

# A Company's capacity to contract: When does a company acquire the capacity?

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Cite as: (2012) PL January S-19

## Gaining corporate personality

A distinguished American academic is recorded as having said: "The limited liability corporation is the greatest single discovery of modern times. Even steam and electricity are less important than the limited liability company." Though this claim sounds a bit overstated, its general thrust is clear and telling; the importance and popularity of the limited liability company as a form of business organisation. A company stands out among various forms of business enterprises because of its peculiar characteristics owing to its corporate personality, perpetuity, limited liability of its owners and its potentiality for unlimited size.

A company acquires the corporate personality on its incorporation i.e. when it comes into existence. A company comes into existence by registration at the office of the Registrar of Companies. According to sub-section (1) of Section 34, on the registration of the memorandum of association of a company, the Registrar shall certify under his hand that the company has been incorporated. On registration of a company the Registrar gives a certificate called the certificate of incorporation, which is a document issued by the Registrar after the registration of a company, certifying that the company has been incorporated. The validity of the incorporation cannot thereafter be challenged. Thus, a certificate of incorporation is a document issued by the Registrar of Companies after registration of a company, certifying that the company is incorporated. For a limited company, the certificate also certifies that the company is a limited company, which indicates that the members have limited liability. The validity of the incorporation cannot thereafter be challenged.

Section 33 of the Act provides for registration of the memorandum and articles. The effect of such registration is as laid down in Section 34 of the Act i.e. the Registrar shall certify under his hand that the company is incorporated. From the date of incorporation, the subscribers of the memorandum and other persons, namely, the members, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company and having perpetual succession and a common seal.

One of the characteristics of a company thus is that it is an incorporated body of persons. It is not mere aggregate of its members. It is not like a partnership firm or a family. The company is constituted into a distinct and independent person in law and is endowed with special rights and privileges; it is in law a person distinct from its members. The advantage of incorporation is that a company never dies. It has perpetual succession and remains in existence however often its members change, until its dissolution. This prevents the dissolution of the company by the death, bankruptcy, or lunacy of any of its members—unlike a partnership firm. This characteristic offers to a company and its shareholders various special advantages; more particularly, the company is permitted to acquire and hold property in its corporate name, and enables the company to use a common seal, to contract with its shareholders and others.<sup>1</sup>

**Form of contracts** A company being an artificial legal person and having no physical existence has necessarily to act through the human agency. A company is competent to contract but the contracts are to be made by the agent acting on behalf of the company. The contracts on behalf of a company may be made in the manner specified in Section 46 of the Companies Act. This section provides for the form of contracts to be made on behalf of a company, and declares that a contract made according to this section shall bind the company. Clause (a) of sub-section (1) states how contracts in writing can be made and its clause (b) states how contracts by parol i.e. oral or by word of mouth, (also called a simple contract or a contract other than one made by deed or a contract under seal) can be made, on behalf of a company. A contract, which any Indian law requires to be in writing will be validly made by a company if written and signed by a person who acts within the scope of his apparent or actual authority. A contract which can validly be made orally, can be made by a company, provided the person acting on behalf of the company is within his apparent or actual authority. A contract made according to this section shall bind the company.?

**Acquisition by a company of the capacity to contract** According to sub-section (2) of Section 34, from the date of incorporation mentioned on the certificate of incorporation, such of the subscribers to the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such limited liability on the part of the members to contribute to the assets of the company in the event of its being wound up as stipulated in the Act.

The date of registration of a company is the date mentioned on the certificate and not that on which the signature of the Registrar was affixed.<sup>2</sup> The effect of Section 34 is that the date mentioned on the certificate is the first day of the company's corporate existence, and it is not open to anyone to prove the moment of time at which a corporate act was executed that day and then to say that the company was not in existence at that moment. **The corporate person is to be**

treated as having been in existence for the whole of the day on which it was incorporated.<sup>3</sup>

29. Unlike an unincorporated company, which has no separate existence and which the law does not distinguish from its members, an incorporated company has a separate existence and the law recognises it as a legal person separate and distinct from its members. This new legal personality emerges from the moment of incorporation and from that date the persons subscribing to the memorandum of association and other persons joining as members are regarded as a body corporate or a corporation aggregate and the new person begins to function as an entity. But the members who form the incorporated company do not pool their status or their personality. If all of them are citizens of India the company does not become a citizen of India any more than if all are married the company would be a married person. The personality of the members has little to do with the persona of the incorporated company. The persona that comes into being is not the aggregate of the personae either in law or in metaphor. The corporation really has no physical existence; it is a mere "abstraction of law".<sup>4</sup>

A company, though a private company, is distinct from the persons composing it.<sup>5</sup> Each company registered under the Act is a separate and distinct legal entity and the mere fact that two companies have common shareholders or common Directors does not make them a single entity.<sup>6</sup> Even where two companies form a partnership by entering into a joint venture agreement and incorporate a company with their shareholding (popularly known as "joint venture company"), the third entity is a company with an independent legal entity though in the nature of a partnership; it is not a partnership firm but a company.<sup>7</sup> But if it is not incorporated as a company, it is just a partnership and not a company.

Validity of a contract made by Directors when company under formation In *Newborne v. Sensolid (Great Britain) Ltd.*<sup>8</sup> In a suit by a company for breach of contract for the sale of certain goods, it was discovered that the company was in the process of formation and not registered when the contract was signed. The contract was signed "LN Ltd." and underneath was the signature of LN, a future Director of the company. Steps were taken to substitute the name of LN for the company as plaintiff. It was held that the contract purported to be a contract by the company and as the company was not in existence when the contract was signed, there never was a contract. The name of LN could not, therefore, be substituted in the place of the name of the company; the contract was a nullity. Lord Goddard, C.J. said:

The company makes the contract. No doubt the company must do its physical acts, and so forth, through the directors, but it is not the ordinary case of principal and agent. It is a case in which the company is contracting and the company's contract is authenticated by the signature of one of the directors. This contract purports to be a contract by the company; it does not purport to be a contract by Mr Newborne. He does not purport to be selling his goods but to be selling the company's goods. The only person who had any contract here was the company, and Mr Newborne's signature merely confirmed the company's signature. The document is signed "Yours faithfully, Leopold Newborne (London) Ltd.", and the signature underneath is the signature of the person authorised to sign on behalf of the company.

In my opinion, unfortunate though it may be, as the company was not in existence when the contract was signed there never was a contract, and Mr Newborne cannot come forward and say: "Well it was my contract". The fact is, he made a contract for a company which did not exist.<sup>9</sup>

A non-existent company cannot be a party to arbitration agreement In a recent significant decision of the Supreme Court on the subject under discussion, the question was concerning an arbitration agreement to which a company yet to be incorporated was stated to be a party and its prospective Managing Director had signed the agreement.<sup>10</sup>

Section 7 of the Arbitration and Conciliation Act defines an arbitration agreement. Sub-section (1) provides that an arbitration agreement means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not. Sub-section (2) provides that an arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement. Sub-section (3) provides that an arbitration agreement shall be in writing. Sub-section (4), *inter alia*, provides that an arbitration agreement is in writing if it is contained in a document signed by the parties. The arbitration agreement between the parties was in writing contained in the lease agreement and management agreement signed by them on 30-3-2002, but the company which was stated to be a party to the agreement was incorporated on 9-4-2002.

The Supreme Court held that on 30-3-2002, there was no such company in existence and the person who had signed the agreement was not the Managing Director of any company of that name on that date. When one of the parties to the lease agreement and management agreement, was a non-existent imaginary party, there was no contract. The Supreme Court said: "This is not a case of one of the parties being in existence, but being under some legal disability to enter into contracts. This is a case where there was no 'party' at all, but someone claiming that there was an existing company capable of entering into contracts."<sup>11</sup>

It is only from the date of incorporation (registration) that a company can enter into contracts in its own name; a contract entered into by a promoter or a person who would be a Director after the company's registration is invalid. When one of the parties to an agreement is a company to be incorporated, it is a non-existent imaginary party and there is no contract. It is not a case of one of the parties being in existence, but being under some legal disability to enter into contracts but is a case where there was no "party" at all, but someone claiming that there was an existing company capable of entering into contracts.

The Supreme Court observed:

13. Section 34(2) of the Companies Act, provides that from the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company.

14. Sub-section (3) of Section 149 provides that the Registrar shall, on the filing of declaration/statement as stated therein, certify that the company is entitled to commence business. Section 149(4) of the Companies Act provides that any contract made by a company (which is already registered) before the date at which it is entitled to commence business shall be provisional only, and shall not be binding on that company until that date, and on that date it shall become binding.

15. A certificate under Section 149(3) of the Act was issued by the Registrar of Companies only on 6-6-2003 certifying that the respondent is entitled to commence business. It is thus clear that the applicant in application under Section 11 of the Act was non-existent on 30-3-2002 when the arbitration agreement was entered into.

\*\*\* 18. The position would have been different, had the agreement been entered by the promoters of the respondent Company before its incorporation for the purposes of the Company and such contract was warranted by the terms of incorporation.<sup>12</sup>

**Specific performance of a pre-incorporation contract** The last sentence of the preceding paragraph sets out the principle concerning pre-incorporation contracts codified in Section 15(h) of the Specific Relief Act, 1963 [corresponding to Section 23(h) of the 1877 Act], according to which the specific performance of a contract may be obtained by the company, when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company and such contract is warranted by the terms of incorporation, provided that the company has accepted the contract and has communicated such acceptance to the other party to the contract. Section 19(e) of the same Act [corresponding to Section 27(e) of the 1877 Act] provides that specific performance of a contract may be enforced against the company, when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company and such contract is warranted by the terms of the incorporation, provided that the company has accepted the contract and communicated such acceptance to the other party to the contract. These two provisions make it clear that in India the pre-incorporation contracts entered into by the promoters of a company before its incorporation are enforceable by or against the company after it is incorporated, if the contract satisfies the requirements of these provisions. But, a contract by a person with the promoters of a company to take shares in the company after its incorporation is not a contract for the purposes of the company and allotment of shares to such a person by the company, if he does not do anything as amounting to acceptance of the allotment, will not make him a shareholder or entitle the company to sue him for the unpaid calls on those shares.<sup>13</sup>

After reviewing the law on this subject, the Andhra Pradesh High Court has held that though under the English law virtually a new contract has to be entered into in order to bind the company in respect of contracts entered into before its incorporation, in India the Specific Relief Act makes provisions making the pre-incorporation contracts binding on the company. Section 15(h) of the Specific Relief Act provides that a company can enforce pre-incorporation contracts, if such contract is warranted by the terms of the incorporation and the company has accepted the contract and has communicated such acceptance to the other party. The converse position is covered by Section 19(e) where a third party can enforce the contract against a company if such contract is warranted by the terms of the incorporation of the company and the company has accepted the contract and communicated such acceptance to the other party to the contract. No doubt, it is true that the sections in the Specific Relief Act are concerned with executory contracts and cannot be applied to conveyances of immovable property.<sup>14</sup>

In A.P. Tourism Development Corpn. case<sup>15</sup> the Supreme Court explained the effect of the provision in Section 15(h) as follows:

20. It is evident from Section 15(h) of the Specific Relief Act that if the lease agreement and the management agreement had been entered into by the promoters of the Company stating that they are entering into the contract for the purpose of the Company to be incorporated, in their capacity as promoters and that such contract is warranted by the terms of the incorporation of the Company, the agreement would have been valid; and the term regarding arbitration therein could have been enforced. But the agreement was entered not by the promoters on behalf of a Company proposed to be incorporated by them, but by a non-existing Company claiming to be an existing Company. This clearly shows that there is no arbitration agreement between the respondent against whom such agreement is sought to be enforced.<sup>16</sup>

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- Floating Services Ltd. v. MV San Fransceco Dipalola<sup>TM</sup>, (2004) 52 SCL 762 (Gui).

- Jubilee Cotton Mills Ltd., In re, (1923) 1 Ch 1 (CA), on appeal Official Receiver and Liquidator v. Lewis, 1924 AC 958 (HL).

- Ibid.

- State Trading Corpn. of India Ltd. v. CTO, AIR 1963 SC 1811, 1822, para 29 : (1963) 33 Comp Cas 1057, per Hidayatullah, J.

- Aveline Scott Ditcham v. James J. Miller, AIR 1931 PC 203 : (1932) 2 Comp Cas 14.

- Indowind Energy Ltd. v. Wescare (I) Ltd., (2010) 5 SCC 306 : (2010) 2 SCC (Civ) 397.

- New Horizons Ltd. v. Union of India, (1995) 1 SCC 478. The Supreme Court's observation in Gammon (I) Ltd. v. Commr. of Customs, (2011) 2 SCC 499 decided on 6-7-2011 (SC) that a partnership formed by two companies but not registered as a company under the Companies Act is a "legal entity i.e. juridical person" does not seem to be correct, since from the facts of the case as appearing in the reported judgment the joint venture was not a company incorporated under the Companies Act unlike in New Horizons case.
- (1954) 1 QB 45 : (1953) 2 WLR 596 : (1953) 1 All ER 708 : (1954) 24 Comp Cas 159 (CA).
- Ibid, 51.
- A.P. Tourism Development Corpn. Ltd. v. Pampa Hotels Ltd., (2010) 5 SCC 425 : (2010) 2 SCC (Civ) 440 : (2010) 160 Comp Cas 1.
- Ibid, 430, para 18.
- Ibid, 429-30, paras 13-15 & 18.
- Imperial Ice Mfg. Co. Ltd. v. Munchershaw Barjorji Wadia, ILR (1889) 13 Bom 415.
- Vali Pattabhirama Rao v. Sri Ramanuja Ginning & Rice Factory (P) Ltd., (1986) 60 Comp Cas 568 (AP).
- (2010) 5 SCC 425 : (2010) 2 SCC (Civ) 440.
- Ibid, 431, para 20.