ARTICLES OF ASSOCIATION

1.0 Articles of Association

Articles of Association is an important document of a Joint Stock Company. It contains the rules and regulations or bye-laws of the company. They are related to the internal working or management of the company. It plays a very important role in the affairs of a company. It deals with the rights of the members of the company between themselves.

The contents of articles of association should not contradict with the Companies Act and the MoA. If the document contains anything contrary to the Companies Act or the Memorandum of Association, it will be inoperative. The pvt concern that are limited by shares and those limited by guarantee and unlimited companies must have their articles of association. Public companies may not have their articles but may adopt Model articles given in Table A of Schedule I of Companies Act, 1956. If a public company has only some articles of its own, for the rest, articles of Table A will be applicable.
Articles that are profound to be registered should be printed, segmented well and sequenced consecutively. Each subscriber to Memorandum of Association must sign the articles in the presence of at least one witness.

2.0 Contents of Articles of Association

The articles generally deal with the following

a) Classes of shares, their values and the rights attached to each of them.

b) Calls on shares, transfer of shares, forfeiture, conversion of shares and alteration of capital.

c) Directors, their appointment, powers, duties etc.

d) Meetings and minutes, notices etc.

e) Accounts and Audit

f) Appointment of and remuneration to Auditors.
g) Voting, poll, proxy etc.

h) Dividends and Reserves

i) Procedure for winding up.

j) Borrowing powers of Board of Directors and managers etc.

k) Minimum subscription.

l) Rules regarding use and custody of common seal.

m) Rules and regulations regarding conversion of fully paid shares into stock.

n) Lien on shares.

3.0 Alteration of Articles of Association

The alteration of the Articles should not sanction anything illegal. They should be for the benefit of the company. They should not lead to breach of contract with the third parties. The following are the regulations regarding alteration of articles:

A company may alter its Articles with a special resolution. Due importance and care should be given to ensure that the alteration of AoA does not conflict with the provisions of the Memorandum of Association or the Companies Act. A copy of every special resolution altering the Articles must be filed with the Registrar within 30 days of its passing.

a) The proposed alteration should not contravene the provisions of the Companies Act.

b) The proposed alteration should not contravene the provisions of the Memorandum of Association.

c) The alteration should not propose anything that is illegal.

d) The alteration should be bonafide for the benefit of the company.

e) The proposed alteration should in no way increase the liability of existing members.

f) Alteration can be made only by a special resolution.

g) Alteration can be done with retrospective effect.

h) The Court does not have any power to order alteration of the Articles of Association.

4.0 Binding Effects of Memorandum and Articles of Association

"Subject to the provisions of this Act, the Memorandum and Articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the Memorandum and of the Articles."

Thus, the Articles bind the company to its members, the members to the company and the members to each other. They constitute a contract between a company and its members in respect of their rights and liabilities as members. A member may sue the company, just as the company may sue the members to enforce and restrain any breach of the articles.

4.1. Binding the company to its members:

The company is bound to the members to observe and follow the articles. In case the company commits a breach of the articles, members can restrain the company from doing so, by bringing an injunction against the company.

Members may sue to restrain a company from doing any ultra-vires or illegal acts or from acting on a resolution obtained by fraud or which is inconsistent with the Articles.

Members may also sue the company for the enforcement of their personal right under the Articles, e.g., right to receive divided which has been declared. However, only a shareholder or a member of the company, in the capacity of a member and not in any other capacity, can enforce the rules and regulations contained in the Articles.

The case of Wood v Odessa Waterworks Co. provides an illustration of binding of articles on the company to its members.

The articles of the Waterworks Co. provided that 'the directors may, with the sanction of the company at general meeting, declare a dividend to be paid to the members'. Instead of paying the dividend in cash to the shareholders a resolution was passed to give them debenture bonds.

In an action by a member to restrain the directors from acting on the resolution, the Court held: "The question is whether that which is proposed to be done in the present case is in accordance with the articles of association of the company.

Those articles provide that the directors may, with the sanction of a general meeting, declare a dividend to be paid to shareholders. Prima facie that means to be paid in cash. The debenture bonds proposed to be issued are not a payment in cash." Accordingly, the directors were restrained from acting on the resolution.

4.2. Binding on members in their relations to the company:

An article of Association is a 'contract of the most sacred character' between the company and each member, binding the members to the company under a statutory covenant.

All money payable by any member to the company under the Memorandum or Articles shall be a debt due from him to the company. Articles are taken to be signed and agreed to be observed by each member. Members are bound by the articles just as if every one of them had contracted to conform to them. A company can sue its members for the enforcement of its Articles as well as for restraining their breach. A case in point is: The articles of association of the company provided that in the event of the bankruptcy of a member his shares would be sold at a price to be fixed by the directors. Borland became

bankrupt. His trustee in bankruptcy wanted to sell these shares at their true value contended that he was not bound by the articles. It was held that he was bound to abide by the provisions of the company's articles.

4.3. Binding between members:

The contractual force given to the articles is limited to the matters arising out of company's relationship of the members as members and does not extend beyond the company relationship. The articles constitute a contract between each member and the company. The articles do not regulate their rights inter se.

Such rights can only be enforced by or against a member through the company. However, this is not without exception. Courts have extended the articles to constitute a contract between individual members qua members without joining the company as a party to the action. The case of Rayfield v Hands (1960) is a pointer to the issue.

Rayfield was a shareholder in a company. He was required to inform the directors in the event of his intention to transfer the shares. The directors were required to take the shares at a fair value. Rayfield informed the directors in accordance with the articles. The directors contended that they were not bound to take and pay for Rayfield's shares and the articles could impose no such obligation on them.

The court set aside this argument by treating the directors as members and compelled them to take Rayfield's shares at a fair value. The court also held that it was not necessary for Rayfield to join the company for bringing a suit against the directors.

4.4. No binding in relation to the outsiders:

The memorandum and articles do not constitute a contract between the company and the third party. Neither the company nor the members of the company is bound to the outsiders to give effect to the provisions of the memorandum and the articles. For example:

In Browne v La Trinidad, the articles of the company contained a clause to the effect that Browne should be a director and should not be removable. He was, however, removed and had brought an action to restrain the company from excluding him.

It was held that there was no contract between Browne and the company. No outsider can enforce articles against the company even if they purport to give him certain rights.

Thus, an outsider cannot take advantage of the Articles to found a claim thereon against the company. Even a member enjoying certain rights in a capacity other than a member cannot enforce them against the company. The member would be an outsider for those 'outside rights'. The leading case is that of Eley v Positive Government Security Life Assurance Co.

The articles of a company contained a clause that Eley would be the solicitor of the company and would not be removed except for misconduct. He became member in the company also. He acted as solicitor of the company but the company removed him. He brought an action against the company for breach of the articles.

His suit was dismissed. The Court held, "An outsider to whom rights purport to be given by the Articles in his capacity as such outsider, whether he is or subsequently becomes as member, cannot sue on those articles to enforce those rights"

5.0 DOCTRINE OF ULTRA VIRES

5.1 Introduction

Companies have to borrow funds from time to time for various projects in which they are engaged. Borrowing is an indispensable part of day to day transactions of a company, and no company can be imagined to run without borrowing from time to time. Balance sheets are released every year by the companies, and you will hardly find any balance sheet without borrowings in the liabilities clause of it. However, there are certain restrictions while making such borrowings. If companies go beyond their powers to borrow then such borrowings may be deemed as ultra-vires.

5.2 What is the doctrine of ultra-vires?

Ultra-vires

It is a Latin term made up of two words "ultra" which means beyond and "vires" meaning power or authority. So we can say that anything which is beyond the authority or power is called ultra-vires. In the context of the company, we can say that anything which is done by the company or its directors which is beyond their legal authority or which was outside the scope of the object of the company is ultra-vires.

Doctrine of Ultra-Vires

Memorandum of association is considered to be the constitution of the company. It sets out the internal and external scope and area of company's operation along with its objectives, powers, scope. A company is authorized to do only that much which is within the scope of the powers provided to it by the memorandum. A company can also do

anything which is incidental to the main objects provided by the memorandum. Anything which is beyond the objects authorized by the memorandum is an ultra-vires act.

5.3 Origin of the doctrine

The doctrine of ultra-vires first time originated in the classic case of Ashbury Railway Carriage and Iron Co. Ltd. v. Riche, (1878) L.R. 7 H.L. 653, which was decided by the House of Lords. In this case the company and M/s. Riche entered into a contract where the company agreed to finance construction of a railway line. Later on, directors repudiated the contract on the ground of its being ultra-vires of the memorandum of the company. Riche filed a suit demanding damages from the company. According to Riche, the words "general contracts" in the objects clause of the company meant any kind of contract. Thus, according to Riche, the company had all the powers and authority to enter and perform such kind of contracts. Later, the majority of the shareholders of the company ratified the contract. However, directors of the company still refused to perform the contract as according to them the act was ultra-vires and the shareholders of the company cannot ratify any ultra-vires act.

When the matter went to the House of Lords, it was held that the contract was ultra-vires the memorandum of the company, and, thus, null and void. Term "general contracts" was interpreted in connection with preceding words mechanical engineers, and it was held that here this term only meant any such contracts as related to mechanical engineers and not to include every kind of contract. They also stated that even if every shareholder of the company would have ratified this act, then also it had been null and void as it was ultra-vires the memorandum of the company. Memorandum of the company cannot be amended retrospectively, and any ultra-vires act cannot be ratified.

5.4 What is the need or purpose of the doctrine of ultra-vires?

This doctrine assures the creditors and the shareholders of the company that the funds of the company will be utilized only for the purpose specified in the memorandum of the company. In this manner, investors of the company can get assured that their money will not be utilized for a purpose which is not specified at the time of investment. If the assets of the company are wrongfully applied, then it may result into the insolvency of the company, which in turn means that creditors of the company will not be paid. This doctrine helps to prevent such kind of situation. This doctrine draws a clear line beyond which directors of the company are not authorized to act. It puts a check on the activities of the directors and prevents them from departing from the objective of the company.

5.5 Difference between an Ultra-Vires and an Illegal act

An ultra-vires act is entirely different from an illegal act. People often mistakenly use them as a synonym to each other, while they are not. Anything which is beyond the objectives of the company as specified in the memorandum of the company is ultra-vires. However, anything which is an offense or draws civil liabilities or is prohibited by law is illegal. Anything which is ultra-vires, may or may not be illegal, but both of such acts are void-ab-initio.

5.6 The doctrine of ultra-vires in Companies Act, 2013

Section 4 (1)(c) of the Companies Act, 2013, states that all the objects for which incorporation of the company is proposed any other matter which is considered necessary in its furtherance should be stated in the memorandum of the company.

Whereas Section 245 (1) (b) of the Act provides to the members and depositors a right to file a application before the tribunal if they have reason to believe that the conduct of the affairs of the company is conducted in a manner which is prejudicial to the interest of the company or its members or depositors, to restrain the company from committing anything which can be considered as a breach of the provisions of the company's memorandum or articles.

Basic principles regarding the doctrine

a) Shareholders cannot ratify an ultra-vires transaction or act even if they wish to do so.
b) Where one party has entirely performed his part of the contract, reliance on the defense of the ultra-vires was usually precluded in the doctrine of estoppel.
c) Where both the parties have entirely performed the contract, then it cannot be attacked on the basis of this doctrine.
d) Any of the parties can raise the defense of ultra-vires.
e) If a contract has been partially performed but the performance was insufficient to bring the doctrine of estoppel into the action, a suit can be brought for the recovery of the benefits conferred.
f) If an agent of the corporation commits any default or tort within the scope of his employment, the company cannot defend it from its consequences by saying that the act was ultra-vires.

5.7 Exceptions to the doctrine

a) Any act which is done irregularly, but otherwise it is intra-vires the company, can be validated by the shareholders of the company by giving their consent.
b) Any act which is outside the authority of the directors of the company but otherwise it is intra-vires the company can be ratified by the shareholder of the company.
c) If the company acquires property in a manner which is ultra-vires of the contract, the right of the company over such property will still be secured.
d) Any incidental or consequential effect of the ultra-vires act will not be invalid unless the Companies Act expressly prohibits it.
e) If any act is deemed to be within the authority of the company by the Company's Act, then they will not be considered as ultra-vires even if they are not expressly stated in the memorandum.
f) Articles of association can be altered with retrospective effect to validate an act which is ultra-vires of articles.

5.8 Types of ultra-vires acts and when can an ultra-vires act be ratified?

Ultra-vires acts can be generally of four types:

a) Acts which are ultra-vires to the Companies Act.
b) Acts which are ultra-vires to the Memorandum of the company.
c) Acts which are ultra-vires to the Articles of the company but intra-vires the company.
d) Acts which are ultra-vires to the directors of the company but intra-vires the company.

5.8.1 Acts which are ultra-vires to the Companies Act

Any act or contract which is entered by the company which is ultra-vires the Companies Act, is void-ab-initio, even if memorandum or articles of the company authorized it. Such act cannot be ratified in any situation. Similarly, some acts are deemed to be intra-vires for the company even if they are not mentioned in the memorandum or articles because the Companies Act authorizes them.

5.8.2 Acts which are ultra-vires to the memorandum of the company

An act is called ultra-vires the memorandum of the company if, it is done beyond the powers provided by the memorandum to the company. If a part of the act or contract is within the authority provided by the memorandum and remaining part is beyond the authority, and both the parts can be separated. Then only that part which is beyond the powers is considered as ultra-vires, and the part which is within the authority is considered as intra-vires. However, if they cannot be separated then whole contract or act will be considered as ultra-vires and hence, void. Such acts cannot be ratified even by shareholders as they are void-ab-initio.

5.8.3 Acts which are ultra-vires to the Articles but intra-vires to the memorandum

All the acts or contracts which are made or done beyond the powers provided by the articles but are within the powers and authority given by the memorandum are called ultra-vires the articles but intra-vires the memorandum. Such acts and contracts can be ratified by the shareholders (even retrospectively) by making alterations in the articles to that effect.

5.8.4 Acts which are ultra-vires to the directors but intra-vires to the company

All the acts or contracts which are made by the directors beyond the powers provided to them are called acts ultra-vires the directors but intra-vires the company. The company can ratify such acts and then they will be binding.

5.9 Development of the doctrine

Eley v The Positive Government Security Life Assurance Company, Limited, (1875-76) L.R. 1 Ex. D. 88

It was held that the articles are not a matter between the company and the plaintiff. They may either bind the members or mandate the directors, but they do not create any contract between plaintiff and the company.

The Directors, &C., of the Ashbury Railway Carriage and Iron Company (Limited) v Hector Riche, (1874-75) L.R. 7 H.L. 653.

The objects of the company as per the memorandum of association were to supply and sell some material which is required in the construction of the railways. Here the contract was for construction of railways which was not in the memorandum of the company and thus, was contrary to them. As the contract was ultra-vires the memorandum, it was held that it could not be ratified even by the assent of all the shareholders. If the sanction had been granted by passing a resolution before entering into the contract, that would have been sufficient to make the contract intra-vires. However, in this situation, a sanction cannot be granted with a retrospective effect as the contract was ultra-vires the memorandum.

In Shuttleworth v Cox Brothers and Company (Maidenhead), Limited, and Others, [1927] 2 K.B. 9

It was held that if a contract is subject to the statutory powers of alteration contained in the articles and such alteration is made in good faith and for the benefit of the company then it will not be considered as a breach of the contract and will be valid.

In Re New British Iron Company, [1898] 1 Ch. 324

It was held that in this particular case the directors will be ranked as ordinary creditors in respect of their remuneration at the time of the winding-up of the company. This was stated because generally articles are not considered as a contract between the company and the directors but only between shareholders. However, in this particular case, the directors were employed, and they had accepted office on the footing of the articles of association. So at the time of winding-up of the company they were considered as the creditors.

Rayfield v Hands and Others, [1957 R. No. 603.]

Field-Davis Ltd. was a private company carrying on business as builders and contractors, The plaintiff, Frank Leslie Rayfield, was the registered holder of 725 of those shares, and the defendants, Gordon Wyndham Hands, Alfred William Scales and Donald Davies were at all material times the sole directors of the company. THere was a provision in the Articles of association of the company where it was required that if he wants to sell his shares, he will inform the directors, who will buy them equally at a fair valuation. However, when he informed the directors, they refused to buy them by saying that there is no such liability imposed by the articles upon them.

The plaintiff claimed that fair value of the shares must be determined and directors must be ordered to purchase them at a fair value. It was held that articles of the company required the directors to buy the shares at a fair price, but the relationship between them was not as a member and director but as a member and a member.

5.10 Effects of ultra vires Transactions – Doctrine of Ultra Vires

1. **Void ab initio:** The ultra vires acts are null and void ab initio. These acts are not binding on the company. Neither the company can sue, nor it can be sued for such acts.[Ashbury Railway Carriage and Iron Company v. Riche].

2. Estoppel or ratification cannot convert an ultra-vires act into an intra-vires act.
3. **Injunction:** when there is a possibility that company has taken or is about to undertake an ultra-vires act, the members can restrain it from doing so by getting an injunction from the court. [***Attorney General v. Gr. Eastern Rly. Co., (1880) 5 A.C. 473***].
4. **Personal liability of Directors**: The directors have a duty to ensure that all corporate capital of the company is used for a legitimate purpose only. If such funds are diverted for a purpose which is not authorized by the memorandum of the company, it will attract a personal liability for the directors. In ***Jehangir R. Modi v. Shamji Ladha, [(1866-67) 4 Bom. HCR (1855***)], the Bombay High Court held, "A shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have by them been employed in transactions that they have no authority to enter into, without making the company a party to the suit".

Criminal action can also be taken in case of a deliberate misapplication or fraud. However, there is a small line between an act which is ultra-vires the directors and acts which are ultra-vires the memorandum. If the company has authority to do anything as per the memorandum of the company, then an act which is done by the directors beyond their powers can also be ratified by the shareholders, but not otherwise.

1. If any property is purchased with the money of the company, then the company will have full rights and authority over such property even if it is purchased in an ultra-vire manner.
2. Relationship of a debtor and creditor is not created in an ultra-vires borrowing. [***In Re. Madras Native Permanent Fund Ltd., (1931) 1 Com Cases 256 (Mad.***)].

5.11 Effects of an act which is Ultra Vires – on borrowings

Any borrowing which is made by an act which is ultra-vires will be void-ab-initio. It will not bind the company and company and outsiders cannot get them enforced in a court.

Members of the company have power and right to prevent the company from making such ultra-vires borrowings by bringing injunctions against the company.

If the borrowed funds of the company are used for any ultra-vires purpose, then directors of the company will be personally liable to make good such act. If the company acquires any property from such funds, the company will have full right to such property.

No estoppel or ratification can convert an ultra-vires borrowings into an intra-vires borrowings, as such acts are void from the very beginning. As no debtor and creditor relationship is created in ultra-vires borrowings only a remedy in rem and not in personam is available.

5.12 Doctrine likely to lose sanctity

It is proposed in the Companies Amendment Bill,2016 that instead of adopting a universal memorandum, business will be free to adopt a model memorandum of association. So now the new companies will be enjoying the benefit of having a single object clause which states that they will be engaged in any lawful act or business. In this situation, it would be challenging to trace out that which act is ultra-vires and which act is intra-vires. The only case where it will be possible will be when a company specifies the exact business instead of just a general clause.

6.0 Conclusion

No company can be imagined to run without borrowings. However, at the same time, it is necessary to protect the interest of the creditors and investors. Any irregular and irresponsible act may result in insolvency or winding up of the company. This may cause considerable losses to them. So to protect the interest of the investors and the creditors, specific provisions are made in the memorandum of the company which defines the objectives of the company.

Directors of the company can act only within the purview of the authority provided to them under these objectives. If any borrowing is made beyond the authority provided by these objective mentioned in the memorandum, it will be considered as ultra-vires. Any borrowing which is made through an ultra-vires act is void-ab-initio, and hence, directors are personally responsible for these acts. However, if such borrowings are ultra-vires only to the articles of the company or ultra-vires directors, then they can be ratified by the shareholders. Then after such ratification, they will be considered valid.

Thus, directors must be very cautious while borrowing funds, as it may not only make them personally liable for the consequences of such acts but also may result in considerable losses to investors and creditors.