

UCC CLASS NOTE

CHAPTER – II : FORMATION OF A COMPANY

According to section 3(1), a Company may be formed for any lawful purpose by-

- (a) Seven or more persons in case of Public Company ;
 - (b) Two or more persons in case of Private Company ;
 - (c) One person Company in case of One person Company ;
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- **STEPS REQUIRED FOR THE FORMATION OF A COMPANY:**

The followings steps are essential for the formation of a Company. They are

1. Name of a Company & Location of the registered address of the said Company.
 2. The amount and forms of its capital
 3. Preparation of Memorandum of Association (MOA) u/s 4 and Article of Association(AOA) u/s 5.
 4. Registration of the Company according to the provision of the Act, 2007. (Sec. 7) .
 5. The capital subscription must be raised and thereafter the allotment of shares must be made.
 6. The prospectus must be issued and registered with the Registrar.
 7. To arrange for loans and other financial assistance from various financial institutions.
 8. To obtain certificate of Incorporation (FORM NO. INC 11) of the business from the Registrar.
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- **PROMOTERS:**

For the formation of a Company, the foremost steps required is promotion of a Company. For promotion, a specified person is required for this task who is known as Promoters.

Promoter is a person who initially plan for the formation of a Company and bring its existence. In other words, a Promoter is a person who does the necessary preliminary work for the formation of a Company.

According to *Palmer*, a Promoter is a person who originates a scheme for the formation of a Company, has a memorandum and Articles prepared, executed and registered and finds the first directors and settles the terms of

preliminary contracts and prospectus and make arrangement for advances and circulating the prospectus.

- **KINDS OF PROMOTER:**

There are 4 types of Promoters:

(a) Professional Promoters are those who are specialized in the job of promotion of a Company.

(b) Occasional Promoters are those who promotes a Company once in a while but not on a regular basis.

(c) Financial Promoters are those who financially promotes the Company, such as Industrial Development bank of India, ICICI Ltd, Commercial Bank etc.

(d) Entrepreneurial Promoters are those who conceive business ideas, takes all necessary steps for bringing a Company into existence and really brings it into existence.

- **FUNCTIONS OF PROMOTERS**

The various functions of Promoter are:

(a) To discover the ideas of the business he conceive.

(b) After conceiving the ideas of the business, the promoters will thoroughly investigate into the soundness of the proposition. The investigation is for discovering the hidden plan and psychology of the investors and customers and the real reason for investing in the company.

(c) The promoters will organize resources for the Company. For this, the following steps are required:

(i) Securing the active co-operation of the required number of person willing to associate themselves in the said project. (in case of Public Company atleast 7 persons are required; for private company, 2 persons are required & in case of One person Company, one person is required).

(ii) Appointing legal advisors ;

(iii) Engaging technical experts;

(iv) Entering into preliminary contracts;

(v) Preparing detailed financial plan ;

(d) Generally it is the duty of the Promoters to appoint the First Director of the Company. For appointment, the promoters will try to obtain the consent of some individuals whom he seems to be fit for the said appointment.

(e) It is the duty of the Promoters to seek the permission from the Registrar of Companies for selecting the name of the Company. He should ensure that the name of the Company should be identical or should not be resemble with another existing companies name.

(f) The promoters usually decides the address of the registered office of the Company.

(g) It is the duty of the promoters to prepare Memorandum of Association and Article of Association after consulting with the Solicitors or legal experts.

(h) The promoters are required to file necessary documents and requisite fees with the Registrar of the Companies for registration of the Company.

(i) The promoters will make necessary arrangements for preparation, advertisement and circulation of the prospectus for raising capital.

(j) It is the function of the Promoters to provide necessary advice, directions or instructions to the Board of Directors as and when required.

- **LEGAL POSITION OF PROMOTERS**

A promoter is a person who brings a Company into existence. As such, a promoter occupied an important position in formation of the Company. The legal position of the Promoter is that he is neither an agent nor a trustee of the proposed Company, But he occupied a very fiduciary position in the Company. For this fiduciary position, the promoter can't make either directly or indirectly any profit at the expenses of the Company he promotes.

- **REMUNARATION OF THE PROMOTER**

A promoter has no legal right to claim proportional expenses or his service unless, there is a valid contract. With such contract, the promoter is not entitled to claim any expenses even his preliminary expenses.

When a promoter makes a proper disclosure, he may expect to be rewarded for his effort. Therefore when the Company is registered, it may pay or agree to pay

some remuneration for the service he rendered. Practically, a promoter is remunerated in the following ways :

(a) He may sell his own property to the Company for cash or against fully paid shares in the Company at an over valuation after making full disclosure to an independent Board of Directors or to the intending share holders.

(b) He may be given an option to buy further shares in the Company at par.

(c) He may take commission on share sold.

(d) He may take a grant of some shares in the Company.

(e) He may be paid a lump-sum by the Company.

Whatever the remuneration may be, it should be disclosed in the prospectus fully.

- **STEPS REQUIRED FOR THE INCORPORATION OF A NEW COMPANY**

Incorporation is a legal process used to form a Corporate entity or a Company. It involves drafting of legal documents that list the primary purpose of the business its name and its location and the number of shares and class of stock being issued, if any.

The Companies Act, 2013, lays down the following rules for the incorporation of both the public as well as private Company. As per section 3 of the Companies Act, 2013, in case of Private Company atleast 2 members are required, whereas in Public Company, 7 persons are required and in case of One person Company, 1 person is required.

Step-1

Filling the proposed name of a Company for approval to the Registrar of the Company (ROC)

According to sec. 4(2) of the Act, a Company cannot be registered with identical name or resemble too nearly to the name of an existing company registered under the Act.

As per section 4(4) of the Act, the person can make an application to propose the name of the Company to be registered with fees as may be prescribed.

Upon receipt of the application, the Registrar on the basis of information and documents furnished along with the application, may reserve the name for a period of 20 days from the date of approval of the said application. Provided that in case of change of name by any existing company, the Registrar may reserve the name for a period of 60 days from the date of approval.

Step -2

Obtaining Director Identification Number

As per sec. 153 of the Act, every individual intending to be appointed as Director of the Company shall make an application for allotment of Director Identification Number in form DIR 3 to the Central Government with prescribed fees.

Step- 3

The Company must have to select the name of persons who will act as Director.

Step-4

Drafting of Memorandum of Association (MOA)

The Memorandum of Association is the Constitution of the Company which must contain the basic information of the Company. The purpose of MOA is to enable the members of the Company, its creditors and the public to know what its powers are and what is the range of its activity.

As per Rule 13 of the Companies (incorporation) Rules, 2014, Memorandum of Association must be signed by every subscriber along with address, description, occupation, if any, in the presence of at least one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any.

Step- 5

Drafting of Article of Association (AOA)

Article of Association which is an important document explain the operation of the company, purpose for which Company is incorporated along

with the information for the process of appointment of Directors and also management of the financial record of the Company.

Step-6

Registered Office

As per section 12 of the Companies (Amendment) Act, 2017, the Company on and from 30 days of its incorporation and at all time thereafter must have registered office capable of receiving and acknowledging all communication and notices as may be addressed thereto. The Company shall furnish to the Registrar verification of its registered office within a period of 30 days of its incorporation in such a manner as may be prescribed.

Step- 7

Application for Incorporation of a Company

According to section 7 of the Companies Act, 2013, an application shall be filed with the Registrar within whose jurisdiction the registered office a Company is proposed to be situated in Form no. INC.2 (in case of One person Company) and Form no. INC. 7 (in case of public and private Company) along with fees as provided in the Companies (Registration office and fees) Rules, 2014 for registration of a company.

Step-8

Issue of certificate of Incorporation

The Registrar, on the basis of the documents and information filed, shall register the name of the Company and issue a certificate of incorporation in the prescribed form (FORM no. INC-11) to the effect that the proposed Company is incorporated under this Act.

On and from the date mentioned in the certificate of incorporation issued, the Registrar shall allot the Company a Corporate Identity Number (CIN) which shall be distinct identity for the Company and which shall also be included in the certificate.

- **MEMORANDUM OF ASSOCIATION**

Memorandum of Association is the first essential documents in the formation of the Company. As per section 2(56) of the Act, Memorandum of Association (MOA) is a document which contains the fundamental rules

regarding the Constitution and activities of Company. It is the basic document which law down how the Company is constituted and what work it shall undertake. The purpose of MOA is to enable the members of the Company, its creditors and the public know what its powers are and what is the range of its activities The Memorandum contains rules regarding the capital structure, liability of the members, the objects of the Company and all other important matters relating to the Company. It is the charter of the Company. It lays down the area of operation of the Company. It also regulates the external affairs of the Company in relation to the outsiders.

- **PURPOSE OF MEMORANDUM**

The purpose of MOA is to acquaint the prospective shareholders to know the field in which their money is going to be used by the Company and what risk they are undertaking in making investment.

The second purpose is that the outsiders dealing with the Company know with the certainty as to what the objects of the Company are and as to whether the contractual relation into which they contemplate to enter with the Company is within the objects of the Company.

- **CONTENTS OF MEMORANDUM**

Section 4 of the Act, 2013, lays down the following particulars in Memorandum of Association :

(a) Name Clause: As per section 4(1)(a), the name of the Company with the word “Limited” in case of Public Company, “Private Limited” in case of Private Company should be written with the Companies name.

(b) Registered Office Clause: Section 4(1)(b), this clause states the place i.e. state at which the registered office of the Company is to be situated.

(c) Object Clause: Section 4(1)(c), it includes the objects for which the Company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

(d) Liability of the members of the Company, whether limited or unlimited under section 4(1)(d).

(e) Details about the share capital of the Company having a share capital under section 4(1)(e).

(f) For One person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the Company under section 4(1)(f).

(g) Subscription or association clause under section 3 & 4(1)(e).

- **LEGAL EFFECTS OF THE MEMORANDUM OF ASSOCIATON**

The legal effects of MOA may be summoned up as follows:

(a) Basic Documents: It is the basic documents for the existence of the Company. As a matter of fact, the preparation of this documents is the first step in formation of a Company.

(b) Contents: It contains the fundamental conditions upon which alone the Company is allowed to be incorporated.

(c) Binding Contract: The various terms and conditions in MOA constitutes a binding contract between the Company and each of its members All moneys payable by members to the Company shall be debt due from him to the Company.

(d) Public Documents: It is a public document open for inspection by every person dealing with the Company. Thus, every person who deals with the Company is presumed to have the sufficient knowledge of the contents.

(e) Power of the Company: It lays down that the power and object of the Company, and the scope of operation of the Company beyond which its action cannot go. In other words, the Company is bound to act according to the objects and powers as contained in its memorandum.

(f) Ultra Vires to Memorandum of Association: If the Company enters into Contract which is beyond the power conferred on it by the Memorandum, such contract will be ultra-vires of the Company and hence void. It cannot rectify even by the unanimous consent of all the members.

(g) Alteration of Ultra-Vires: The memorandum cannot be so easily altered. The company has to follow the strict procedure for the alteration of its clause . In some cases, the alteration requires the approval of the Tribunal.

- **ALTERATION OF MEMORANDUM OF ASSOCIATION (SECTION 13)**

Sec. 13(1) of the Act provides that subject to the provision of section 61, a Company may by special Resolution and after complying with the procedure may alter the clauses of the Memorandum of Association of the Company.

- **Alteration of name Clause(Section 13(2) & 13(3))**

As per section 13(2) of the Act, the name clause of the MOA can be altered by adopting the following procedure:

(a) Special Resolution: A company may change its name by passing a special resolution at a general meeting of the share holders (sec. 13(1)).

(b) Approval of Central Govt. Sec.13(2): Approval of Central Govt. is needed in writing in addition to special resolution.

(c) Approval of Central Govt. Not needed : Sec. 13(2): When a Company is changing from public to private or vice versa, then deletion of the word "Limited" or "Private Limited" does not required the Central Govt. approval.

(d) Filing of Central Govt's. order with ROC: A copy of approval order of Central Govt. must be filed with the Registrar of the Companies.

(e) Entry of new name by ROC : Sec. 13(3): the Registrar shall enter the Company's new name in place of old name.

(f) Issue of Fresh Certificate of Incorporation by ROC: Sec. 13(3) : The Registrar shall issue a fresh certificate with the new name.

(g) Effectiveness : Sec. 13(3) : The change of name shall be complete and effective only on issue of such certificate.

- Alteration of Memorandum in relation to changing of Registered Office from one State to another : [Sec. 13(4), 13(5) & 13(7)]

The Company can change its registered office from one State to another by:

(a) Special Resolution: Sec. 13(1) :- Special resolution regarding change of registered office should be passed in its general meeting.

(b) Application to Central Govt. Sec. 13 (4):- Application to be made to Central Govt. for confirmation of the change.

(c) Confirmation of Central Govt : Sec. 13(5):- The Central Govt. shall dispose f the application for change of registration office within 60 days from the date of the application.

(d) Consent of the Affected parties : Sec. 13(5):- The Central Govt. shall satisfy that the alteration has the consent of the creditors, debenture holders and other persons concerned with the Company or that the sufficient provision has been made by the Company either for adequate security has been provided for such discharge.

(e) Filing of Central Govt. order with ROC: Sec. 13(7):- A certified copy of the order of the Central Govt. should be filed with the ROC of each state with a time as may be prescribed.

(f) Entry of New location of the Registered office by ROC : Sec. 13(7):- The Registrar shall enter the new location on the register of the company.

(g) Issue of fresh certificate of Incorporation by ROC: Sec. 13(7) :- The Registrar of the State from which such office is transferred shall issue of certificate regarding change of State.

- Alteration of Memorandum in Specific case

(a) Condition of Alteration : Sec. 13(8):- If a Company has raised money from the public through prospectus and has still any unutilized amount out of the money raised, then it shall not change the object fro which the fund was raised unless and until :

- (i) a special resolution as passed by the Company.
- (ii) the details, as may be prescribed in respect of such resolution shall be published in the newspaper.
- (iii) such details are placed on the website of the company if any,,
- (iv) The dissenting shareholders are given an opportunity to exist by the promoters and share holders having control in accordance with the regulation as specified by the Securities and Exchange Board.

(b) Entry of Alteration by ROC: Sec. 13(9):- The Register shall register any alteration of the Memorandum in respect of the objects of the Company.

(c) Issue certificate of Registration by ROC : Sec. 13(9):- The Registrar shall certify the registration within a period of 30 days from the date of filling of the special resolution as per sec. 13(6)(a).

- Alteration of Memorandum relating to Company Limited by Guarantee]Sec. 13(11)]

According to sec. 13(11), any alteration of Memorandum of Company limited by guarantee and nit having a share capital, purporting to give any person a right to participate in the divisible profit of the company otherwise than as a member, shall be void.

1. (a) Filling of Documents with ROC:- According to sec. 13(6) of the Cat, subject to the provision of section 64, a Company shall file with the ROC in respect of alteration of its Memorandum-

- (i) the special resolution passed by it as per sec. 13 (1);
- (ii) the approval of the Central Govt. under sec. 13(2) for change of its name .

(b) Alteration of Memorandum effective only on registration :[Sec. 13(10):- Acc to sec. 13(10), any alteration of Memorandum of Association of a Company made u/s 13 shall have effect only if it is registered with the Registrar as per the provision of this section.

2. Alteration of Memorandum of Companies having charitable objects and registered u/s 8 :- No alteration of Memorandum by a Company registered u/s 8 except with previous approval of the Central Govt.

3. Alteration of capital clause: As per sec 61 of the Act,

(a) A limited company having a share capital may, if so authorized by its article alter its memorandum in its general meeting to –

(i) increase its authorized share capital by such amount as it think fit.

(ii) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.

(iii) convert all or any of its fully paid up shares into stock and reconvert that stock into fully paid up shares of any denomination.

(iv) sub- divide its shares or any of them into shares of smaller amount than is fixed by the Memorandum, so however, that in the sub-division , the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived.

(v) cancel shares which at the date of passing of the resolution in behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

(b) The cancellation of shares under sub section (1) shall not be deemed to be the reduction of share capital.

- **ARTICLE OF ASSOCIATION**

As per sec. 2(5) of the Act, Article of Association (AOA) are the regulations and bye laws for governing the internal affairs of the Company. Its is called as the secondary documents of th company. They may be described as the internal regulations of the Company governing its management and embodying the powers of the Directors and officers of the Company as well as the powers of the share holders. They are framed with the object of carrying out the aims and objects by MOA.

- **CONTENTS OF ARTICLE OF ASSOCIATION**

Article of Association contains the following particulars:

- (a) Division of the share capital of the Company and rules regarding allotment, issue, transfer, forfeiture of shares and procedure for conversion of shares into stock and vice-versa.
- (b) Procedure of holding and conducting the various meetings, notices, proxy, quorum, poll etc.
- (c) Voting rights of the members and rules regarding methods of voting.
- (d) Matters relating to appointment, powers, duties, qualification and remuneration of Directors.
- (e) Methods of increase, reduce or alter the share capital.
- (f) Rules relating to share certificates including duplicate certificates and procedure of lien of shares.
- (g) Declaration of Dividend and rules regarding its payment.
- (h) Constitution and composition of Audit Committee, Remuneration Committee.
- (i) Terms of appointment, remuneration, delegation of authority etc of Secretary, manager if any.
- (j) Rules relating to account, audit, charging of depreciation and creation of reserves etc.
- (k) Rules regarding borrowing powers of the Company and the mode of exercise of those powers.
- (l) Procedure of winding up of the Company.

- ALTERATION OF ARTICLES

A company may by passing a special resolution under section 14(1) of Act, can alter regulations contained in Articles any time. Any new regulations in the Articles may be adopted which could have been lawfully included in the original Article. Further, a copy of every special resolution altering the Article should be filed with the Registrar of Companies within 15 days u/s 14(2) of the Act of passing. Any alteration to be made in the Article shall be valid as if originally contained in the Articles as per sec. 14(3) of the Act, 2013.

- **DOCTRINE OF ULTRA VIRES:**

The word “ultra” means beyond and “vires” means power. So ultra-vires means beyond power i.e. an act done by the Company beyond its legal power and authority.

It had been observed that a Company has an independent legal existence and is a separate body corporate, distinct from its members. The Company can therefore perform act on its own. The acts which the Company performs are authorized by (a) the objects specified in the MOA of the Company with which it is registered. And (b) The Companies Act.

Any act done by the Company which is neither authorized by the object nor by the Companies Act, that Act is called “ultra vires” the powers and authority of the Company. Any Act which is ultra vires to the Company is void and cannot bind the Company.

- **DOCTRINE OF CONSTRUCTIVE NOTICE**

The doctrine of Constructive Notice is also popular as the doctrine of presumed notice. Presumed notice means every person dealing with the Company is presumed to have read the conditions contained in MOA and AOA.

Sec. 399 of the Act, provides that MOA and AOA when registered with ROC become public documents and they can be inspect by any one by electronic means on payment of the prescribed fees. Sec. 17 read with Rule 34 of the Companies (Incorporation) Rule, 2014 also provides that a Company shall on payment of the prescribed fees are bound to supply the copy of the documents i.e. memorandum and Article to the members within 7 days from the date, the request is made . If failed to supply the said copy, the company as well as every office shall be liable to pay a fine of Rs. 1000/- per day for each day of default of Rs. 1,00,0000/- whichever is less.

- **DOCTRINE OF INDOOR MANAGEMENT**

When the Article of Association of a Company prescribed a particular procedure for doing a thing , the duty of carrying out the provision lies on the person in charge of the management of the Company and outsiders are entitled to assume that the rules have been complied with. This is known as the “Doctrine of Indoor Management”. It is an exception to the rule of Constructive notice. As per the doctrine, a person dealing with a company is bound to read only the public documents.

The Doctrine of Indoor Management does not apply under the following cases:

(a) Where the Act is void-ab initio, the Company is not bound. (b) Where the person dealing with the Company has notice actual or constructive that the prescribed procedure has not been complied with, the Company is not bound.

The Doctrine of constructive Notice operates subject to one limitation laid down in the celebrated case of Royal British Bank –vs- Turquand (1856) . That rule is known as Indoor management where an outsider is not supposed to know. In other words this rule operates in favour of an outsider but against the Company.

The reason of the indoor management rule is that as an outsider cannot enter into a place where closed door policy is adopted. It is similar to trial by cameral where an unauthorized person became a trespasser. One expects that everything has been closed properly inside the Chamber, but the result would be otherwise if the Article provides for special resolution instead of ordinary resolution. Special resolution are public documents and accessible to public.

Exception to the Doctrine of Indoor Management

In the following circumstances, relief of Indoor management cannot be claimed by an outsider who is dealing with the Company.

(a) Where the outsider had knowledge of irregularity: The Rule will not apply if the person dealing with the Company as slight knowledge about the lack of authority of person who is acting on behalf of the Company. In this situation, the doctrine does not apply.

(b) No Knowledge of Memorandum and Article: The Rule cannot be invoked by a person on the ground that he doesnot have the knowledge of memorandum and Article and thus he does not rely on them.

(c) Forgery: The Rule doesnot apply to the transaction involving forgery or illegal transaction which are void-ab-initio. In the case of the forgery transaction, there is lack of consent. There the question of forgery cannot arise as the person whose signature is forged, he is not even aware of the transaction.

(d) Negligence: The Doctrine is not applicable to those who act negligently. Thus, where an officer of a Company does something which shall not ordinarily be within his authority, the person dealing with him must make proper enquiries and satisfy him as to the officer's authority. If he fails to make enquiry, he is stopped from relying in the rule.

(e) The doctrine does not apply where the question is in regard to the every existence of an agency.

(f) This doctrine is also not applicable where pre-condition is required o be fulfilled before the Company itself can exercise a particular power. In other words, the act done is not merely ultra vires the Directors or officers, but ultra vires the company itself.

