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INTRODUCTION TO THE NEW AVATAR OF 'MEMORANDUM OF ASSOCIATION' AND ANALYSIS OF THE 'DOCTRINE OF *ULTRA-VIRES*'.

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ABSTRACT

This paper is the comparative analysis of the memorandum of association of The Companies Act, 1956 and The Companies Act, 2013. The paper will explain the concepts of memorandum of association and the doctrine of *ultra-vires.* The paper will also try to locate the doctrine in the Indian perspective by discussing the evolution of company law and will also try to analyze the difference that has been made in one of the branch of the doctrine, called substratum, under the new legislative regime. At last the paper will argue that though some changes are made under the new regime of the company law legislation in memorandum clause, still the legislature has failed to address the plight of the innocent third parties which enter into transaction with a corporation, through a legislative recourse.

Keywords: Company; Corporation; Share Capital; Company; Corporation; Guarantee; Joint Stock Company; Limited; Memorandum of Association; Private Limited; Share Capital; *Ultra-Vires.*

I. INTRODUCTION

We will start our journey with the understanding the concept of the memorandum of association and then proceed towards the role performed by it. We will see during our course of journey that what are the parts of a memorandum of association and what are the changes which are brought by the legislation in it in the new era of The Companies Act, 2013. As if a company does not abide by its constitution the transactions entered into by the company would be void and no remedy would be availed in any court. This acts which are done in the contravention of the company's constitution are called *ultra-vires* act. Due to the recent statutory developments of many countries, questions have been arisen on the existence of the doctrine. For example, first, a statutory development, is seen in the introduction into the Companies Acts of the various Australian territories and states, of provisions which are aimed at giving to companies almost unlimited powers and which are aimed at virtually abolishing the doctrine except for limited purposes; the second is seen in the interpretation given to an objects clause in a company's memorandum of association which vests in the directors the power to carry out whatever business "they deem would be beneficial to the company."[1] But in India no there is no as such development and doctrine is still is in existence. We will analyze the doctrine at length since its inception in India, as well as effects which follow an *ultra vires* act. But before understanding the doctrine of *ultra vires*, one must know the concept of memorandum of association and the relationship that exist between the two. So let

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[1] Ss. 19 and 20 of the Uniform Companies Legislation. See Wallace and Young, *Australian Company Law and Practice,* 1965, p. 95-100.

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us start our journey with the memorandum of association.

II. The Memorandum of Association

It would not be an exaggeration to say that the memorandum of association is the constitution of a company. It is the document which lays down the foundation of the company and its clauses provide the basic feature of the company's constitution.[2] It is fairly clearly established that the memorandum and articles of association constitute a contract between the company and the members in so far as they confer rights or duties on the members qua members,[3] but not in so far as they confer rights or obligations on members in some other capacity, for example qua directors.[4] If we look into Section 2(56) of The Companies Act, 2013(hereinafter referred to as 'Act') the word memorandum is defined as' "memorandum" means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.' From this definition one cannot infer the exact meaning or nature of the term memorandum but Section 4 of the Act provide us the clauses of the memorandum(which are discussed in the later half of this segment). As clauses in the memorandum provide the basic feature of the company's constitution, it is imperative that it must in the harmony with the legislation that governs companies. As a state cannot exercise their powers beyond the limits drawn by the constitution similarly the company has to keep itself within the limits set by the memorandum.[5] The contours of the term memorandum of association were best drawn by Lord Cairns in the landmark case of *Ashbury Carriage & Iron Co. Ltd. V. Riche*[6] in which your lordship propounded that : "*the memorandum of association of a company defines the limitation on the powers of the company....it contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation and it states, if it is necessary to state, negatively, that nothing shall be done beyond that ambit...*"

Broadly memorandum of association serves following purposes. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities.[7] An intending shareholder can find out the purpose for which his money is going to be used by the company and what risk he is taking in making the investment.[8] Likewise, anyone dealing with the company, say, the supplier of goods or money, will know whether the transaction he intends to make with the company is within the objects of the company and not *ultra vires* its objects.[9] The document also controls the business field of the company and the conduct of its management through its objects clause.[10]

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[2] A Ramaiya, *Guide To The Companies Act* 17th Edition 2010, LexisNexis Butterworths Wadhwa, p. 401.

[3] *Hickman v. Kent A Romney Marsh Sheepbreeders Association,* [1915] 1 Ch. 881.

[4] *Beattie v. Beattie,* [1938] Ch. 708

[5] *Ibid.*

[6] (1875) L.R. 7 H.L. 653.

[7] A.K. Majumdar and G.K. Kapoor, *Company Law and Practice* 15th Edition 2010, Taxman Publications (P.) Ltd., p. 135.

[8] *ibid.*

[9] *ibid.*

[10] A Ramaiya, *Guide To The Companies Act* 17th Edition 2010, LexisNexis Butterworths Wadhwa, p. 401.

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III.The Memorandum of Association : The Companies Act, 2013 vis-à-vis The Companies Act, 1956.

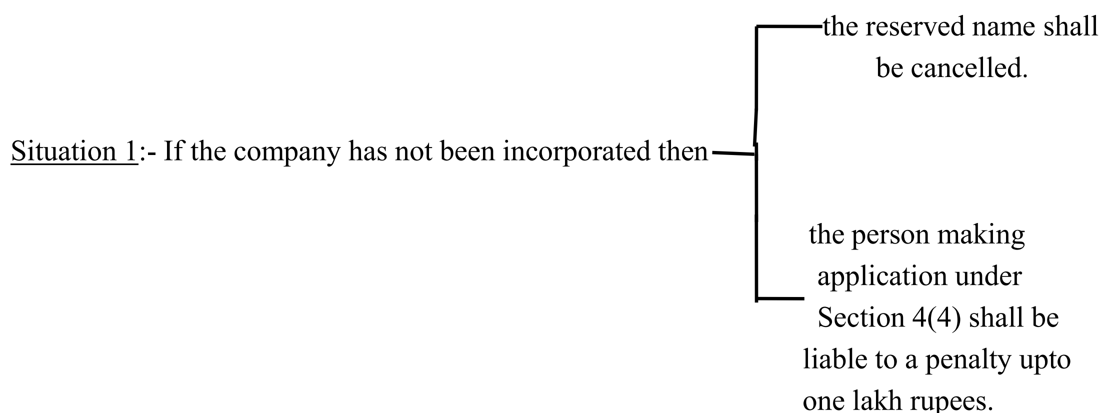
Before going into the nuances of Section 4 let have a bird's eye-view of the major changes that are brought in the new The Companies Act, 2013 vis-à-vis old The Companies Act, 1956:-

i)Section 4 of the new Act is the consolidated form of the Sections 13, 14, 20, 23 of the old Act.

ii) There is no more requirement to divide objects clause into main, ancillary and objects. Under the new legislation only objects for which company is incorporated along with matters considered necessary for its furtherance shall be mentioned.

iii) The Old Act which provided for an additional period of 30 days for which the name can be reserved by the company after expiry of its original period on payment of necessary fees has been dispensed with by the New Act. The New Act provides that a name will be reserved for a period of 60 days from the date of application(Section 4(5)(i) New Act).[11]

iv) The spectrum of the powers of the Registrar of companies is also broadened in the New Act. If the name was applied by furnishing wrong or incorporation, two kind of situations may arise[12]:-



[11] Satwinder Singh, *Comapnies Act 2013 -Knowing the changes*, Corporate Law Adviser, p. 51.

[12] Section 4(5)(ii), *The Companies Act, 2013.*

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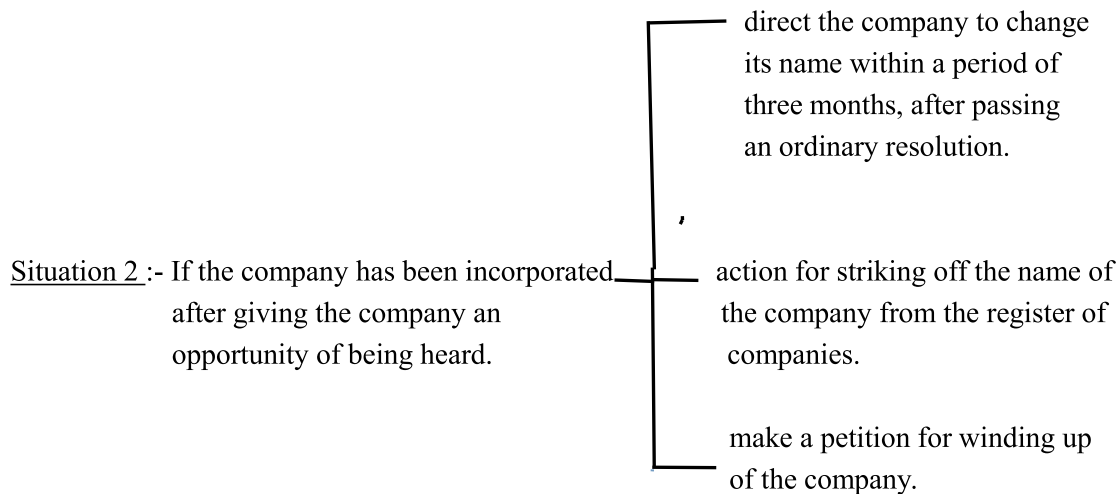

v) The New Act specifically provides that in case of a company limited by guarantee and not having share capital, a provision empowering any person other than the member the right to participate in the divisible profits shall be void.[13]

IV. The Memorandum of Association : The Companies Act, 2013.

Now moving forward Section 4 of the Act as earlier mentioned provided the clauses which are basic features of the company's constitution, let us try to understand the nature of those clauses as enshrined in the Act.

Following is the brief introduction to each of these sub-sections:-

A) Sub-Section 1 :- This sub-section laid down the particulars which should be stated in the memorandum these are:-

i) the name of the company with the last word "Limited" in the case of a public limited company and "Private Limited" in case of a private limited company;

ii) the State in which the registered office of the company is to be situated;

iii) the objects for which the company is proposed to be a incorporated and any matter considered necessary for furtherance thereof;

These objects are basically the ambit of the company's activities. As an act, which is beyond the powers of a company as specified in the memorandum, is *ultra vires*, the practice has become common of making the objects in company's memorandum as wide as possible, in order to obviate the necessity of seeking consent of general meeting by special resolution

[13] Section 4(7), *The Companies Act, 2013.*

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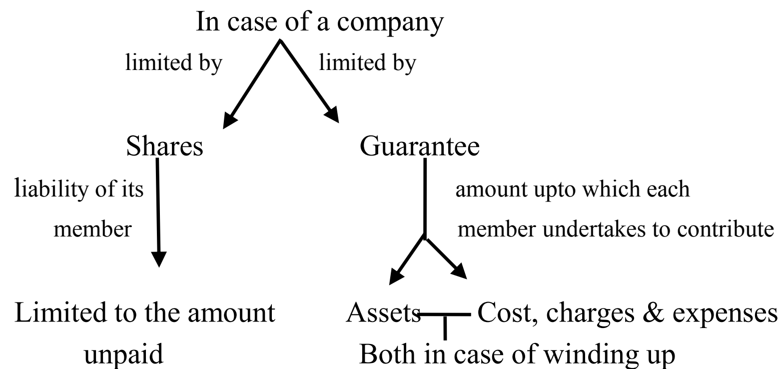
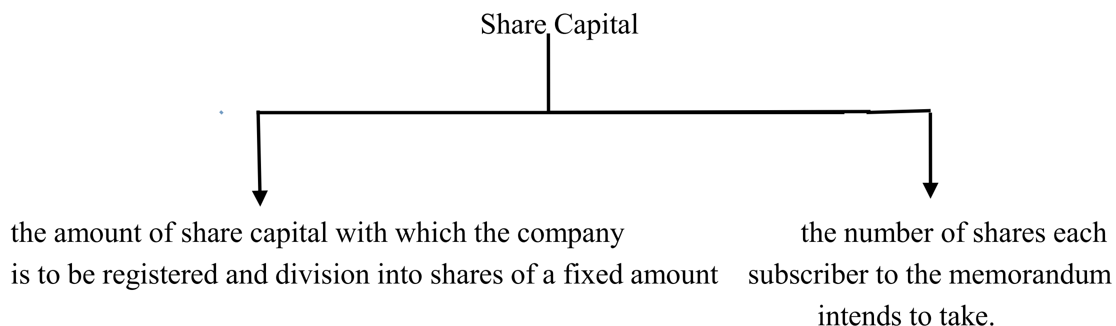
when any new venture is contemplated.[14] If a company do any act which is beyond the objects as laid down in object clause of memorandum of association then the legal consequences of that act would render the act as void and same cannot even ratified by the assent of the shareholders.

It is also worth noticing that in England the objects is required to be made in the articles of association.

iv) the liability of the members of the company, whether limited or unlimited and also state,-



v) in case of a company having a share capital:-



<u>B) Sub-Section 2</u>:-This subsection laid down the rules regarding name of the company. There are certain restrictions by the legislation which should be kept in mind while giving the name to a company. In clause(a) of sub-section one, it is specifically written that if the company is a public limited company then its name must end with suffix 'Limited' and if it is a private company then the ending suffix should be 'Private Limited'. The purpose of this requirement is to warn a person dealing with the company that it is a body with limited liability, though whether it is very effective in this regard is another matter.[15] This sub-section has two clauses. The key points of these clauses are:-

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[14] A Ramaiya, *Guide To The Companies Act* 17th Edition 2010, LexisNexis Butterworths Wadhwa, p. 413.

[15] Paul L. Davies, *Gower And Davies- Principles of Modern Company Law* 18th Edition 2008, Sweet & Maxwell Ltd, p. 84.

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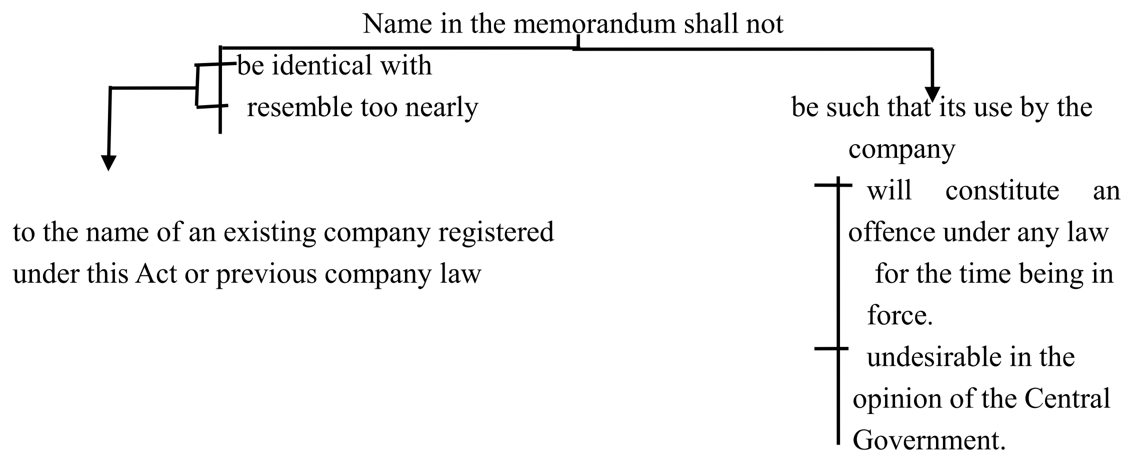

The test of identical name or resemblance of the names is too ambiguous. The following case laws are an attempt to just have a vague idea about the said test:-

M/s Mahalaxmi Jewellers & Another Vs. M/s Mahalaxmi Jewellers of Chakwal[16], the plaintiff succeeded in obtaining an injunction from the court as the defendant firm name as held by the court was similar with that of the plaintiff firm.

In *Ewing v. Buttercup Magarine Co. Ltd.*[17], the plaintiff carried his business under the firm name Buttter Cup Dairy Co. and the defendant's firm was doing business under Buttercup Magarine Co. , your lordship granted injunction on the basis that both the names were closely related and the public might think that the two businesses were connected since the word 'Buttercup' was an unnecessary fancy one.

In *Asiatic Government Society Life Assurance Company Ltd. V. New Asiatic Insurance Company Ltd*[18], the court held two names were not too identical as a result of which plaintiff is not entitled for any relief.

In *Manipal Housing Finance Syndicate Ltd. and others v. Manipal Stock and Share Brokers Ltd. and others*[19], the plaintiffs used the name of a city as the name of their corporation, similarly defendants also used the same name of the city for their business corporation. Plaintiff sought injunction on the ground that they used this name prior to the defendants. Court held that prior user of city name as part of their corporate name does not confer monopoly in favour of plaintiffs. What is in public domain cannot be appropriated and made one's own merely by being first user and right to use available to others in same measure as available to plaintiff. Neither plaintiffs nor defendants can claim exclusive right to commercial use of name.

C) <u>Sub-section 3:-</u> This sub-section is mainly refraining to use any name or word which has resemblance or which give the expression that any company is related to or have patronage from any Central Government or State Government company or connected with any body

[16] (1981) PTC 197.
[17] (1917) 2 Ch. 1.
[18] (1939) 9 Comp. Cas. 208.
[19] (1999) 98 Comp.Cas. 432 (Mad).

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constituted by the Central Government or any State Government under any law.
D) Sub-section 4, 5, 6:- Sub-section 4 provided that an application for the reservation for the name of the company should be made to the Registrar of Companies. Sub-section 5 provided that if application for the reservation of the name is made to the Registrar of Companies, who if satisfied, may reserve the name for the period of 60 days from the date of application(more details regarding this sub-section are discussed in the preceding paragraph). Sub-section 6 provided that memorandum shall be in forms specified in Tables A,B,C,D and E in Schedule I.
After discussing in detail the concept of memorandum of association, we are now able to understand by and large what is the importance of it. To further expanding the area of memorandum of association, let us now move to the legal consequences, embedded in the doctrine of *ultra-vires*, which follow from it.

V. DOCTRINE OF *ULTRA VIRES*

Ultra vires is a Latin phrase composed of two words *ultra* meaning beyond and *vires* meaning power. So *ultra vires* act means acts done beyond the power or authority. This doctrine was emerged in the early nineteenth century. The courts developed the *ultra vires* doctrine to ensure that companies only exercised powers to carry out the objects together with anything incidental thereto.[20] A company was required by the legislation to include a statement of its objects in the memorandum of association and from that the courts deduced that the company did not have legal capacity to act outside its objects and any such action was in principle void.[21] A corporation is organized under a special charter or a general act which provides that the corporation may do certain things, and either expressly or by implication that it may not do other things.[22] Questions involving the application of the doctrine of ultra vires most commonly arise in respect to the powers of corporations as exercised by the directors or trustees in managing the affairs of a given corporation.[23] Earlier the position was that an *ultra vires* act could not even ratified by all the shareholders.[24] But subsequently it was held that a company can do things which were reasonably incidental to its stated objects.[25] It is clear that a company should have a very broad memorandum of association and it should be meticulously drafted so that even covering the near possible future prospects of a company. However it is a still debatable issue that what legal consequences are attached to *ultra vires* transactions ? The answer is not clear and simple, but contradictory, uncertain, and frequent unjust.[26] This confusion is due in some measure to the carelessness with which the courts have used this term. It does not seem to be an exaggeration to say that there are no sound

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[20] Stephen Girvin, Sandra Frisby & Alstair Hudson, *Charlesworth's Company Law* 18th Edition 2010, Thomson Reuters (Legal) Limited, p. 95.
[21] Paul L. Davies, *Gower And Davies- Principles of Modern Company Law* 18th Edition 2008, Sweet & Maxwell Ltd, p. 153.
[22] Edward Avery Harriman, *Ultra Vires Corporation Leases,* Harvard Law Review, Vol. 14, No. 5, 1901, p. 332-352.
[23] D.L. , *Ultra Vires,* The American Law Register, Vol. 25, No. 9, 1877, p. 513-526.
[24] *Ashbury Railway Carriage & Iron Co Ltd v. Riche (1875) L.R. 7 H.L. 653.*
[25] *Attorney General v. Great Eastern Railway Co. (1880) 5 App. Cas.473.*
[26] Charles E. Carpenter, *Should the Doctrine of Ultra Vires Be Discarded ?,* The Yale Law Journal, Vol. 33, No. 1, 1923, p. 49.

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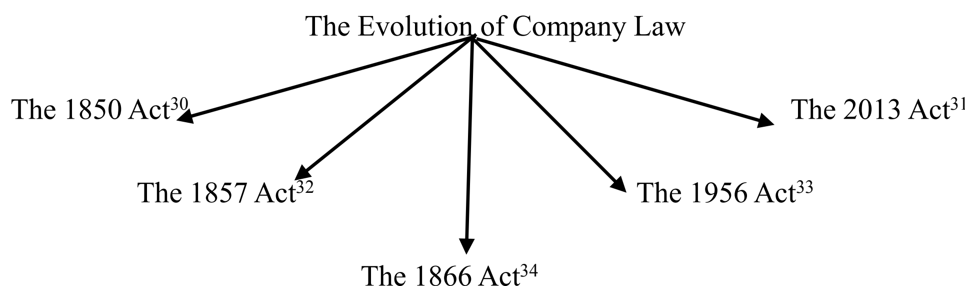
theories consistently applied and there are many unsound ones discordantly applied.[27] We will touch upon this issue in later half of this research paper, let us now locate this doctrine in Indian scenario and check how it got incorporated into Indian legal system and what advancements are made in it from time to time.

VI. DOCTRINE OF *ULTRA VIRES* : THE INDIAN PERSPECTIVE

If we try to find out *ultra vires* in the Indian perspective then the case of *Jahangir Rastamji Modi v. Shamji Ladha.*[28] would be the authority in which this doctrine was established.
Before discussing this case at length, it is imperative for us to first have a brief introduction of the important provisions that were laid down in the various company law legislation which came into effect from time to time, so that we are able to understand clearly that under what type of legislative regime doctrine of *ultra vires* paved the way to Indian company law.

VII. EVOLUTION OF THE COMPANY LAW IN INDIA

The history of the company law traces back to the year 1850 when the first Registration of Joint Stock Companies Act, No. XLIII was promulgated. Since then various new advancements and acts came up repealing the previous one, here we are only discussing the first three acts of the company law.[29]



A) <u>REGISTRATION OF JOINT STOCK COMPANIES ACT, NO. XLIII, 1850</u> :-

i) This Act provided for the first time for the registration of joint stock companies.[35]
ii) The Supreme Courts of Judicature at Calcutta, Madras and Bombay were authorized to order registration of a company on a petition together with deed of partnership or copy of the

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[27] *Ibid.* p. 49.
[28] (1866-67) 4 Bom. H.C.R. 185.
[29] As important provisions for The Companies Act, 1956 and The companied Act, 2013 are already discussed in this paper.
[30] Registration of Joint Stock Companies Act, No. XLIII, 1850.
[31] The Companies Act, 2013.
[32] Act for the incorporation and regulation of Joint Stock Companies, 1857.
[33] The Companies Act, 1956.
[34] Indian Companies Act, 1866.
[35] Section 1.

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deed of partnership being present to them.[36]
iii) There was no clause corresponding to the objects clause.[37]
As it is clear from the relevant sections of the act that there was no clause for the objects of a company so as a natural result of this there was no place for the doctrine of *ultra vires* in this Act because objects are the spectrum of authority of the company.

B) ACT FOR THE INCORPORATION AND REGULATION OF JOINT STOCK COMPANIES, 1857 :-

i) This Act for the first time enabled the members of companies other than for the purpose of banking or insurance to limit their liability.[38]
ii) This Act replaced the petition and deed of partnership of the 1850 Act by memorandum of association and articles of association.[39]
iii) The Act required that the memorandum of association should state, *inter alia,* "The objects for which the proposed Company is to be established."[40]
iv) It further required that the articles of association were for " prescribing regulations for the company."[41]
v) The Act provided for alteration of the articles of association by means of special resolution.[42]
This Act specifically laid down the provisions for the memorandum of association and articles of association. The objects of a company were to be stated in the memorandum of association.

C) INDIAN COMPANIES ACT, 1866 :-

i) Section 6 of the Act provided that : "Any seven or more persons associated for any lawful purpose may, by subscribing their names to a memorandum of association, and otherwise complying with the requisition of the Act in respect of registration, form an incorporated company, with or without limited liability."
ii) Section 8 provided that in the memorandum of association of the company, the objects for which the company is established, should also be stated.
iii) Section 11 provided that the memorandum of association shall, when registered, "bind the company and members thereof to the same extent as if each member had subscribed his name thereto, and there were in the memorandum contained, a covenant to observe all conditions of such memorandum subject to the provisions of this Act."
iv) Section 12 provided that "Any company limited by shares may so far modify the conditions contained in its memorandum of association,... as to increase its capital...or to consolidate and divide its capital into shares of larger amount than its existing shares, or to convert its paid up shares into stock; but, save as aforesaid, and save as hereinafter provided in the case of a change of name, no alteration should be made by any company in the

[36] Sections 2 and 3.
[37] Section 3.
[38] Section 1.
[39] Sections 1 and 7.
[40] Section3(3).
[41] Section 7.
[42] Section 39.

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conditions contained in its memorandum of association."
The provisions contained in these sections were similar to the provisions contained in the (English) Companies Act,1862.[43]

This was the history of the evolution of company law in India. Now let us discuss at length the founding case which gave birth to the doctrine of *ultra vires* in India.

JAHANGIR RASTAMJI MODI V. SHAMJI LADHA[44]

It was the case in which the doctrine of *ultra vires* laid down in India. In this case plaintiff was the registered shareholder and the defendants were the directors. The allegation of the plaintiff was that the objects of the association as defined in the memorandum of association of the company did not include the dealing in shares, nor the purchase of the company's own shares. But the defendants did deal in shares and bought the shares of the company.
Two major issues which were framed were : a) Whether the purchase of its own shares by the company was *ultra vires,* b) whether the purchase of shares in joint stock companies was *ultra vires.*
Justice Sargent held that the directors were not authorized to do so and the transaction accordingly was *ultra vires*.
Your lordship observed that:-
"A long series of decisions of the courts of law and equity in England has decided that an incorporated joint stock company can do no act which is not expressly or impliedly authorized by... the deed of settlement of the company...It is therefore to the memorandum and articles of association that we must turn to determine whether those transactions are expressly or impliedly authorized; or as it has been sometimes expressed, whether they fall within the scope of the objects for which the company was established."[45]
While discussing the purchase of the company of its own shares was *ultra vires*, Your lordship holds that :
"I have not arrived at this decision without some regret, as I can not but be aware of a fact perfectly notorious, that it has been the practice not only of companies similar to this, but for other companies, to purchase their own shares, and that this decision may press somewhat harshly upon individuals; but at the same time if the joint stock companies are to flourish, more specially in a country like this, it can only be by the public feeling assured that the courts of law while refusing to interfere with directors in carrying out the objects of these associations into full and complete activity, will prevent the application of the funds of the company to other than legitimate purposes and objects of the association."[46]
From the above cited paragraph of the judgment it is clear that the learned judge had emphasized more on the assurance of the public regarding the expending of the money of a company. The public should be assured that the money or fund is expended within the objects entailed in the memorandum of association of a company. As this was the first case on the

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[43] 25 & 26 Vict. c. 89.
[44] (1866-67) 4 Bom. H.C.R. 185.
[45] *ibid.* p.190.
[46] *ibid.* p. 198.

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ultra vires so it can be said that Sargent J. was the founder of the doctrine of *ultra vires* in Indian company law jurisprudence.

Many critical views had also been put forward regarding this foundational case. Some of the critics have commented that by reading this judgment one gets the feeling that the learned judge decided the case by the English law and not by the Indian law; though the relevant provisions of the two Acts were quite similar.[47] Though these were similar but the spirit of the doctrine is well applied by the learned judge.

Having discussed at length the origin of the doctrine of *ultra vires*, let us now discuss the effects and nuances of this doctrine.

VIII. EFFECTS OF THE DOCTRINE OF *ULTRA VIRES*

As objects of a company restricts a company to do an act which is beyond its authority, a natural question which arise in mind is that what would be the effects if the transaction is still made to effect inspite of the restriction imposed by that of the objects. The doctrine of *ultra vires* is the means by which the courts have worked out the answer to this question.[48] The court has applied the doctrine on some of the following common grounds: because the corporation lacked the power to make the contract,[49] because it was illegal,[50] because the party who dealt with the corporation was charged with notice of the limits of the corporation's power.[51] The question which is still unanswered is that : what would be the effects of an *ultra vires* transaction? Let us try to answer this question:-

1) EFFECT ON LIABILITY OF A DIRECTOR OF A CORPORATION

Any director which acts beyond the authority or which enters into an *ultra vires* transaction would be personally liable for the consequences that would naturally follow from that transaction unless the members of the company ratify the transaction. This is so because; it is not possible for a company with restricted objects to give its directors or other agents authority to cause it to enter into any transaction which is not for the purpose of, or reasonably incidental to, attaining or pursuing those objects.[52]

2) INJUCTION

This is the right which is given to the members or shareholders of a company by virtue of this doctrine. Any member can move to the court and can seek relief of injunction on the ground that the company is entering into an *ultra vires* transaction. The court on the basis of the merits of the case can grant such injunction.

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[47] P.S. Sangal, *Ultra Vires and Companies: the Indian Experience,* The International and Comparative Law Quarterly, Vol. 12, No. 3, 1963, p. 972.

[48] Charles E. Carpenter, *Should the Doctrine of Ultra Vires Be Discarded ?,* The Yale Law Journal, Vol. 33, No. 1, 1923, p. 49.

[49] See footnote to Warren, *Executory Ultra Vires Trasansactions* in (1911) 24 Harv. L. Rev. 534, 543.

[50] Machen, *op. cit. ibid.* note 5, sec. 1020.

[51] *Pittsburgh R. Co. V. Keokuk Bridge Co., ibid.* note 53. (There are many other grounds also but contemplating the risk that paper would become lengthy if all are cited also it is not possible to cover all the grounds.)

[52] *Rolled Steel Products (holdings) Ltd v. British Steel Corporation (1986) Ch. 246* per Slade LJ at p. 295.

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3) REPUDIATION OF TRANSACTIONS

A company may repudiate any transaction which is entered by any person acting as an agent of the company but has no actual authority to do so. But this transaction would not be void as such there is one exception when the board of the company ratifies the transaction then it would be binding on the company.The third party will be at the mercy of the board, which, in effect, has an option whether to commit the company to contract or not.[53]

IX. SUBSTRATUM

Before the commencement of The Companies Act, 2013, there was a rule of substratum, which was borrowed from the common law, in The Companies Act, 1956, under Section 433(f). The section provided that if a company does not commence its business within one year from the date of incorporation or suspends its business for one year than it would be a ground for winding up of a company. The courts had held that the objects here under this clause should be the main objects. If the conditions were fulfilled under the above said section then a member of the company could file a petition in the court for winding up the company. For example in case of *Ajay Kumar Gupta Dochania v. M/s. Bhagyanagar Silk Mills Pvt. Ltd, a Private Limited Company and another,*[54] where the defendant company was unable to carry on its business for several years, the plaintiffs as shareholders accordingly filed a petition for winding up. The Andhra Pradesh High Court invoking the above mentioned section allowed the petition for the winding up of the company.

But it is interesting to note here that under the regime of The Companies Act, 2013, the above mentioned section is repealed and also the requirement for stating ancillary and other objects is repealed. So now more or less the rule of substratum is obsolete in India.

X. CONCLUSION

We have seen that various new amendments have been made in The Companies Act, 2013 pertaining to the memorandum of association. The requirement for ancillary and others objects has been repealed and in place of that only objects clause has been inserted, though it would not effect the ambit of the doctrine of *ultra-vires* in any way. As we have seen that in the discussion that there is no fundamental rule for establishing the grounds for the *ultra-vires* transactions, the vulnerable are only the third parties who don't have the knowledge of the objects of the company and act in good faith. The legislature has failed to provide legislative protection to those bona-fide third parties. As in England, after the reforms of 1972 and 1989 the legislature has specifically provided the statutory protection to third parties who acted in good faith. The same kind of protection was expected but legislature has failed to do so.

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[53] Paul L. Davies, *Gower And Davies- Principles of Modern Company Law* 18th Edition 2008, Sweet & Maxwell Ltd, p. 157.

[54] (2013) 178 Comp.Cas. 135 (AP).

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