

## Company Law

### **Unit-1**

Introduction to Company law Companies Act 2013 – Definition of a Company, Characteristics of Company – Lifting or Piercing the Corporate Veil – Company Distinguished from Partnership and Limited Liabilities Partnerships – Classification of Companies – Based on Incorporation, Liability, Number of Members, Control.

### **COMPANY MEANING**

A company means an association of individual formed for some common purpose. But it is a voluntary association of persons. It has capital divisible into parts, known as shares, an artificial person created by a process of law and it has a perpetual succession and a common seal.

### **Definition**

According to Prof. Lindley, company is defined as, “An association of many persons who contribute money or money’s worth to a common stock, and employ it in some common trade or business (i.e., for a common purpose), and who share the profit or loss (as the case may be) arising therefore. The common stock so contributed is denoted in money and it 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”.

### **Characteristics of a Company**

#### ➤ **Separate Legal Entity**

A company formed and registered under the company’s act is a distinct legal entity. It is a creation of law and is sometimes called artificial person having invisible and intangible. It is a fiction of law with legal, but no natural or physical existence.

Case of Salomon Vs Salomon Co Ltd: S Sold his boots business to a newly formed company for

\$30, 000. His wife, one daughter and four sons took up one share of \$ 1 each. S took 23, 000 shares of \$ 1 each and \$ 10, 000 debentures in the company. The debentures gave S a chargeover the assets of the company as the consideration for the transfer of the business. Subsequently when the company was wound up, its assets were found to be worth \$6, 000 and its liabilities amounted to \$ 17, 000 of which \$ 10, 000 were due to S (secured by debentures) and \$ 7, 000 due to unsecured creditors.

The unsecured creditors claimed that S and the company were one and the same person and that the company was a mere agent for S and hence they should be paid in priority to S. Held, the company was, in the eyes of the law, a separate person independent from S and was not his agent. S, though virtually the holder of all the shares in the company, was also a secured creditor and was entitled to repayment in priority to the unsecured creditors.

#### ➤ **Perpetual Succession**

A company is an artificial person, as such it never dies. Its life does not depend on the life of its members. It may not be affected by insolvency, mental disorder or retirement of its members. It is created by law and can be put an end to only by the process of law. Even the earthquake, flood or hydrogen bomb cannot destroy it. It continues to exist even if all its human members

are dead. 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.

➤ **Limited Liability**

In a company limited by shares, the liability of members is limited to the unpaid value of the shares. 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 upto 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 amount as the members may undertake to contribute to the assets of the company in the event of its being wound up.

➤ **Common seal**

A company is a juristic person with a perpetual succession and a common seal. Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal acts as the official signature of the company. Every company must have a seal with its name engraved on it.

➤ **Transferability of shares**

The capital of a company is divided into parts, called shares. These shares are, subject to certain conditions, freely transferable so that no shareholder is permanently or necessarily wedded to the company. When the joint stock companies were established, the great object was that the shares should be capable of being easily transferred.

➤ **Capacity to sue and be sued**

A company can sue and be sued in its corporate name. It may also inflict or suffer wrongs. It can in fact do or have done to it most of the things which may be done by or to a human being. On incorporation, a company acquires separate and independent legal personality. As a legal person, it can sue and be sued in its name.

➤ **Separate Property**

A company, as already observed, is a legal person distinct from its members. It is therefore capable of owing, enjoying and disposing of property in its own name. Although, the capital and assets of the company are contributed by its shareholders, they are not the private and joint owners of the property of the company. The property of the company is not the property of the shareholders; it is the property of the company.

## **LIFTING THE CORPORATE VEIL**

A company is a legal person distinct from its members. This principle may be referred to as 'the veil of incorporation'. The effect of this principle is that there is a veil between the company and its members i.e., the company has a corporate personality which is distinct from its members.

But over a period, the abuses of this corporate personality became apparent. Thus, it became necessary for the court to break through or lift the corporate veil or crack the shell of corporate personality and look at the persons behind the company who are the real beneficiaries of the corporate fiction.

### **The corporate veil is lifted in the following cases;**

- Determination of the character
- Where company is a mere cloak or sham
- Where the company is acting as an agent of the shareholders
- Protection of revenue

### **Statutory exception**

#### **Number of members below statutory minimum**

Sec.45, if a company carries on business for more than 6 months after the number of its members has been reduced below 7 in case of a public company or 2 in case of private company, every person who knows this fact and is a member during the time that the company so carries on business after the six months, is severally liable for the whole of the debts of the company contracted during that time, i.e., after six months. It may be noted that in such a case the continuing members (i.e., those who continue to be members after six months).

- Can be sued and not those who have withdrawn from the membership;
- Shall be liable only if they are aware of the fact of the member falling below the statutory minimum.

#### **Failure to refund application money**

Sec.69 (5), the directors of a company are jointly and severally liable to repay the application money with interest if the company fails to refund the application money of those applicants who have not been allotted shares, within 130 days of the date of issue of the prospectus.

#### **Misdescription of company's name**

Sec.147 (4) where an officer or agent of a company does any act or enters into a contract without fully or properly mentioning the company's name and the address of its registered office, he shall be personally liable. Thus, where a bill of exchange, hundi or promissory note is signed by an officer of a company or any other person on its behalf, without mentioning this fact that he is signing on behalf of the company; he is personally liable to the holder of the instrument unless the company has already paid the amount.

#### **Fraudulent Trading**

Sometimes in the course of the winding up of a company it may appear that some business of the company has been carried on with intent to defraud creditors of the company, or any other person or for any fraudulent purpose. In such a case, the court may declare that any persons who were knowingly parties to the carrying on of the business in this way are personally liable without any limitations of liability for all or any of the debts or other liabilities of the company as the court may direct. The court may do so on the application of the official liquidator, or the liquidator or any creditor or contributory of the company.

## Holding and Subsidiary Companies

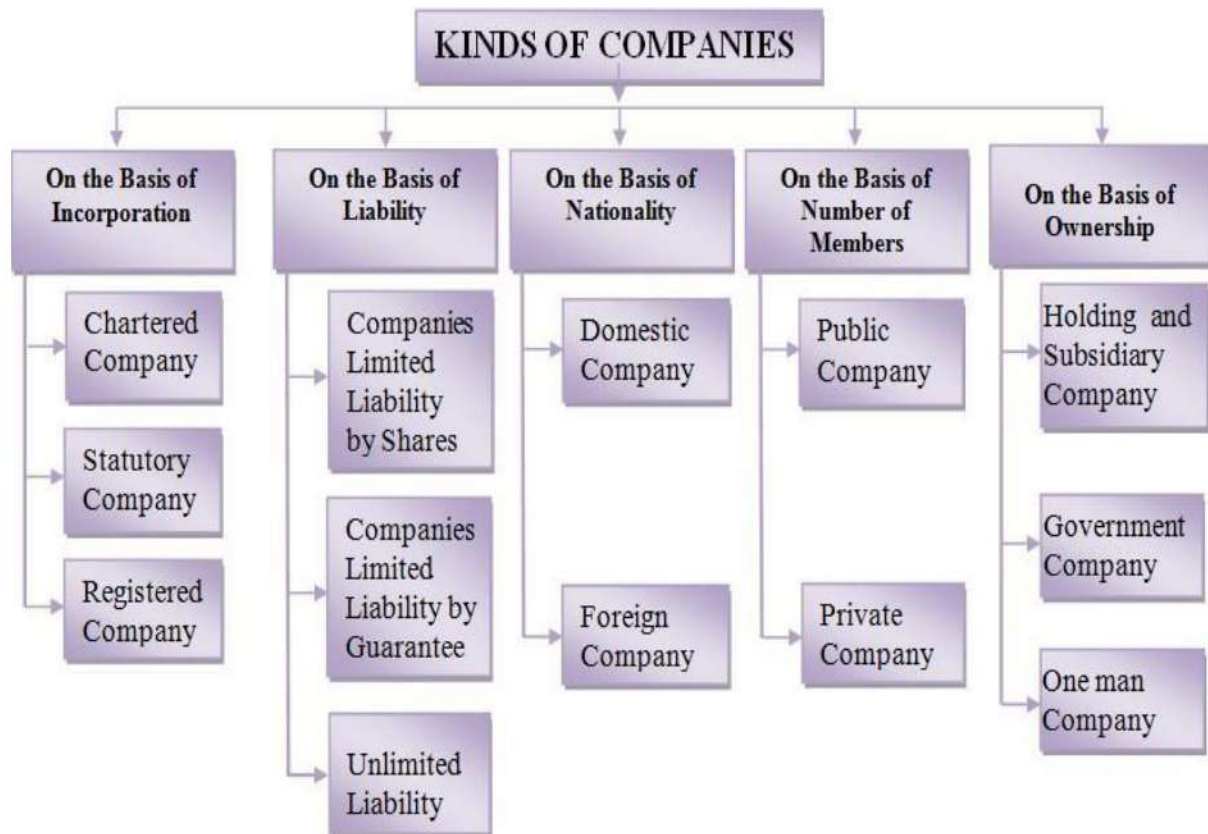
In the eyes of the law, the holding company and its subsidiaries (for definition of holding and subsidiary companies) are separate legal entities. But in the following two cases, a subsidiary company may lose its separate identity to a certain extent:

Where at the end of its financial year, a company has subsidiaries, it must lay before its members in general meeting not only its own accounts, but also a set of group accounts showing the profit or loss earned or suffered by the holding company and its subsidiaries collectively and their collective state of affairs at the end of the year.

The court may, on the facts of a case, treat a subsidiary company as merely a branch or department of one large undertaking owned by the holding company.

## KINDS OF COMPANIES

Joint Stock Companies can be classified on the basis of corporation, nature of liability, extent of public interest, ownership, nationality etc. let us examine briefly the different kinds of companies.



### 1. On the Basis of Incorporation

Any company is to be incorporated under an Act. The provision of the particular Act under which it is established governs its working. Companies of this kind are of three types. They are;

## **Statutory Companies**

These are the companies which are created special act of the Parliament or State Legislature, e.g., the Reserve Bank of India, the State bank of India, the Life Insurance Corporation, etc. these are mostly concerned with public utilities, e.g., railways, tramways, electricity companies and enterprise of national importance.

## **Registered Companies**

Companies which are registered under the Companies Act, 1956, or were registered under any of the earlier companies Acts are called registered companies. A vast majority of companies we come across belong to this category. Tata Motors Limited, Reliance Telecommunication Limited, EID Parry Limited, etc belong to this category.

## **Chartered Companies**

Companies established as a result of a charter granted by the King or Queen of a country is known as chartered companies. The charter issued, governs their functioning. In other words, 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. **Example** – Bank of England, East India Company, etc.

## **2. On the Basis of Liability**

On the basis of the extent of liabilities of the shareholders such companies are divided into three categories.

### **Companies Limited by Share**

Where the liability of the members of a company is limited to the amount unpaid on the shares such a company is known as a company limited by shares. If the shares are fully paid, the liability of the members holding such shares is nil.

### **Companies Limited by Guarantee**

In a company limited by guarantee the liability of a shareholder is limited to the amount he has voluntarily undertaken to contribute to meet any deficiency at the time of its winding up. Such a company may or may not have a share capital. If it has a share capital a member's liability is limited to the amount remaining unpaid on his share plus the amount guaranteed by him. This type of company is started with the object of promoting science, arts, sports, charity, etc. it is clear that its objective is not profit earning. It gets subscription from its members and donations and endowments from philanthropists.

### **Unlimited Liability**

A company without limited liability is known as an unlimited liability. In case of such a company, every member is liable for the debts of the company, as in an ordinary partnership, is proportion to his interest in the company. In other words, their liability extends to their private properties also in the event of winding up. Unlimited companies are almost non-existent.

## **3. On the Basis of Nationality**

They are of two types' viz., domestic companies and foreign companies.

## **Domestic Company**

Companies registered under the Companies Act, 1956, or under earlier Acts are considered domestic companies.

## **Foreign Company**

Foreign company means a company incorporated outside India but having a place of business of India. It has to furnish to the authorities the full address of the registered or principal office of the company or a list of its directors or names and addresses of the residents in India authorized to receive notices, documents, etc.

## **4. On the Basis of Number of Members**

### **Private Company**

A private company means a company which by its articles

- restricts the rights to transfer its shares
- Limits the number of its members minimum 2 and maximum number of members fifty (excluding the employees)
- Prohibits any invitation to the public to subscribe for any shares or debentures of the company. The name of the company must end with the words 'private limited'.

### **Public Company**

The public is invited to subscribe to the shares of the company usually by issuing a prospectus. Shares are easily transferable. A public company must have at least 7 persons to form and no maximum limit as to its number of shareholders or members. The name must end with the word 'limited'.

On the Basis of Control/ Ownership

## **5. Holding Company and Subsidiary Company**

A company is known as the holding company of another company if it has control over that other company. A company becomes a holding company of another

- if it can appoint or remove all or majority of the directors of the latter company or
- if it holds more than 50% of the equity share capital of the latter or
- if it can exercise more than 50% of the total voting power of the latter.

A company is known as a Subsidiary of another company when control is exercised by the latter (called holding company). Over the former called a subsidiary company.

## **Government Companies**

A Government company is one in which not less than 51% of the paid up capital is held by the Central Government or by any one or more State Governments or partly by the Central Governments and partly by one or more State Governments. Examples: Bharath Heavy Electricals Limited, Steel Authority of India Limited, etc.

A subsidiary of a Government company is also treated as a Government company. A Government company also enjoys a separate corporate existence. It should not be identified with the Government and its employees are not Government employees.

### One-man 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.

### DISTINCTION BETWEEN PUBLIC COMPANY AND PRIVATE COMPANY (Write Any 10 Points)

S.NO	Public Company	Private Company
1.	Minimum No. of Members: 7 persons	2 persons
2.	Maximum No. of Members: No limits	Not more than fifty members excluding past and present employees
3.	Name of the Company: The company name must be ended with 'Limited'.	'Private Limited' must be added at the end of the name.
4.	Article of Association: Can have its own Articles or can adopt Table A of the Companies Act, 1956.	Prepare own AOA.
5.	Commencement of Business: Shall not commence business unless granted the certificate of commencement of business	Commence business as soon as it incorporated
6.	Invitation to public: May invite public to subscribe to its share/debentures by issuing prospectus	Cannot extend such invitation to the public
7.	Transferability of shares: No restriction on transfer of shares	Restrict the right of members to transfer the shares by its articles
8.	Qualification Shares: The directors should acquire the prescribed qualification shares	Need not acquire qualification shares
9.	Quorum: Minimum number of members should be present in a meeting is five	Two number of members should be present in a meeting
10.	Issue of Prospectus: A public limited company can issue prospectus	A private company is prohibited from issuing prospectus
11.	Issue of subsequent shares: Public company new shares are offered first to the existing shareholders	Rights issue does not arise
12.	Issue of share warrants: It can issue share warrants	A private company cannot issue share warrant
13.	Number of directors: At least three directors	At least two directors
14.	Statutory meetings: Compulsory	No such obligations
15.	Managerial remuneration: Cannot exceed 11% of the net profit	No such restriction

## DISTINCTION BETWEEN PARTNERSHIP FIRM AND JOINT STOCK COMPANY

S. No.	BASIS OF DIFFERENCE	PARTNERSHIP FIRM	JOINT STOCK COMPANY
1.	The Acts	Partnership firm is governed by the Indian Partnership Act, 1932	Companies are governed mainly by the provisions of the Companies Act, 1956
2.	Registration	Registration is optional	Registration is compulsory
3.	Number of members	Minimum of 2 persons and Maximum number is restricted to 10 in the case of Banking business and to 20 in other types of businesses	Minimum number of members Public – 7 persons Private – 2 persons Maximum number of members Public – unlimited Private – 50 excluding members or employees
4.	Legal status	No separate legal existence	It is an artificial person created by law
5.	Liability	Liability of a partner is joint, several and unlimited	Limited to the unpaid number of shares held
6.	Transfer of shares	A partner cannot transfer his interest in the firm without the consent of all other partners	Shares are fully transferable
7.	Management	Management of a firm is carried on by all or by any of them acting for all	Board of directors elected by the members carry out the management
8.	Stability	A partnership firm is not stable, it can be affected by death, insanity or insolvency of any one or all its partners	A company is stable as it is totally unaffected by any such contingencies
9.	Procedural complexities	Both for formation and dissolution, the procedures are simple	Both the formation and winding up are subject to many legal formalities
10.	Financial resources	The capital contribution as well as the finance that can be raised tend to be limited	The scope for mobilizing larger resources is very wide
11.	Membership	In a partnership only individuals can become its members	In a company, an institution can also become a member by purchasing its shares

12.	Nature	Partnership is the relation between persons who have agreed to share the profits or losses of a business	A company is an artificial person
13.	Mutual relationship of the members	In the partnership, each partner is an agent of the others	The members of the company are not its agents or representatives
14.	Audit	Audit of accounts is not except in certain circumstances	It is essential for every company to get its accounts annually audited by chartered accountant
15.	Dissolution	Partnership can be mutually dissolved at any time	Legal formalities for winding up are many

Rajesh SDC