler Co. Ltd. v. Continental Tyre and Rubber Co. (Great Britain) Ltd****:* This is an instance of determination of the enemy character of a company. In this case, there was a German company. It set up a subsidiary company in Britain and entered into a contract with Continental Tyre and Rubber Co. (Great Britain) Ltd. for the supply of tyres. During the time of war, the British company refused to pay as trading with an alien company is prohibited during that time. To find out whether the company was a German or a British company, the Court lifted the veil and found out that since the decision making bodies, the board of directors and the general body of shareholders were controlled by Germans, the company was a German company and not a British company and hence it was an enemy company.

3. ***Gilford Motor Co. v. Horne****:* This is an instance for prevention of façade or sham. In this case, an employee entered into an agreement that after his employment is terminated he shall not enter into a competing business or he should not solicit their customers by setting up his own business. After the defendant's service was terminated, he set up a company of the same business.

   His wife and another employee were the main shareholders and the directors of the company. Although it was in their name, he was the main controller of the business and

the business solicited customers of the previous company. The Court held that the formation of the new company was a mere cloak or sham to enable him to breach the agreement with the plaintiff.

4. ***Re, FG (Films) Ltd**:* In this case the court refused to compel the board of film censors to register a film as an English film, which was in fact produced by a powerful American film company in the name of a company registered in England in order to avoid certain technical difficulties. The English company was created with a nominal capital of 100 pounds only, consisting of 100 shares of which 90 were held by the American president of the company. The Court held that the real producer was the American company and that it would be a sham to hold that the American company and American president were merely agents of the English company for producing the film.
5. ***Jones v. Lipman**:* In this case, the seller of a piece of land sought to evade the specific performance of a contract for the sale of the land by conveying the land to a company which he formed for the purpose and thus he attempted to avoid completing the sale of his house to the plaintiff. Russel J. describing the company as a "devise and a sham, a mask which he holds before his face and attempt to avoid recognition by the eye of equity" and ordered both the defendant and his company specifically to perform the contract with the plaintiff.
6. ***Tata Engineering and Locomotive Co. Ltd. State of Bihar**:* In this case, it was stated that a company is also not allowed to lay claim on fundamental rights on the basis of its being an aggregation of citizens. Once a company is formed, its business is the business of an incorporated body thus formed and not of the citizens and the rights of such body must be judged on that footing and cannot be judged on the assumption that they are the rights attributable to the business of the individual citizens.
7. ***N.B. Finance Ltd. v. Shital Prasad Jain:*** In this case the Delhi High Court granted to the plaintiff company an order of interim injunction restraining defendant companies from alienating the properties of their ownership on the ground that the defendant companies were merely nominees of the defendant who had fraudulently used the money borrowed from the plaintiff company and bought properties in the name of defendant companies. The court did not in this case grant protection under the doctrine of the corporate veil.
8. ***Shri Ambica Mills Ltd. v. State of Gujarat**:* It was held that the petitioners were as good as parties to the proceedings, though their names were not expressly mentioned as persons filing the petitions on behalf of the company. The managing directors in their individual capacities may not be parties to such proceedings but in the official capacity as managing directors and as officers of the company, they could certainly be said to represent the company in such proceedings. Also as they were required to so act as seen from the various provisions of the Act and the Rules they could not be said to be total strangers to the company petition.

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6. Types of Companies

Classification of Companies by Mode of Incorporation

I. Chartered companies

These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charted, the Sovereign can annul the latter and close the company. Such companies do not exist in India.

II. Statutory Companies

These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alternations in the powers of such companies can be brought about by legislative amendments.

The provisions of the Companies Act shall apply to these companies also except in so far as provisions of the Act are inconsistent with those of such Special Acts [Sec 616 (d)].

These companies are generally formed to meet social needs and not for the purpose of earning profits.

III. Registered or Incorporated Companies

These are formed under the Companies Act, 1956 or under the Companies Act passed earlier to this. Such companies come into existence only when they are registered under the Act and a certificate of incorporation has been issued by the Registrar of Companies. This is the most popular mode of incorporating a company. Registered companies may further be divided into three categories of the following:

i. Companies limited by Shares

These types of companies have a share capital and the liability of each member or the company is limited by the Memorandum to the extent of face value of share subscribed by him. In other words, during the existence of the company or in the event of winding up, a member can be called upon to pay the amount remaining

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unpaid on the shares subscribed by him. Such a company is called company limited by shares. A company limited by shares may be a public company or a private company. These are the most popular types of companies.

ii. *Companies Limited by Guarantee*

These types of companies may or may not have a share capital. Each member promises to pay a fixed sum of money specified in the Memorandum in the event of liquidation of the company for payment of the debts and liabilities of the company [Sec 13(3)] This amount promised by him is called 'Guarantee'. The Articles of Association of the company state the number of member with which the company is to be registered [Sec 27 (2)]. Such a company is called a company limited by guarantee. Such companies depend for their existence on entrance and subscription fees. They may or may not have a share capital. The liability of the member is limited to the extent of the guarantee and the face value of the shares subscribed by them, if the company has a share capital. If it has a share capital, it may be a public company or a private company.

The amount of guarantee of each member is in the nature of reserve capital. This amount cannot be called upon except in the event of winding up of a company. Nontrading or non-profit companies formed to promote culture, art, science, religion, commerce, charity, sports etc. are generally formed as companies limited by guarantee.

iii. *Unlimited Companies*

Section 12 gives choice to the promoters to form a company with or without limited liability. A company not having any limit on the liability of its members is called an 'unlimited company' [Sec 12(c)]. An unlimited company may or may not have a share capital. If it has a share capital it may be a public company or a private company. If the company has a share capital, the article shall state the amount of share capital with which the company is to be registered [Sec 27 (1)] The articles of an unlimited company shall state the number of member with which the company is to be registered.

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On the Basis of Number of Members

I. *Private Company*

According to Sec. 3(1) (iii) of the Indian Companies Act, 1956, a private company is that company which by its articles of association:

i. limits the number of its members to fifty, excluding employees who are members or ex-employees who were and continue to be members;

ii. restricts the right of transfer of shares, if any;
iii. prohibits any invitation to the public to subscribe for any shares or debentures of the company.

Where two or more persons hold share jointly, they are treated as a single member.

According to Sec 12 of the Companies Act, the minimum number of members to form a private company is two. A private company must use the word "Pvt" after its name.

The main features of a private of a private company are:

i. A private company restricts the right of transfer of its shares. The shares of a private company are not as freely transferable as those of public companies. The articles generally state that whenever a shareholder of a Private Company wants to transfer his shares, he must first offer them to the existing members of the existing members of the company. The price of the shares is determined by the directors. It is done so as to preserve the family nature of the company's shareholders.
ii. It limits the number of its members to fifty excluding members who are employees or ex-employees who were and continue to be the member. Where two or more persons hold share jointly they are treated as a single member. The minimum number of members to form a private company is two.
iii. A private company cannot invite the public to subscribe for its capital or shares of debentures. It has to make its own private arrangement.

II. Public Company

According to Section 3 (1) (iv) of Indian Companies Act. 1956 "A public company which is not a Private Company".

If we explain the definition of Indian Companies Act. 1956 in regard to the public company, we note the following:

i. The articles do not restrict the transfer of shares of the company.
ii. It imposes no restriction no restriction on the maximum number of the members on the company.
iii. It invites the general public to purchase the shares and debentures of the companies.

On the Basis of Control

I. Holding Company

A company is known as the holding company of another company if it has control over the other company. According to Sec 4(4) a company is deemed to be the holding company of another if, but only if that other is its subsidiary.

A company may become a holding company of another company in either of the following three ways:

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a. by holding more than fifty per cent of the normal value of issued equity capital of the company; or
b. By holding more than fifty per cent of its voting rights; or
c. by securing to itself the right to appoint, the majority of the directors of the other company , directly or indirectly.

The other company in such a case is known as a “Subsidiary company”. Though the two companies remain separate legal entities, yet the affairs of both the companies are managed and controlled by the holding company. A holding company may have any number of subsidiaries. The annual accounts of the holding company are required to disclose full information about the subsidiaries.

II. Subsidiary Company

A company is known as a subsidiary of another company when its control is exercised by the latter (called holding company) over the former called a subsidiary company. Where a company (company S) is subsidiary of another company (say Company H), the former (Company S) becomes the subsidiary of the controlling company (company H).

On the basis of Ownership of Companies

I. Government Companies

A Company of which not less than 51% of the paid up capital is held by the Central Government of by State Government or Government singly or jointly is known as a Government Company. It includes a company subsidiary to a government company. The share capital of a government company may be wholly or partly owned by the government, but it would not make it the agent of the government . The auditors of the government company are appointed by the government on the advice of the Comptroller and Auditor General of India. The Annual Report along with the auditor’s report are placed before both the House of the parliament. Some of the examples of government companies are Mahanagar Telephone Corporation Ltd., National Thermal Power Corporation Ltd., State Trading Corporation Ltd. Hydroelectric Power Corporation Ltd. Bharat Heavy Electricals Ltd. Hindustan Machine Tools Ltd. etc.

II. Non-Government Companies

All other companies, except the Government Companies, are called non-government companies. They do not satisfy the characteristics of a government company as given above.

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<u>On the basis of Nationality of the Company</u>

I. *Indian Companies*

These companies are registered in India under the Companies Act. 1956 and have their registered office in India. Nationality of the members in their case is immaterial.

II. *Foreign Companies*

It means any company incorporated outside India which has an established place of business in India [Sec. 591 (I)]. A company has an established place of business in India if it has a specified place at which it carries on business such as an office, store house or other premises with some visible indication premises. Section 592 to 602 of Companies Act, 1956 contain provisions applicable to foreign companies functioning in India.

7. Public and Private Company: A Reciprocative Relationship

<u>Differences between a Public Company and a Private Company</u>

i. ***Minimum number:*** The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.

ii. ***Maximum number:*** There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 50 in a private company.

iii. ***Number of directors:*** A public company must have at least 3 directors whereas a private company must have at least 2 directors (Sec. 252).

iv. ***Restriction on appointment of directors:*** In the case of a public company, the directors must file with the Register a consent to act as directors or sign an undertaking for their qualification shares. The directors or a private company need not do so (Sec 266).

v. ***Restriction on invitation to subscribe for shares:*** A public company invites the general public to subscribe for shares. A public company invites the general public to subscribe for the shares or the debentures of the company. A private company by its Articles prohibits invitation to public to subscribe for its shares.

vi. ***Name of the Company:*** In a private company, the words “Private Limited” shall be added at the end of its name.

vii. ***Public subscription:*** A private company cannot invite the public to purchase its shares or debentures. A public company may do so.

viii. ***Issue of prospectus:*** Unlike a public company a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting shares.

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ix. ***Transferability of Shares:*** In a public company, the shares are freely transferable (Sec. 82). In a private company the right to transfer shares is restricted by Articles.

x. ***Special Privileges:*** A private company enjoys some special privileges. A public company enjoys no such privileges.

xi. ***Quorum:*** If the Articles of a company do not provide for a larger quorum. 5 members personally present in the case of a public company are quorum for a meeting of the company. It is 2 in the case of a private company (Sec. 174).

xii. ***Managerial remuneration:*** Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits (Sec. 198). No such restriction applies to a private company.

xiii. ***Commencement of business:*** A private company may commence its business immediately after obtaining a certificate of incorporation. A public company cannot commence its business until it is granted a "Certificate of Commencement of business".

Special privileges of a Private Company

Unlike a private a public company is subject to a number of regulations and restrictions as per the requirements of Companies Act, 1956. It is done to safeguard the interests of investors/shareholders of the public company. These privileges can be studied as follows:

A. Special privileges of all companies. The following privileges are available to every private company, including a private company which is subsidiary of a public company or deemed to be a public company:

   a. A private company may be formed with only two persons as member. [Sec.12(1)].
   b. It may commence allotment of shares even before the minimum subscription is subscribed for or paid. (Sec. 69)
   c. It is not required to either issue a prospectus to the public of file statement in lieu of a prospectus. (Sec 70 (3))
   d. Restrictions imposed on public companies regarding further issue of capital do not apply on private companies. (Sec 81 (3))
   e. Provisions of Sections 114 and 115 relating to share warrants shall not apply to it. (Sec. 14)
   f. It need not keep an index of members. (Sec. 115)
   g. It can commence its business after obtaining a certificate of incorporation. A certificate of commencement of business is not required. (Sec. 149 (7))
   h. It need not hold statutory meeting or file a statutory report. (Sec. 165 (10))
   i. Unless the articles provide for a larger number, only two persons personally present shall form the quorum in case of a private company, while at least five member personally present form the quorum in case of a public company. (Sec. 174)

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j. A director is not required to file consent to act as such with the Registrar. Similarly, the provisions of the Act regarding undertaking to take up qualification shares and pay for them are not applicable to directors of a private companies. (Sec. 266 (5) (b))

k. Provisions in Section 284 regarding removal of directors by the company in general meeting shall not apply to a life director appointed by a private company on or before 1st April 1952. (Sec. 284 (1))

l. In case of a private company, poll can be demanded by one member if not more than seven members are present, and by two member if not more than seven member are present. In case of a public company, poll can be demanded by persons having not less than one-tenth of the total voting power in respect of the resolution or holding shares on which an aggregate sum of not less than fifty thousand rupees has been paid-up. (Sec. 179)

m. It need not have more than two directors, while a public company must have at least three directors. (Sec. 252)

B. Privileges available to an independent private company (i.e. one which is not a subsidiary of a public company).

An independent private company is one which is not a subsidiary of a public company. The following special privileges and exemptions are available to an independent private company.

a. It may give financial assistance for purchase of or subscription for shares in the company itself.

b. It need not, like a public company, offer rights shares to the equity shareholders of the company.

c. The provisions of Sec. 85 to 90 as to kinds of share capital, new issues of share capital, voting, issue of shares with disproportionate rights, and termination of disproportionately excessive rights, do not apply to an independent private company.

d. A transfer or transferee of shares in an independent private company has no right of appeal to the Central Government against refusal by the company to register a transfer of its shares.

e. Sections 171 to 186 relating to general meeting are not applicable to an independent private company if it makes its own provisions by the Articles. Some provisions of these Sections are, however made expressly applicable.

f. Many provisions relating to directors of a public company are not applicable to an independent private company. e.g.

    i. It need not have more than 2 directors.

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ii. The provisions relating to the appointment, retirement, reappointment, etc. of directors who are to retire by rotation and the procedure relating, there to are not applicable to it.

iii. The provisions requiring the giving of 14 days' notice by new candidates seeking election as directors, as also provisions requiring the Central Government's sanction for increasing the number of directors by amending the Articles or otherwise beyond the maximum fixed in the Articles, are not applicable to it.

iv. The provisions relating to the manner of filing up casual vacancies among directors and the duration of the period of office of directors and the requirements that the appointment of directors should be voted on individually and that the consent of each candidate for directorship should be filed with the Registrar, do not apply to it.

v. The provisions requiring the holding of a share qualification by directors and fixing the time within which such qualification is to be acquired and filing with the Registrar of a declaration of share qualification by each director are also not applicable to it.

vi. It may, by its Articles, Provide special disqualifications for appointment of directors.

vii. It may provide special grounds for vacation of office of a director.

viii. Sec. 295 prohibiting loans to directors does not apply to it.

ix. An interested director may participate or vote in Board's proceedings relating to his concern of interest in any contract of arrangement.

g. The restrictions as to the number of companies of which a person may be appointed managing director and the prohibition of such appointment for more than 5 years at a time, do not apply to it.

h. The provisions prohibiting the subscribing for, or purchasing of, shares or debentures of other companies in the same group do not apply to it.

i. The provisions of Section 409 conferring power on the Central Government to present change in the Board of directors of a company where in the opinion of the Central Government such change will be prejudicial to the interest of the company, do not apply to it.

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<u>When a Private company becomes a Public Company</u>

A private company shall become a public company in following cases:

i. By default: When it fails to comply with the essential requirements of a private company provided under Section 3 (1) (iii) Default in complying with the said three provisions shall disentitle a private company to enjoy certain privileges (Sec. 43).

ii. A private company which is a subsidiary of another public company shall be deemed to be a public company.

iii. By provisions of law: Section 43-A.

Section 43-A

a) Where not less than 25% of the paid-up share capital of a private company is held by one or more bodies" corporate such a private company shall become a public company from the data in which such 25% is held by body corporate [Sec. 43-A (1)].

b) Where the average annual turnover of a private company is not less than Rs. 10 crores during the relevant period, such a private company shall become a public company after the expiry of the period of three months from the last day of the relevant period when the accounts show the said average annual turnover [Sec. 43 A (1 A)].

c) When a private company holds not less than 25% of the paid up share capital of a public company the private company shall become a public company from the date on which the private company holds such 25% [Sec. 43A (IB)].

d) Where a private company accepts, after an invitation is made by an advertisement of receiving deposits from the public other than its members, directors or their relatives, such private company shall become a public company [Sec. 43A (IC)].

iv. By Conversion: When the private company converts itself into a public company by altering its Articles in such a manner that they no longer include essential requirements of a private company under Section 3 (1) (iii). On the data of such alternations, it shall cease to be private company. It shall comply with the procedure of converting itself into a public company [Sec. 44].

The Articles of Association of such a public company may continue to have the three restrictions and may continue to have two directors and less than seven members. Within 3 months of such a conversion. Registrar of Companies shall be intimated. The Registrar shall delete the word 'Private' before the words 'Limited' in the name of the company and shall also make necessary alternations in the certificate of incorporation.

8. Formation of a Company

The formation of a company is a lengthy process. For convenience the whole process of company formation may be divided into the following four stages: 1. Promotion Stage 2. Incorporation or Registration Stage 3. Capital Subscription Stage 4. Commencement of Business Stage.

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I. Promotion Stage

Promotion is the first stage in the formation of a company. The term 'Promotion' refers to the aggregate of activities designed to bring into being an enterprise to operate a business. It presupposes the technical processing of a commercial proposition with reference to its potential profitability. The meaning of promotion and the steps to be taken in promoting a business are discussed in brief here.

Promotion of a company refers to the sum total of the activities of all those who participate in the building of the enterprise upto the organisation of the company and completion of the plan to exploit the idea. It begins with the serious consideration given to the ideas on which the business is to be based.

According to C.W. Grestembeg, "Promotion may be defined as the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom."

According to H.E. Heagland, "Promotion is the process of creating a specific business enterprise. Its scope is very broad, and numerous individuals are frequently asked to make their contributions to the programme. Promotion begins when someone gives serious consideration to the formulation of the ideas upon which the business in question is to be based. When the corporation is organised and ready for operation, the major function of promotion comes to an end."

According to Guthmann and Dougall, "Promotion starts with the conception of the idea from which the business is to evolve and continues down to the point at which the business is full, ready to begin operations in a going concern."

II. Incorporation or Registration Stage

Incorporation or registration is the second stage in the formation of a company. It is the registration that brings a company into existence. A company is properly constituted only when it is duly registered under the Act and a Certificate of Incorporation has been obtained from the Registrar of Companies.

In order to get a company registered or incorporated, the following procedure is to be adopted:

a) Preliminary Activities

Before a company is incorporated, the promoter has to take decision regarding the following:

i. To decide the name of the company
ii. Licence under Industries Development and Regulation Act, 1951

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b) *Filing of Document with the Registrar*

Following documents needs to be submitted before the incorporation:

i. . Memorandum of Association
ii. Articles of Association
iii. List of directors
iv. Written consent of directors
v. Statutory declaration

Certificate of Incorporation

On the registration of memorandum and other documents, the Registrar will issue a certificate known as the Certificate of Incorporation certifying under his hand that the company is incorporated and, in the case of a limited company that the company is limited.

Effects of Incorporation

The certificate of incorporation is conclusive evidence of the fact that:

i. The company is properly incorporated and duly registered;
ii. The terms of the Memorandum and Articles are within the law;
iii. All requirements of the Act in respect of registration have been complied with;
iv. A private company can start its business after getting the certificate of incorporation; and
v. With the issue of certificate, the company takes birth with a separate legal entity.

III. Capital Subscription Stage

A private company or a public company not having share capital can commence business immediately on its incorporation. As such 'capital subscription stage' and 'commencement of business stage' are relevant only in the case of a public company having a share capital. Such a company has to pass through these additional two stages before it can commence business.

Under the capital subscription stage comes the task of obtaining the necessary capital for the company.

For this purpose, soon after the incorporation, a meeting of the Board of Directors is convened to deal with the following business:

i. Appointment of the Secretary. In most cases the appointment of pre-term secretary (who is appointed at the promotion stage) is confirmed.
ii. Appointment of bankers, auditors, solicitors and brokers etc.
iii. Adoption of draft 'prospectus' or 'statement in lieu of prospectus'.
iv. Adoption of underwriting contract, if any.

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Besides the above mentioned business, the Board also decides as to whether:

i. A public offer for capital subscription is to be made, and
ii. Listing of shares at a stock exchange is to be secured.

The company will now proceed to obtain the permission of the Controller of Capital Issue, New Delhi, under the Capital Issue Control Act, 1947 if a public offer for sale of shares and debentures exceeding Rs. one crore is to be made during a period of 12 months, unless the issue fulfils the conditions of exemption as laid down in the Capital Issue (Exemption) Order, 1969.

The Capital Issue Control Act, 1947 however, does not apply to a private company, a banking company, an insurance company, and a government company provided it does not make an issue of securities to the general public.

After the above formalities have been completed, the directors of the company file a copy of the 'prospectus' with the Registrar and invite public to subscribe to the shares of the company by putting the 'prospectus' in circulation.

Application for shares are received from the public through the company's bankers and if the subscribed capital is at least equal to the minimum subscription amount as disclosed in the prospectus, and other conditions of a valid allotment are fulfilled, the directors of the company pass a formal resolution of allotment.

Allotment letters are then posted, return of allotment is filed with the Registrar and share certificates are issued to the allottees in exchange of the allotment letters. If the subscribed capital is less than the minimum subscription or the company could not obtain the minimum subscription within 120 days of the issue of prospectus, all money will be refunded and no allotment can be made.

It may be noted that a public company having a share capital, but not issuing a 'prospectus' has to file with the Registrar 'a Statement in lieu of Prospectus' at least three days before the directors proceed to pass the first allotment resolution.

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IV. Commencement of Business Stage

After getting the certificate of incorporation, a private company can start its business. A public company can start its business only after getting a' certificate of commencement of business'.

After getting the certificate of incorporation:

i. A public company issues a prospectus of inviting the public to subscribe to its share capital,
ii. A minimum subscription is fixed, and
iii. The company is required to sell a minimum number of shares mentioned in the prospectus.

After making the sale of the required number of shares a certificate is sent to the Registrar stating this fact, along-with a letter from the banks, that it has received application money for such shares.

The Registrar scrutinizes the documents. If he is satisfied, then issues a certificate known as Certificate of Commencement of Business. This is the conclusive evidence of the commencement of the business.

Restrictions on the Commencement of Business

Section 149 of the Companies Act, 1956 has imposed some restrictions on the commencement of business by public companies, which are as follows:

1. Companies which issue a prospectus

A company having share capital issues prospectus to the general public for subscription of their shares or debentures.

But this company cannot commence business or exercise borrowing powers unless the following formalities are complied with [Sec. 149 (1)]:

i. The shares payable in cash have been allotted equal to an amount not less than the minimum subscription.
ii. The directors have taken up and paid for the qualification shares in cash an amount equal to the amount payable by other subscribers on application and allotment.
iii. No money is liable to become refundable to applicants, because of company's failure to apply for, or to get permission for the share or debentures to be dealt in on any recognised stock exchange.
iv. A statutory declaration duly verified by any one of the company should be filed with the Registrar stating that all conditions given above in (i), (ii) and (iii) have been complied with.

2. Companies which do not issue a prospectus

A company which has not issued a prospectus must file the following documents with the Registrar or in other words, cannot commence the business unless the following formalities are complied with [Sec. 149 (2)].

i. A statement in lieu of prospectus has been filed with the Registrar.
ii. The directors have taken up and paid for the qualification shares in cash an amount equal to the amount payable by other subscribers on application and allotment.
iii. A statutory declaration duly verified by any one of the directors or secretary of the company that the directors have taken up and paid for the qualification shares in cash an amount equal to the amount payable by other subscribers on application and allotment.

If the above requirements have been complied with, the Registrar issues a certificate that the company is entitled to commence business. This certificate of commencement of business, like the certificate of incorporation, is a conclusive evidence that the company is so entitled [Sec. 149 (3)].

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9. Pre-Incorporation Contracts

Before a company commences business, it has to enter into several contracts and incur several initial expenses. Contracts which are entered into by promoters with parties to acquire some property or right for and on behalf of a company yet to be formed are called as 'pre-incorporation contracts' or 'preliminary contracts'.

Legal status of Pre-incorporation contract

The legal status of a pre-incorporation contract is not easy to define. Going by the definition of the contract, there have to be at least two parties/persons who enter into contract with each other. So, the general principle goes that no contract is there if one of the parties to the contract is not in existence at the time of entering into the contract. Hence, the company can't enter into a contract before it comes into existence, and it comes into existence only after its registration. It may be argued that, the pre-incorporation contract is entered into by the promoters on behalf of the company. But here also, is a tangle. The promoters, while entering into the contract, act as agents of the company. But when the principal, i.e. the company is itself not in existence, how can it appoint an agent to act for it? So, the promoters, themselves and not the company, become personally liable for all contracts entered into by them even though they claim to be acting for the prospective company.

But, u/s 230 of the Indian Contract Act, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them if he specifies clearly, at the time of making the contract, that he is only acting as an agent and he is not personally liable under the contract. So if this principle is applied, the contract becomes in fructuous as neither of the parties is liable under the contract.

However, u/s 15 (h) and u/s 19 (e) of the Specific Relief Act of 1963, lies the solution to our problem. These provisions, while deviating from the common law principles to some extent, make the pre-incorporation contracts valid. U/s 15 (h), Except as otherwise provided by this Chapter, the specific performance of a contract may be obtained by:

a) any party thereto;
b) the representative in interest or the principal, of any party thereto.

Provided that where the learning , skill, solvency or any personal quality of such party is a material ingredient in the contract, or where the contract provides that his interest shall not be assigned, his representative in interest or his principal shall not be entitled to specific performance his part of the contract, or the performance thereof by his representative in interest, or his principal, has been accepted by the other party; when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of the incorporation, the company. U/s 19 (e), Except as otherwise provided by this Chapter, specific performance of a contract may be enforced against the company, when the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation. In **Weavers Mills Ltd. v. Balkies Ammal** [AIR 1969 Mad 462], the Madras High Court extended the scope of this principle through its

decision. In this case, promoters had agreed to purchase some properties for and on behalf of the company to be promoted. On incorporation, the company assumed possession and constructed structures upon it. It was held that even in absence of conveyance of property by the promoter in favour of the company after its incorporation, the company's title over the property could not be set aside.

End Note: Pre-incorporation contracts, though at first, might appear to be with no legal status and value, but they are very much important and legally valid as well as enforceable. Pre-incorporation contracts may be undertaken by the company after its incorporation either by:

i. incorporating the contract in the terms of incorporation, or
ii. by entering into a fresh contract with the other party or with the promoters, or
iii. by accepting the benefits from the contract, either expressly or impliedly.

And hence, the pre-incorporation contract becomes legally enforceable against the company.

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