

NATURE OF A COMPANY

A company is a business entity registered under the Companies Act.

It is a legal entity with a separate identity from those who are its members or operate it. Therefore it can be considered as an artificial person created by the law. In terms of the Companies Act, 2013 (Act No. 18 of 2013) a “company” means a company incorporated under the Act [i.e Companies Act, 2013] or under any previous company law [Section 2(20)].

According to Chief Justice Marshall of USA, “A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation confers upon it either expressly or as incidental to its very existence”.

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

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

The advantages of incorporating a company (i.e registering a company under the Companies Act) are as under:

1. Separate Legal Entity

A company is perceived to be a distinct legal entity. Once incorporated under the Act, the company is vested with a corporate personality which does not depend on its members. The money credited by the creditors of the company can be recovered only from the company and the properties owned by the company. Individual members cannot be sued. Similarly, the company in any way is not liable for the individual debts of the members.

The company bears its own name, acts under its own name, has a seal of its own and its assets are separate and distinct from those of its members. It is a different 'person' from the members who compose it. Therefore it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. Thus, 'incorporation' is the act of forming a legal corporation as a juristic person. A juristic person is in law also conferred with rights and obligations and is dealt with in accordance with law. In other words, the entity acts like a natural person but only through a designated person, whose acts are processed within the ambit of law [*Shiromani Gurdwara Prabandhak Committee v. Shri Sam Nath Dass* AIR 2000 SCW 139].

The principal of separate of legal entity was explained and emphasized in the famous case of *Solomon v Solomon & Co. Ltd.*

The facts of the case are as follows :

Mr. Soloman, the owner of a very prosperous shoe business, sold his business for the sum of \$ 39,000 to Soloman and Co. Ltd. which consisted of Soloman himself, his wife, his daughter and his four sons. The purchase consideration was paid by the company by allotment of & 20,000 shares and \$ 10,000 debentures and the balance in cash to Mr. Soloman. The debentures carried a floating charge on the assets of the company. One share of \$ 1 each was subscribed by the remaining six members of his family. Soloman and his two sons became the directors of this company. Soloman was the managing director. After a short duration, the company went into liquidation. At that time the statement of affairs' was like this: Assets: \$ 6000, liabilities: Soloman as debenture holder \$ 10,000 and unsecured creditors : \$ 7,000. Thus, its assets were running short of its liabilities by \$11,000.

The unsecured creditors claimed a priority over the debenture holder on the ground that company and Soloman were one and the same person. But the House of Lords held that the existence of a company is quite independent and distinct from its members and that the assets of the company must be utilized in payment of the debentures first in priority to unsecured creditors.

Soloman's case established beyond doubt that in law a registered company is an entity distinct from its members, even if the person holds all the shares in the company.

2.Limited liability

Limited liability means the company's debts are its own and members are protected from personal liability unless they are negligent or gave personal guarantees. A company may be limited by shares or by guarantee. In a company limited by shares, the liability of members is limited to the unpaid value of the shares. If the shares are fully paid i.e if the amount has already been fully paid to the company, then the member need not contribute any more towards the company's debts. If the amount has not been fully paid, then the member's liability is limited to the unpaid amount. For example, if X holds shares of the total nominal value of Rs.10,000 and has already paid Rs.5000/- (or 50% of the value) as part payment at the time of allotment, he cannot be called upon to pay more than Rs.5000/-, the amount remaining unpaid on his shares. If he holds fully-paid shares, he has no further liability to pay even if the company is declared insolvent.

In the case of a company limited by guarantee, the liability of members is limited to a specified amount of the guarantee mentioned in the memorandum.

3.Perpetual Existence.

Perpetual succession means that the membership of a company may keep changing from time to time, but that shall not affect its continuity.

Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s). Law creates it and law alone can dissolve it.

Professor L.C.B. Gower rightly mentions, "Members may come and go, but the company can go on forever. During the war all the members of one private company, while in general meeting, were killed by a bomb, but the company survived — not even a hydrogen bomb could have destroyed it".

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

5. Shares: In a public company, the shares are freely transferable.

The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares shall be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be

ultra vires. However, the law allows, in the case of a private company to have such articles which restrict the right of member to transfer his shares in company.

6.Capacity to Sue and Be Sued

A company being a body corporate can sue and be sued in its own name. All legal proceedings against the company are to be instituted in its name. Similarly, the company may bring an action against anyone in its own name. A company's right to sue arises when some loss is caused to the company, i.e. to the property or the personality of the company. Hence, the company is entitled to sue for damages in libel or slander as the case may be [*Floating Services Ltd. v. MV San Fransceco Dipaloo* (2004) 52 SCL 762 (Guj)]. A company, as a person distinct from its members, may even sue one of its own members.

7. Common Seal

A company cannot sign documents by itself. It acts through natural persons who are called its directors. A common seal is used with the name of the company engraved on it as a substitute of its signature. To be legally binding on the company, a document has to carry the company seal on it.