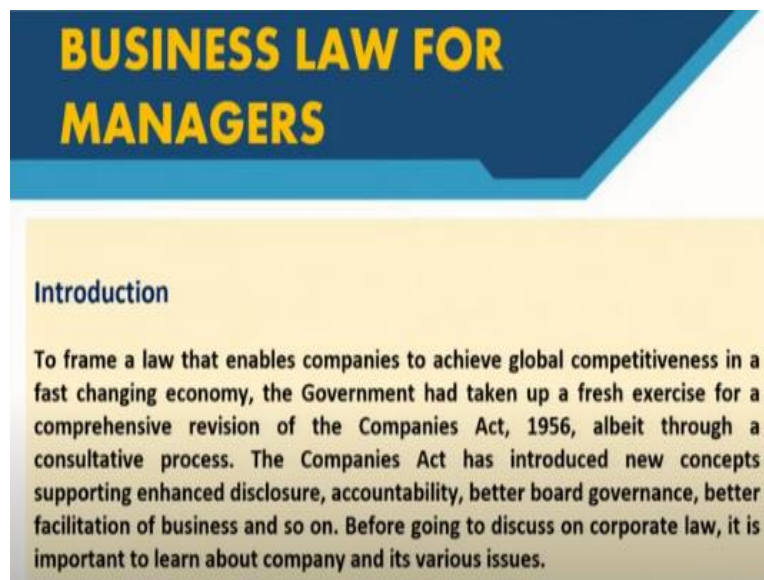


Business Law for Managers
Name of Faculty: Mr. Kaushik Mukherjee
Vinod Gupta School of Management
IIT Kharagpur
Module-1: Corporate Law
Lecture - 01
Concept, Definition and Features of Company

Hello, good afternoon. Welcome to the session on business law for managers. This is the first module, lecture 1, which will cover concept, definition and features of company.

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Basically, we would be dealing with Companies Act and how it unfold before the business communities and what was the need for this Companies Act. What brought about this Companies Act when there were different forms of other organizations prevalent. What was the need of the business? Any requirement need or formation of another form of organization comes only out of business needs.

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KEY POINTS

- Definition of a Company
- Features of a Company
- Distinction between a Company and a Partnership
- Lifting of a Corporate Veil
- Private and Public companies
- Distinction between Private and Public Company



The key points which we need to cover basically would be definition of a company, the features, the distinction between a company and other forms of organization. Well, the most paramount importance of a company form of organization is very thin but very solid facade which is created by law which we call in corporate parlance and corporate legal used word is corporate veil.

Then of course, the two forms of companies most widely talked of is the private and the public, controlled and the partially controlled. I would not say uncontrolled, partially controlled and the distinction between them. And host of other things, but the key points are like this.

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Company

Concept and Definition

The word 'company' is derived from the Latin word Com Panis (Com means 'With or together' and Panis means 'Bread'), and it originally referred to an association of persons who took their meals together.

In popular parlance, a company denotes an association of like minded persons formed for the purpose of carrying on some business or undertaking

The company definition the concept, you know they all comes from something or the other. You ask any word under the sun, they have got something to do with some initial thought process by which it has come. So initial thought process from a word called Latin word, most of the words are coming from all Latin words. So the company is also no exception.

Com means with or together and sharing bread Panis is originally referred to an association of persons who took their meals together. So very concept is an association or togetherness, likeness of mind, objective, purpose, philosophy and finally leading to some return therefore you can take your meals. So that is the purpose of an association of like-minded persons carrying of some business or undertaking.

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Company

Concept and Definition

In the legal sense, a company is an association of both natural and artificial persons and is incorporated under the existing law of a country.

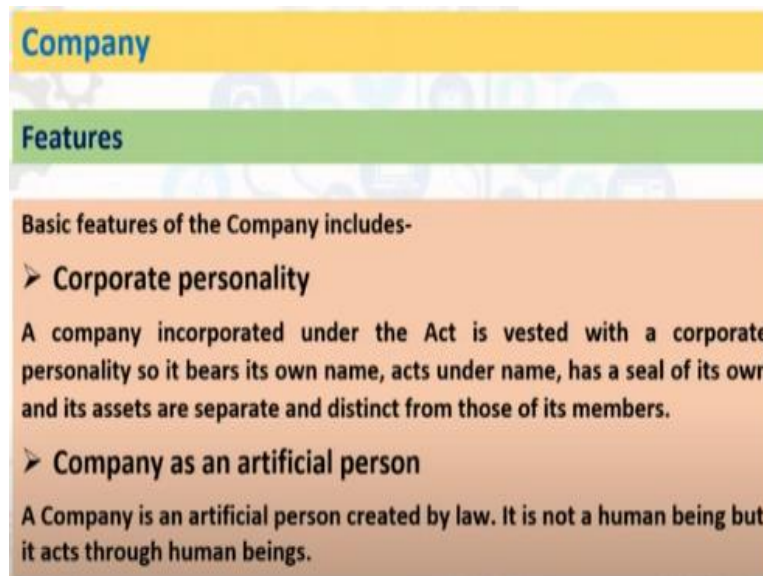
In terms of the Companies Act 2013, a "company" means a company incorporated under this Act or under any previous company law

In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members.

Very important concept in a company is a company is a separate legal entity, we go on saying that. I have been into this for years and I also think this is something which I have heard during my time as student and I think all of you would be hearing and for generations as long as company exists, this concept would be there as a separate legal entity.

And that is the boneyard that is the very purpose that is the very edifice, that is the structure that is the pyramid of a company form of organization. It is a legal separate legal entity. Now what is what do you mean by separate legal entity? All these we will discuss in our next slides as we go forward.

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Company

Features

Basic features of the Company includes-

- **Corporate personality**
A company incorporated under the Act is vested with a corporate personality so it bears its own name, acts under name, has a seal of its own and its assets are separate and distinct from those of its members.
- **Company as an artificial person**
A Company is an artificial person created by law. It is not a human being but it acts through human beings.

The basic features would be a corporate personality. Personality meaning any company under the sun is known by the company. By the name of that company signifies, say for example if I take the name of a company like ITC Limited, Exide Limited, Bata Limited, Hindustan Lever Limited, the company is known by its name.

It has got a personality, it has got a brand, it has got an understanding, it has got a visibility. The owners, the management may come may go but that brand, that entity remains. That is the personality of a company. Yes, it is an artificial person. It is not a human being. It cannot vote in elections. Barring that, it has got all the features of an artificial person, of a person.

It has got a birth, it has got a birth certificate, we call that Certificate of Incorporation. It has got a growth, development. It has got expansion diversifications. And finally, like human beings, death is inevitable. Perhaps, for companies also mergers are also kind of deaths. Amalgamations are also kind of deaths and liquidation of course is a permanent death.

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Company

Features

- **Company is not a citizen:**
The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India.
- **Company has nationality and residence**
Though it is established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence.

I already discussed it is not a citizen in that voting exercise it does not come into. But yes, a company can be a member of another company. It can buy the shares of another company. So that extent it has got an identity, it has got a separate position everywhere. Yes, it has got nationality. Yes, it has got residence. Indian company, resident in India registered in India.

Indian company, but having its wholly owned subsidiaries outside, branches outside, all these are possible.

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Company

Features

- **Limited liability**
The company, being a separate person, is the owner of its assets and bound by its liabilities. The liability of a member as shareholder, extends to the contribution to the capital of the company up to the nominal value of the shares held and not paid by him.
- **Perpetual succession:**
An incorporated company never dies, except when it is wound up as per law. Perpetual succession, means that the membership of a company may keep changing from time to time, but that shall not affect its continuity.

Another very cardinal principle in a company form of organization, why it has become so popular. It has become so popular because of the concept of limited liability. Liability of the owners of the company or the promoters of the company are

limited. By the word limited we mean their personal assets, their personal wealth, their wealth of their kith and kin are never considered assets of the company.

So the company may run into risks, there may be huge losses, but the personal assets of the promoters or the owners are never touched barring exceptional circumstances. Exceptional circumstances mean circumstances which would require a further introspection, investigation and what we call as I explained in the first slide or second one that corporate veil.

That corporate veil gets lifted, then only that happens. But that is an exceptional situation. That is not at all a situation which is desirable or something which is at all should happen, but it happens, exceptional cases happen. But other than that, for business, for business losses, none of the promoters, owners are personally responsible.

It is only to the extent of the shares they have invested in that company that share value goes down and the market cap of an organization meaning the total number of shares, the price that is being traded of the shares in the market, we call it the market cap. The market cap of the organization goes down to the extent the promoters take a hit, the owners take a hit.

That is a liability. Barring that, there is no liability. But if it is a sole proprietorship organization, it is a partnership organization, in that case, your entire personal wealth is exposed to that risk. It can be attached, it can be taken away, it can be mortgaged, it can be sold to realize the dues.

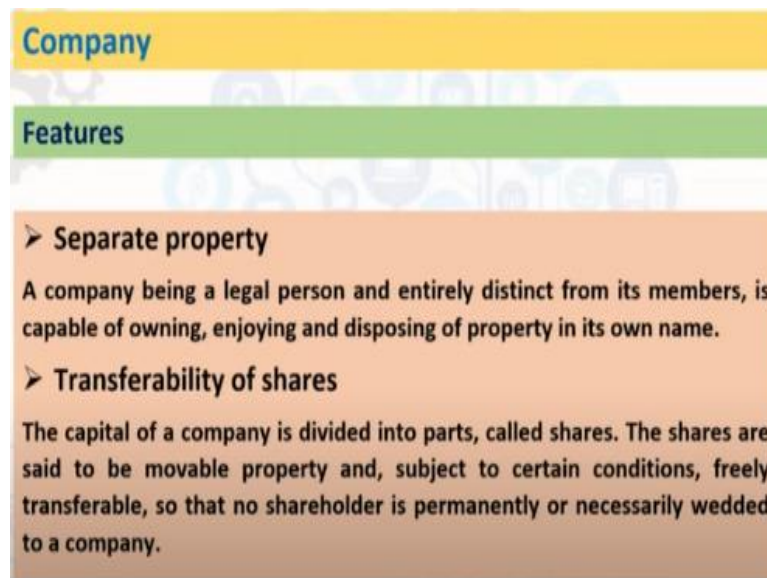
So the liability concept is another, limited liability concept is another very important aspect for which the company form of organization has become so popular, not only popular has become very sustainable. We passed the act in 1956. The English Companies Act is 1913. Even much before that the concept was there. In 2013 we redrafted, remodeled, everything we did about the Companies Act.

We never touched this concept. Can the liability be extended? Can we do something with the liability? No one dared to touch because that is the whole you know strength

of that form of organization. Then the other thing is perpetual succession meaning it goes on. As I said companies may come, companies may, I mean members may come members may go. Directors may come directors may go.

But company goes on forever. There is no death of a company just because the members have gone or the owners have gone or the promoters have gone or the shareholders have gone. The company has a perpetual succession.

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Company

Features

- **Separate property**
A company being a legal person and entirely distinct from its members, is capable of owning, enjoying and disposing of property in its own name.
- **Transferability of shares**
The capital of a company is divided into parts, called shares. The shares are said to be movable property and, subject to certain conditions, freely transferable, so that no shareholder is permanently or necessarily wedded to a company.

It is a separate property. It holds its all its properties in its own name. If there is any plant and machinery, if there is any factory building, if there is any land, we do not say it is x's land and y's land. It is that company's land, registered in the name of the company. All the assets are registered in the name of the company. The company is the sole custodian holder of assets of that company.

No one else, no individual, no promoter, no owner holds any property of any company. There are misconception. We take names, individual's names for companies, x's company, y's company, z's company. Yes, we say so because they are the largest shareholder. But by that process, they do not become the owner of the assets of the company. The assets belong to the company.

Transferability of shares is another concept where anyone is free to trade in the shares, can sell the shares, another and other person can buy the shares. So the shareholders changes every moment. Why I say every moment because today we live

in the age of scripless trading. Earlier we had trading of physical shares. Now we do not have trading of physical shares. It is scripless trading.

You do not trade on any physical certificate. So anytime the trades can take place during the day. So a particular company on a particular day does not know who are the owners of that company on that particular day. Others may come, the shares may hold, next day they may sell. So freely transferable shares. Why it is done, to give liquidity to the market.

There is a purpose behind it why it works like this. Enough of funds are raised in the market because of this transferability of shares. We call it liquidity of shares. Are the shares liquid? Are the shares tradable? Are the shares available in the market?

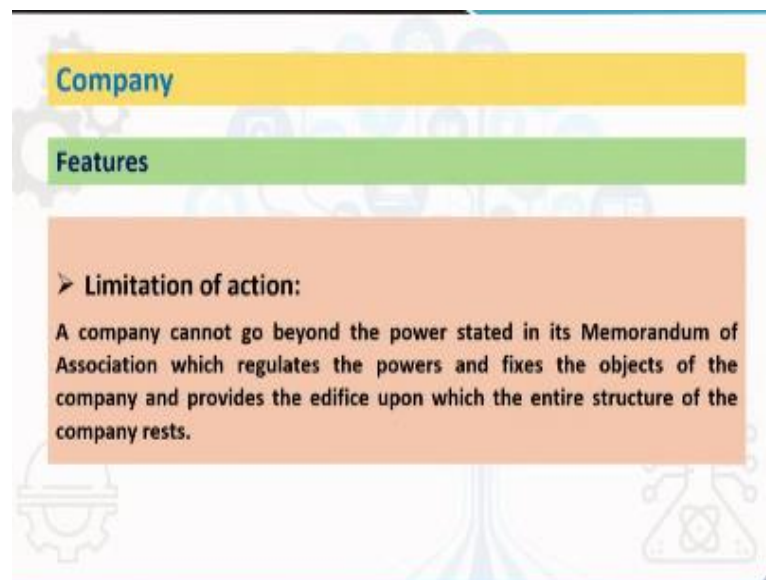
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Company can be sued, a case can be filed against the company. Normally when you file a case against the company, you file it also against the board of directors and management of the company. But specifically against the company you have to file a case. You just cannot file a case against the directors. You have to make it mandatorily for the company plus the directors.

Or you can file only against the company if you want. Then of course the board of directors will come and represent, they will be responsible. But in the name of the company, XYZ Limited versus this. So always in the name of the company. Contractual rights, all contractual rights are in the name of the company.

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This is something we will discuss more in detail when we go to the Memorandum and Association, Articles Association the two solid documents without which a company cannot be formed. The Memorandum of Association, we call the doctrine of constructive notice. Why it is called doctrine of constructive notice?

Because we tell the outside world when you enter into a company with any transaction of a company with any kind of contractual agreement with the company, please look into the Memorandum of Association of that company because that contains the most important documents or criteria based on which that particular company has been formed. Every company has its own Memorandum of Association.

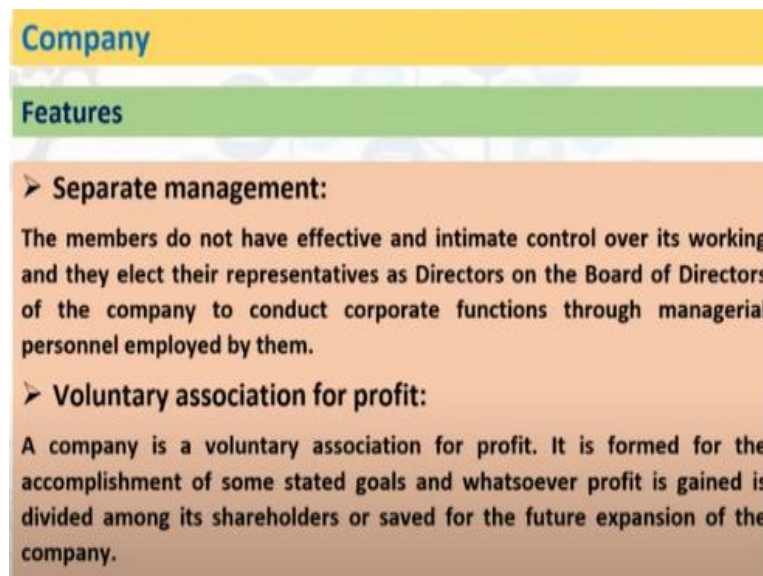
Own meaning, what will be the contents of that Memoranda of Association. But the broadly the items are the same. And you cannot go beyond the Memorandum of Association. For example, the Memorandum of Association contains one of the clauses called the objective clause. What is the purpose for which that particular company is formed?

If the company is formed for generation of power, then that company cannot very next day go for generation of paper just because the business of paper is become very exciting. There is a process.

If the very next day the company goes for generation of paper or even now why next day, even after one year it goes, but the Memorandum of Association contains only generation of electricity power, then that whatever business it is doing, it becomes ultra vires, we say beyond the powers. Again, a Latin word, ultra vires, beyond the powers. So it regulates. It gives the powers with which a company can work.

That is called the Memorandum of Association. Very important for any outside person who is dealing with a company to check the Memorandum of Association. All bankers before giving loan to the company looks at the Memorandum of Association to find out what is it contains.

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Company

Features

- **Separate management:**
The members do not have effective and intimate control over its working and they elect their representatives as Directors on the Board of Directors of the company to conduct corporate functions through managerial personnel employed by them.
- **Voluntary association for profit:**
A company is a voluntary association for profit. It is formed for the accomplishment of some stated goals and whatsoever profit is gained is divided among its shareholders or saved for the future expansion of the company.

It has a separate management. A company is just like three circles. First circle is the company and the circle next to that company is the owner and another circle is the management. There is no intervening area between the owners and the management and owners and the company; company and the management and company and the owners. There is no common area, shaded area, common shaded area.

The common shaded area is there among the management and the owners. Three circles, one circle distinct, not crisscrossing, or no common area with the other two circles. And the other two circles are one is ownership, the other is management. So companies separate. Now when I am talking of ownership and management, these two circles have a common shaded area where the owners and the management are the same.

Why this common area? This common area when the owners become part of the board of directors of a company. Therefore, we have a particular person as the chairman or a managing director of a particular company, who holds the majority shares. So here the shares, who is the owners of the company, who are the shareholders are the owners of the company, they become a part of the board of directors, so they become a part of the management.

So separation of ownership and management is definitely there in a corporate form of organization with an exclusion, that there is a common area. But largely separate. Those who are the owners of the company are not the companies are the management of the company. When you go to board of directors and ownership, this thing further will unfold.

Yes, it is a voluntary association of profit. But again, for profit, it is not for charity. We sometimes confuse that whether it is for charity. Yes, there are organizations which are for charity. NGOs are there for charity. But a company end of the day, its purpose is also to meet one of the stakeholder's interests which is shareholders. And shareholder's primary interest is to get return on the investment.

And now return on the investment comes only in the form of profit. So a company form is created for making profits as well. Profit is not a bad word, profiteering is a bad word. Profit is the return that the shareholders would get by investment in the shares of a company. And therefore, it is not something for charity.

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Company

Features

➤ **Termination of existence:**

A company, being an artificial juridical person, does not die a natural death. It is created by law, carries on its affairs according to law throughout its life and ultimately is effaced by law. Generally, the existence of a company is terminated by means of winding up

Termination of existence. Yes, there are various forms of termination of existence as I told you. Like human beings, death is inevitable companies perhaps liquidation, absorption, amalgamation are also kinds of termination. But if you ask for straight termination, it happens only when there is a winding up by the order of the court. You have done something beyond the regulations.

You have violated law, you have breached law. Your management your board of directors have done something which is not acceptable as per the law. In that case, court would give you an order for winding up. The other is voluntary winding up. When you say the business is no longer profitable.

And we feel that we are done with and there is no other way we can further explore, the only way is the net worth of the company is going to go down, why not stop now, distribute the profits, whatever is there, get back to the shareholders, pay off all the debts and have a closing down of the company. It has happened in many cases.

It has happened in many cases, even in private companies, it has happened and in public limited companies though rare but has happened.

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Company

Features

- Incorporated association
- Artificial person
- Separate legal entity

The facts of the famous Salomon's case were as follows :

- Salomon carried on business as a leather merchant. He sold his business for a sum 30,000 to a company formed by him along with his wife, a daughter and four sons. The purchase consideration was satisfied by allotment of 20,000 shares of 1 each and issue of

This little bit we have already touched upon but one particular case without which perhaps no law and separate legal entity or corporate law can end up any discussion is the famous Salomon versus Salomon case. Here Salomon was a person who started a sole proprietorship business in which he was the main sole proprietor and he was running his leather marching business quite well.

But he thought of expanding. So he converted into a company and you can only convert into company when you separate yourself from that company. It is a separate legal entity and you bring in shareholders. So he brought his daughter and four sons and wife as shareholders, added shares.

So here is a company which is some X Company Limited in which the majority shareholders was Salomon and some of them were his relations. So that was the company form, mostly we call it a closely held private company. We normally called it a closely held private company. Now that company is fine. You know it helps to run business, separation of liability.

Salomon will not be hold good or his assets will not be attached if the company runs into risk. Exactly that happens.

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Company

Features

- Debentures worth 10,000 secured by floating charge on the company's assets in favour of Mr. Salomon. All the other shareholders subscribed for one share of \$1 each. Mr. Salomon was also the managing director of the Company. The company almost immediately ran into difficulties and eventually became insolvent and winding up commenced. At the time of winding up, the total assets of the company amounted to \$ 6,050; its liabilities were \$10,000 secured by the debentures issued to Mr. Salomon and \$8,000 owing to unsecured trade creditors. The unsecured sundry creditors claimed the whole of the company's assets, viz. \$6,050 on the ground that the company was a mere alias or agent for Salomon.

But before that what Salomon did? Salomon also raised money in the form of debentures. Debentures are nothing but kind of loan instruments, which has a fixed rate of interest. All debenture holders are basically lenders. So he creates a charge, floating charge means a kind of mortgage. There are two types of things, one is mortgage and hypothecation.

Mortgage is on immovable property, hypothecation is on movable properties. Here he created a floating charge, most likely it will be a kind of a hypothecation on the company's assets, maybe on stocks on both dates he created a mortgage and on that basis 10,000 worth of debentures were allotted to him. So company mortgaged and he contributed 10,000 rupees and he got a certificate of debenture holders.

So he had the assets of the company mortgaged against it and he had a certificate saying that yes, these assets are mortgaged to you to secure 10,000 rupees or 10,000 whatever will be the currency that you have given to the company. So company had a loan. Loan from whom, from a lender. Lender is who, Salomon. Salomon is also the owner along with the relations.

Company after that went into business difficulties. Business difficulty means losses. Losses means what I say after some time, they will say enough is enough, let us not continue with the business, business is not doing well. So we will liquidate. The moment you go for liquidation, what happens is you need to pay off the debts.

Debts means the dues. To pay off the debts the hierarchy is very simple. First you pay the dues of the workers, employees, provident fund, gratuity etc. Then you go ahead and pay for all the secured debts. Secured means secured against the assets of the company. Then you pay the unsecured debts, those which are not secured. Then you go for the payment of the equity shareholders or the shareholders of the company.

There are two types of shareholders. One is called the preference shareholders, other is called the equity shareholders. Now normally the preference shareholders are paid first, and then the equity shareholders are faced. Now in this case, there is one more party.

Other than this the business they did Salomon did while the company was formed, he did business for some time and then the company ran into difficulties. When he did business, he did business on credit. So he took materials, did not pay, he will pay after say 10 days, 15 days, 30 days depending upon the agreement. We call it business on credit basis.

Very much prevalent; 60 days credit, 30 days credit. So when the company ran into liquidation these were these creditors. They were also at the time of this 10,000 was secured by debentures and there were creditors who were also looking at this amount which was owed to them at that point of time, 8000. So 10,000 secured debentures, 8000 to the unsecured creditors.

When the company ran into liquidation, the assets were only 6050. So here is a position, the company went into loss. And after going into loss, the asset showed that it has got assets of only rupees 6050. Forget the denomination, pound, dollar, rupees let us forget. 6050 is an amount which is lying to the credit to be distributed. To whom?

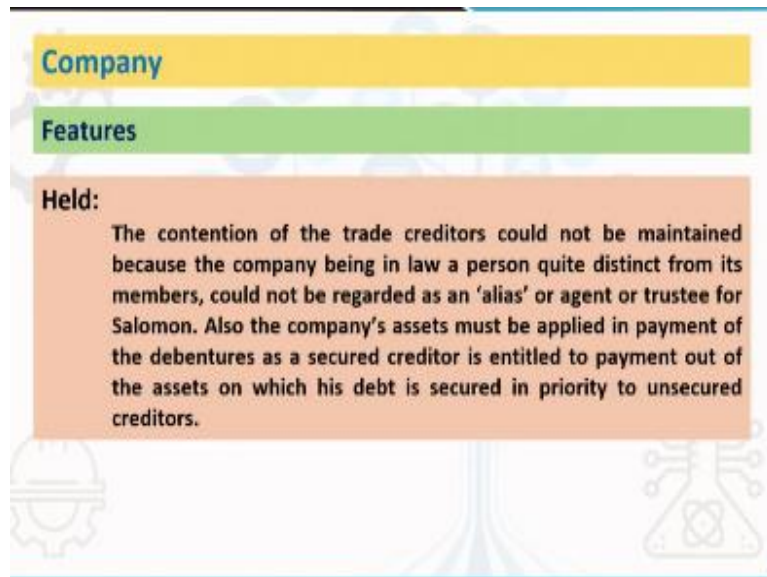
The claimants were first the secured ones, the secured debenture holders. Debenture holders were secured. So they have to be paid first because assets were mortgaged. Then the unsecured which was the trade creditors of 8000. And finally, if anything is left that would go to Salomon as shareholder. This will be the order.

Now the creditors came and said no it cannot be the order because here is a peculiar situation. Here Salomon is the secured debenture holder. The Salomon is an owner, he is holding the shares, he is also the debenture holder. So Salomon and the debenture holders are the same. Therefore, entire money of 6050 should come to the in settlement of the trade creditors. 8000 was their due so entire 6050 will come to them.

However, Salomon debated. Solomon said no, as a secure debenture holder I have the claim. I have got 10,000, 6050 should come to me. So matter went to the English court. The decision of the English court was very fantastic. I mean, which is recorded everywhere. The court said that Salomon and the company are different.

A company is a separate legal entity. So when the company has taken a date and issued a certificate to Salomon that the debenture holders that this amount is due to him as debenture holder, secure debenture holder, then you cannot say that the Solomon and the company are the same. They are separate legal entities. So Salomon's due should come first before the trade creditors.

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Company

Features

Held:

The contention of the trade creditors could not be maintained because the company being in law a person quite distinct from its members, could not be regarded as an 'alias' or agent or trustee for Salomon. Also the company's assets must be applied in payment of the debentures as a secured creditor is entitled to payment out of the assets on which his debt is secured in priority to unsecured creditors.

The decision was like this. So this is a good case to understand how strict interpretation of law takes place, when it comes after separate legal entity.

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Company

Features

- Limited liability
- Separate property
- Transferability of shares
- Perpetual existence
- Common Seal
- Company may sue and be sued in its own name

There are other features which more or less limited liability, separate property, transferability of shares, perpetual existence all we have covered. Common seal is actually the signature of the company. We buy seal we mean wherever the company wants to put its signature, he will put the seal and the beauty of the seal is once the seal is put it will be taken as evidence in the court, yes, the company has signed.

But the seal has to be authenticated by a board resolution that it has been passed the resolution of the board. That is very important. Unless it is done, the seal does not have its sanctity.

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Distinction Between a Company and a Partnership

Distinctions are in the context of

- Agreement, Procedure
- Registration
- Separate legal existence
- Perpetual existence
- Liability of a partner is unlimited
- The number of partners cannot exceed ten in the case of banking business and twenty in non-banking business.
- Cannot transfer his share in the partnership without the consent of all the other partners.
- The capital of a partnership is limited, as the number of partners are either ten or twenty.

A company and a partnership is different basically for the following points; agreement, registration, perpetual existence, we all explained this. Number of partners

cannot exceed 10. In case of members there is no restriction, n number of members can take place in a public limited company. In a private limited company, the restriction is 50.

Transfer of ownership can take place so many times in a partnership form that cannot happen. If it happens a new set of partners will come, a new partnership deed would be required for that.

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Distinction Between a Company and a Partnership

Distinctions are in the context of

- The scope of business of a partnership firm can be changed at any time with the consent of all the partners.
- Every partner is entitled to take part in the day-to-day management of the partnership firm.
- The audit of accounts in the case of a partnership firm is not compulsory. In the case of a company, audit of its accounts by a qualified auditor (i.e. a chartered accountant) is compulsory.

Scope of business partnership. Scope of business and partnership is limited because again the concept is liability. Nobody wants to take huge liability, huge risks. So it keeps its business you know totally under control and therefore cannot expand much. And that is why the company form of organization has become so sustainable.

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Lifting of the Corporate Veil

Following are some such cases

- For the protection of revenue
- Where the company is acting as agent of the shareholders
- Where a company has been formed by certain persons to avoid their own valid contractual obligation
- Where a company has been formed for some fraudulent purpose or is a 'sham'
- Where a company formed is against public interest or public policy.
- Where the number of members falls below the statutory minimum
- Where prospectus includes a fraudulent misrepresentation
- Investigation into related companies
- For investigation of ownership of a company
- Where in the course of winding up of a company

This is important for the purpose to understand that when the rarest of rare cases, when the corporate veil is lifted and the promoters and the owners of the company are held personally liable for certain you know malpractices in a company, it is all malpractices, not business losses. Losses which happened because of some malpractices. Some contractual violation deliberately done.

Some fraudulent purpose the company has been run, public interest a company has been run. When you create the company for a bubble. When there has been siphoning of funds from the company to some other company deliberately done by the promoters. It has happened in the recent past. Kingfisher is one of the cases. The famous Satyam case is one of the cases.

Satyam Maytas case. I am not saying for a second or a minute that it is not happening now. Maybe many of the cases it is happening. But things are becoming tighter. Regulators are becoming day by day more robust in unearthing and finding out this kind of malpractices.

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Lot of references are there of the books, which I have taken clue of but basically I always believe in one thing, the personal experience that I have for more than 30 years now helps me to you know not get influenced by books, but come out more from my experience that I have seen. Thank you.