

## Ch. 4 ARTICLES OF ASSOCIATION

<b>Meaning</b>	A.A. are the rules, regulations for the internal management of the affairs of a co. The articles regulate the internal management of the company. They define the powers of its officers. They also establish a contract between the company and the members and between the members inter se.
<b>Definition [Section 2(5)]</b>	'Articles' means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company laws or of the present Act, i.e., the Act of 2013.  It also includes the regulations contained in Table F in Schedule I of the Act, in so far as they apply to the company.
<b>Signing of AOA</b>	AOA must be signed by those persons who have signed MOA.
<b>Model form of A.OA</b>	Section 5(6) of the Companies Act, 2013 provides that the articles of association shall be in respective Forms specified in Tables F, G, H, I, or J of Schedule I to the Act, as may be applicable in relation to the type of company proposed to be incorporated.
Form in Table F is applicable to	companies limited by shares.
Form in Table G is applicable to	companies limited by guarantee having a share capital.
Form in Table H is applicable to	companies limited by guarantee not having a share capital.
Form in Table I is applicable to	unlimited companies having a share capital.
Form in Table J is applicable to	unlimited companies not having a share capital.
<b>Adoption of Table</b>	The company has three alternatives:- <ol style="list-style-type: none"> <li>1. It may adopt Table in full. [Section 5(7)]</li> <li>2. It may wholly exclude Table and set out its own A.A. in full.</li> <li>3. It may frame its own A.A. and adopt part of Table.</li> </ol> <p><b>NOTE:-</b> Unless the A.A. of a public co. expressly exclude any or all provisions of relevant Table, that Table shall automatically apply to it. [Section 5(8)]</p>

<b>A.A. &amp; M.A. – Their Relation</b>	<ol style="list-style-type: none"> <li>1. The AOA are subordinate to MOA and any clause in the Articles going beyond the memorandum will be ultra vires.</li> <li>2. The MOA must be read in conjunction with AOA, when it is necessary to explain any ambiguity in the terms of the MOA. The AOA may explain or supplement the MOA but cannot extend or enlarge its scope.</li> <li>3. The terms of the MOA cannot be modified or controlled by the AOA.</li> </ol>
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	Articles do not exceed the powers of the company as laid down by its memorandum [ <b>Ashbury vs. Watson</b> ]. Articles that go beyond the company's sphere of action are inoperative, and anything done under the authority of such article is void and incapable of ratification.
	But neither the articles nor the memorandum can authorize the company to do anything so as to contravene any of the provisions of the Act. [ <b>Re Peveril Gold Mines</b> ]

### ENTRENCHMENT PROVISIONS

The Companies Act, 2013 recognizes an interesting concept of entrenchment.

<b>Entrenchment [Section 5 (3)]</b>	The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution, are met or complied with.
<b>Purpose</b>	Essentially, the entrenchment provisions allow for certain clauses in the articles to be amended upon satisfaction of certain conditions or restrictions (such as obtaining a 100% consent) greater than those prescribed under the Act.  This provision acts as a protection to the minority shareholders and is of specific interest to the investment community. This shall empower the enforcement of any pre-agreed rights and provide greater certainty to investors, especially in joint ventures.
<b>For Pvt. Co &amp; Public Co. [Section 5 (4)]</b>	The provisions for entrenchment referred to in section 5(3) shall be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.
<b>Notice to Registrar [Section 5(5)]</b>	Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provision.

### Distinction between Memorandum of Association and Articles of Association

Basis	MOA	AOA
<b>1. Nature of document</b>	MOA is the charter of the co. indicating the nature of its business, nationality, and its capital	AOA are regulations for the internal mgt. of the co. and are subsidiary to the MOA.
<b>2. Scope</b>	MOA define the scope of the activities of the co. (beyond which it cannot do anything).	AOA. are the rules for carrying out the objects of the co

<b>3. Supremacy</b>	MOA is the supreme document.	AOA are subordinate to the MOA. If there is any conflict between the AOA and MOA, the latter prevails.
<b>4. Requirement</b>	Every co. must have its own MOA.	A co. limited by shares need not have AOA. of its own. It can adopt Table F.
<b>5. Restrictions on alteration</b>	There are strict restrictions on its alteration in the MOA.	AOA can be altered by a special resolution.
<b>6. Ultra-vires</b>	An act ultra-vires the MOA. is wholly void and cannot be ratified even by the whole body of the shareholders.	An act ultra-vires the AOA (but intra-vires the MOA) can be confirmed by the shareholders.

### **REGISTRATION OF ARTICLES**

Section 7(1) provides that at the time of incorporation of a company there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company duly signed by all the subscribers to the memorandum in the prescribed manner.

Section 5(2) provides that the articles shall also contain such matters, as may be prescribed. However, nothing prescribed in this sub-section shall be deemed to prevent a company from including such additional matters in its articles as may be considered necessary for its management.

### **STATUTORY REQUIREMENTS**

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum.

The articles must not contain anything illegal or ultra vires the memorandum, nor should it be contrary to the provisions of the Companies Act, 2013.

### **PROVISION IN ARTICLES AS REGARDS EXPULSION OF A MEMBER**

Section 5(2) provides that the articles shall also contain such matters, as may be prescribed. But if a company intend to introduce some more internal rules, then it can do so.

Section 6 of the Companies Act, 2013 provides that: -  
 (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors;  
 and

(b) any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be.

In the light of above provisions, if there is a provision in the Articles empowering the Directors of the company to expel any member of the company under any of the given conditions, then such a provision shall be totally inconsistent with the provisions of Section 6 of the Act. It is opposed to the fundamental principles of the company's jurisprudence and is ultra vires of the company. [(Circular No. 32 of 1975)]

But the Stock exchanges, registered under the provisions of the Companies Act, can carry such a provision in its Articles.

The regulation of stock exchanges is mainly governed by Securities Contracts Regulation Act, 1956 (SCRA) and SEBI, Act, 1992 which are Special Acts.

### **Alteration of A.A.**

Companies have been given wide powers to alter their A.A.

#### Procedure

1. By passing a special resolution.
2. A copy of resolution altering A.A. shall be filed with the ROC within 15 days of its passing. [section 14(1)]
3. ROC shall register the same. [Section 14 (2)]
4. Any alteration of the articles registered under section 14(2) shall be valid as if it were originally in the articles. [Section 14(3)]

Section 14(1) provides that subject to the provisions of this Act and the conditions contained in its memorandum, if any, a company may, by a special resolution, alter its articles including alterations having the effect of conversion of a private company into a public company; or a public company into a private company.

First proviso to section 14(1) lays down that where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company.

Second proviso to section 14(1) stipulates that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit. (yet to be notified)

The right to alter the articles is so important that a company cannot in any manner, either by express provisions in the articles or by independent contract, deprive itself of the powers to alter its articles. [**Walker vs. London Tramway Co**]

However, in spite of the power to alter its articles, a company can exercise this power subject only to certain limitations.

### **Limitations to Alteration**

1. Must not be inconsistent with the Act.
2. Must not conflict with the M.A.

3. Must not sanction anything illegal.
4. Must be for the benefit of the co.
5. Must not increase the liability of members.
6. Alteration by special resolution only.
7. Must not result in expulsion of a member.
8. Alteration must not be with retrospective effect. The Articles of Association cannot be altered so as to have retrospective effects. The articles only operate from the date of the amendment **[Pyare Lal Sharma vs. Managing Director, J.K. Industries Ltd.]**
9. The alteration must not constitute a fraud on the minority by a majority. If the alteration is not for the benefit of the company as a whole, but for majority of shareholders, then the alteration would be bad. In other words, the alteration should not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage over the latter.

**Case: Brown vs. British Abrasive Wheel Co.**

The majority which held 98% of the shares passed a special resolution that upon the request of holders of 9/10th of the issued shares, a shareholder shall be bound to sell and transfer his share to the nominee of such holder at a fair value. The alteration was held to be invalid since it amounted to oppression of minority.

The minority shareholders not being less than the number specified in Section 397 and 398 could move the Court for redressing their grievances. The Courts have entertained such applications from shareholders even where they are smaller in number [ Re. **Menier N. Hooper Telegraph Works**].

10. Amendment of Articles relating to Managing, Whole-time director and non-rotational directors requires Central Government's approval. (Section 268 –This section is of the Companies Act, 1956)

By effecting alteration in its articles, a company cannot defeat/ escape from its contractual obligation with any person. The company will always be liable in such a case. Therefore, a company is not prevented from altering its Articles on the ground that such an alteration would be breach of a contract but an action for damages may lie against the company. [**Southern Foundries vs. Shirlaw,**]

**Section 8 Company cannot alter Article except with the approval of Central Government**

Section 8(4)(i) provides that a company registered under section 8 i.e. companies with charitable objects shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

**LEGAL EFFECT OF THE MEMORANDUM AND ARTICLES or  
BINDING EFFECT OF AOA & MOA**

The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles.

The memorandum and articles bind:

- (a) the members to the company;

	<p>(b) the company to the members;  (c) the members inter se; and  (d) the company to outsiders.</p>
<p><b>1. Company is bound to members</b></p>	<p>(a) Every member of the company is given some individual rights under the Act and the articles. If a company deprives any of its members of such rights, such a member can sue the company for enforcement of his rights.  (b) The company is bound to comply with all the terms and conditions contained in the MOA and AOA.</p> <p>Therefore, the following conclusions may be drawn:  If a company is about to commit a breach of any terms and conditions of memorandum and articles, any member can obtain an injunction from the Court, thereby restraining the company from committing such breach.</p> <p>If a company has already committed a breach of any terms and conditions of memorandum or articles, any member can sue the company, directors and the other officers who are responsible for the breach.</p> <p><b>Wood vs. Odessa Waterworks</b>  The directors proposed to pay dividend in kind, by issuing debentures. The articles provided for payment of dividends. The court held that payment means payment in cash and, therefore, the company could be compelled to pay dividend in terms of the articles.</p>
<p><b>2. Members are bound to the company</b></p>	<p>When memorandum and articles are registered, it shall be deemed that these documents were signed by every member of the company individually.  Every member shall be bound to comply with the provisions contained in the memorandum and articles.</p> <p><b>Borland's Trustee vs. Steel Bros. Co. Ltd.</b></p> <p>The articles of a company contained a clause that on the bankruptcy of a member, his shares should be sold to other person and at a price fixed by the directors. 'B', a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at the true value.  Held, that the trustee was bound by the articles, as a share was purchased by 'B' in terms of the articles.</p>
<p><b>3. Members are bound Inter se (with each other)</b></p>	<p>Every member is bound to all the other members.  However, there is no privity of contract between the members.  But a member may enforce his rights against another member only through the company and not directly.</p> <p><b>Rayfield vs. Hands</b>  The articles of a company provided that whenever any member wished to transfer his shares, he was under an obligation to inform the directors of his intention and the directors were under an obligation to take the said shares equally between them at a fair value. The directors refused to take shares of a particular member on the ground that the articles did not impose an enforceable liability upon them.</p>

	Held that the directors were under an obligation to purchase the shares, as members of the company, in terms of the provisions of the articles. There was a personal liability of members inter se.
<b>4. Company not bound to outsiders</b>	<p>The articles do not bind a company to the outsiders. This is based on the general rule of law that a stranger to a contract does not acquire any rights under the contract. Therefore, an outsider cannot take the help of the articles to establish a contract with company.</p> <p><b>Eley vs. Positive Life Insurance Co.</b> In this case, the articles provided that the solicitor to the company would not be removed from office except for misconduct. Eley acted as solicitor to the company and also became a member of the company. The company discontinued his services and then he sued the company for damages for breach of contract. It was held that he had no cause of action because the articles did not constitute any contract between the company and himself. His action was dismissed.</p>

<b>Doctrine of Constructive Notice</b>	
<b>Meaning</b>	<p>Every person dealing with the company is presumed to have read these documents and understood them in their true perspective. This is known as "doctrine of constructive notice".</p> <p>Even if the party dealing with the company does not have actual notice of the contents of these documents it is presumed that he has an implied (constructive) notice of them.</p>
<b>Applicability</b>	This doctrine operates in favor of the company, i.e., it creates a presumption in favor of company. It operates against the persons dealing with the company.
<b>Effect</b>	<p>Once registered with ROC, the MOA and AOA become public documents. Therefore, every person dealing with the company is presumed to have read these documents and have understood the provisions correctly, i.e., in the right sense.</p> <p>Thus, it is required of every person to apprise himself with the requirements of these documents before entering into any contract with a company. The doctrine prevents any person dealing with the company from alleging that he/ she did not know the provisions contained in the articles or memorandum. If a person enters into a contract with the company in contravention of the provisions of MOA and AOA, he cannot enforce such a contract.</p>
	<p><b>Koda Venakataswamy vs. C Rammurthi</b> The articles of a company required that the documents and deeds of the company shall be signed by: -</p> <ul style="list-style-type: none"> <li>(i) MD,</li> <li>(ii) the secretary and</li> <li>(iii) a working director of the company.</li> </ul>

	A mortgage deed was signed by the secretary and a working director only. It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilized for the benefit of the company.
<b>DOCTRINE OF INDOOR MANAGEMENT OR TURQUAND'S RULE</b>	
The limitation of the doctrine of constructive notice is known as <b>DOCTRINE OF INDOOR MANAGEMENT.</b>	
<b>Meaning</b>	The outsiders dealing with the co. are entitled to assume that as far as the internal proceedings of the co. are concerned, everything has been regularly done. They are presumed to have read these documents and to see that the proposed dealing is not inconsistent, but they need not inquire into the regularity of the internal proceedings as required by the MOA. & AOA. This is termed as Doctrine of Indoor Management.
<b>Applicability</b>	The doctrine of indoor management operates in favor of the outsiders, i.e., this doctrine creates a presumption in favor of outsiders.
<b>Royal British Bank v. Turquand</b>	<p>The directors of a company were authorized by the articles to borrow on bonds such sums of money as should from time to time, by a resolution of the company in general meeting, be authorized to be borrowed. The directors gave a bond to T without the authority of any such resolution. The question arose whether the company was liable on the bond.</p> <p>Held, the company was liable on the bond, as T was entitled to assume that the resolution of the company in general meeting had been passed.</p>
<b>Conclusion</b>	The benefit of doctrine of indoor management can be availed only if the person dealing with the company has the knowledge of the memorandum and articles.
<b>Exceptions to Doctrine of Indoor Management</b>	
<b>1. Where the outsider had knowledge of irregularity</b>	<p>Where the persons dealing with the company have knowledge of an internal irregularity, obviously the presumption is that every internal proceeding has been conducted regularly i.e., they cannot assume that everything has been done regularly.</p> <p>Therefore, the benefit of doctrine of indoor management shall not be available in such a case.</p>
	<p><b>Howard vs. Patent Ivory Manufacturing Company</b></p> <p>The directors of a company could borrow money upto £1,000 without the sanction of members in GM.</p> <p>The consent of the shareholders was required to borrow in excess of £1,000. The directors themselves lent £3,500 to the company.</p> <p>It was held that the directors had the notice of the internal irregularity and therefore the company was liable to repay them only for £1,000.</p>

<p><b>2. Negligence</b></p>	<p>Where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make an enquiry, he shall be estopped from relying on the Rule.</p> <p><b>Anand Behari Lal vs. Dinshaw &amp; Co. (Bankers) Ltd.</b></p> <p>An accountant of a company transferred some property of a company in favour of Anand Behari. On an action brought by him for breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.</p>
<p><b>3. No knowledge of articles</b></p>	<p>The rule of indoor management cannot be applied in favour of a person who did not consult the memorandum and articles and thus did not rely on them.</p> <p><b>Rama Corporation vs. Proved Tin &amp; General Investment Co.</b></p> <p>Mr. T was a director in the investment company. He purporting to act on behalf of the company entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles.</p> <p>Later, it was found that the directors of the company did not delegate their powers to T. Plaintiff relied on the rule of indoor management. Held, they could not, because they even did not know that power could be delegated.</p>
<p><b>4. Forgery</b></p>	<p>The rule of indoor management does not extend to transactions involving forgery or otherwise void or illegal ab initio.</p> <p><b>Ruben vs. Great Fingal Consolidated</b></p> <p>The secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company. The certificate was held to be a nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management.</p>

### DOCTRINE OF ALTER EGO

It is used by the courts to ignore the status of shareholders, officers, and directors of a company in reference to their liability in their respective capacity so that they may be held personally liable for their actions when they have acted fraudulently or unjustly.

In **Lennards Caring Co. Ltd. vs. Asiatic Petroleum Co. Ltd.** it was held that the default of the managing director who is the “directing mind and will” of the company, would be attributed to him and he be held for the wrong doing of the company.