COMPANY LAW 1

KUNLE AINA

MODULE 1 – UNIT 1

HISTORY OF COMPANY LAW

UNIT 1 – HISTORY OF COMPANY LAW UNTIL 1720

UNIT 2 – HISTORY OF ENGLISH COMPANIES FROM 1720 UNTIL THE REPEAL OF THE BUBBLE ACT IN 1825

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UNIT 1

HISTORY OF COMPANY LAW UNTIL 1720

1. INTRODUCTION

This study material is the first part of Company Law. Company law itself is the study of law regulating the management and regulation of companies. A company is described as an association of a number of people for a common object. This object is usually for economic gain or profit. Though as we shall soon learn, not all company objectsare for profit motive, some companies are set up principally for non-profit reasons. In this study, we shall be concerned with Joint Stock Companies. Joint stock company system is the greatest contribution of lawyers to the economic world because it contributed in a big way to trading by many members of the society, and without the contributors taking part in the management of the company.

In this unit we commence by looking at the historical development of company law. Quite clearly many parts of the law, need not be studied with the historical development, but company law cannot be easily understood except in relation to its historical development, all the concepts, doctrines and developments in the law takes root from the history, and it is an important aspect of the course that cannot be over emphasized. There are three important areas of the history of company law.

(1) The period before 1720

(2) the period after 1720 until 1825 and

(3) from 1825 to the present day.

In this until we shall discuss the period before 1720.

2. OBJECTIVES

At the end of this unit the student will learn, the historical development of company law in United Kingdom; the rise of the joint stock company system, and the fraudulent practices that followed the boom and what led to the promulgation of the Bubble Act of 1720.

3. MAIN CONTENTS

i. Evolution and Development

The advantages of Joint Stock Company would have been lost but for the foresight of lawyers. This is because in the early formation stage of Joint Stock Companies, the system paved the way for its own abolition bythe fraudulent practices it engendered. It was finally rejected as a trading institution in England, but was later revived by the law.

Like most institutional devices legal regulations, judicial or otherwise are necessary to make it fulfill its economic steal. The history and the present nature of the system have been greatly influenced by this consideration because it is in the nature of law formulated from time to time to reflect the problem of the past: Historical past and modern setting of the laws relating to companies cannot be easily understood without a brief reference to the history and development of the system.

II. Early Forms of Commercial Associations

The Joint Stock Companies originated in Britain and it was later brought to Nigeria in 1912.

In England, Joint Stock Company system developed from ecclesiastical bodies. Corporate evolution in terms of association of persons noted for a common purpose began from the churches in England. It was then defined as "a body of persons having in law separate and distinct existence and duties from those of the individual persons who from time to time formed the corporation" (Gower, 1979, Gower's Principles of Modern Company

Law, 4th ed. Stevens & Sons, London p. 23) incorporation was then only associated with such bodies like monasteries, chapters, and borough. Corporate personality was specifically conferred upon these ecclesiastical bodies by the crown pursuant to grant of a royal charter. However, this grant of corporate personality was never granted for commercial purpose but for strictly public purpose and it was never granted for a commercial purpose or granted to individuals for purpose of gain or profit.

iii. Boroughs And Guilds

Corporate and separate legal entities which church bodies enjoyed by charter were translated in the towns into economic and administrative instrument of political powers. Each town willing to gain independence from the feudal lords could not do so without the performance of certain duties. The obligations could be burdensome and difficult, and quite almost impossible for individuals to singularly achieve. The individuals therefore find it easier to come together as a group in order to apply for the charter to trade jointly as a corporate body. The borough was not a corporation of traders or merchants. It was political and administrative organization formed principally for proper administration of the towns. The commercial associations are known as the Guilds of Merchants. Though the guild does not resemble any modern company, but we still discover the origin of commercial, organized and common commercial activities in the guild. The aim of these organizations was to supervise and to protect trade; it enables the members of the guild to come together under one umbrella to apply for charters, and to trade with the charters. Mainly, members of the same trade form the guild of merchants and apply for the grant of charters from the crown. This was an effective way for obtaining for their members a monopoly of any particular commodity or branch of trade. Each member still traded on his own account subject only to obedience to the regulations of the guild. Trading on joint account, as opposed to individual trading subject to the roles of the guild, was carried on through partnerships of which two types were known to the medieval law merchant. The first of this was the commenda. This type of partnership is similar to that of the sleeping partnership. The financier advances some amount of money not actually a loan, to the active member of trade with an agreement that he will share in the profits that will be made eventually. However his liability is limited to the amount of money advanced.

Another type of partnership that was prevalent this period and also subject to the rules of the guild was the societas. This was a more prevalent form of association which developed into the present day partnership. Each partner is liable to the full extent of his private assets for partnership debts. The main elements of unlimited liability were already in existence during this period. The privileges which the guilds reserved for themselves included the right of "lot", this was the beginning of profit or dividend sharing. Where the members contributed for a common commercial object, the profits will be shared according to the level of contribution of each member, the 'lot' to be shared is the entitlement of the member subject to his investment in the project.

Merchant Adventurers

The development of the company was also influenced by the discovery of wider world. The growth of merchant adventurers and the need to attract resources to finance the adventures into the unknown world for purposes of discovery and trade also contributed immensely to the development of companies. In fact as noted by Gower (op. cit) the name 'company' was first applied and adopted by the merchant adventurers. These type of regulated companies were extension of the guilds system for the purpose of foreign trade and expansion. Each member is requested to trade with his own stock and or his own account, subject to obeying the rules of the company. At this point in time, the liability of the contributors is totally separate from that of the company and the members. Charters were applied for and obtained to enable them trade effectively and to gain monopoly over the scheduled territory in the charter and therefore prevent others from the territory. However, the company was later to convert the individual stocks to joint stock and the trading was entirely with the stocks contributed by the members but now owned by the company as joint stock. Writing about this type of companies, Samuel Williston (History of the Law of Business Associations before 1800 Harvard Law Review, Vol. 2, No. 3, 1888) explained thus,

> *"During the sixteenth century of the growth of the commercial spirit, fostered by the recent discovery of the New World, the more thorough exploration of the Southern Atlantic and Indian Oceans, and the Search for a North-West passage, led to the establishment and incorporation of companies of foreign adventures, similar in all respects to the earlier guilds, except that their members were foreign instead of domestic traders."*

Amongst the earliest of these were the African Company, the Russia Company and the Turkey Company. The last two were called "regulated companies" that is, the members had a monopoly of the trade to Russia and to Turkey, but each member traded on his own account. In 1600, Queen Elizabeth chartered a company named company of merchants of London, trading to the East Indies. The principle and rationale for these companies, was that the expense incident to fitting of ships for voyages, often taking several years for their completion, was too great to be borne easily by individual merchants, and it was one of the claims to favourable consideration which the East India company put forward, that "noblemen, gentlemen, shopkeepers, widows, orphans and all other subjects may be traders and employ their capital in a joint stock."

Till 1614, the joint stock was subscribed for separately for each voyage, and at the end of which the profits are shared. New stocks were contributed for the next voyage whether long or short term. New members are admitted on the payment of a fixed amount of money.

Companies and Incorporation

By the second half of the 17th century, two different types of commercial association have emerged. The first and more popular was the partnerships which are unincorporated, though may later grow into joint stock company and apply for a charter. Capital was generally raised by contributions from the members. The capital was divided into transferable shares and infact could be transferred by the original partners.

The other types were the ones that are incorporated. Incorporation has its own peculiar advantages, the company was capable of existing in perpetuity, it has a common seal, cansue and may be sued in its own name, and there is a distinction between the acts of the company and that of its members as well as the assets of the company and the members thereof. The important advantage also is the advantage of limited liability or a similitude of what is regarded as limited liability today. The company as Gower explained is always liable to pay its debts and in order to raise money to do so it would make calls on its members. Moreover, the creditors by a process resembling subrogation could proceed directly against the members, if the company refrained from taking the necessary action.

EVENTS LEADING TO THE BUBBLE ACT

At the end of the seventeenth century the advantages of corporate enterprises seem to have been realized, and the acts of parliament, authorizing the king to grant charters to various business associations, were more frequent. In 1694 the Bank of England received its first charter. The act authorizing it was essentially a scheme to raise money for the government. Those who advanced money to the government were to receive a corresponding interest in the bank; the capital of which was to consist of the debt of the government. Many companies were granted charters at this time, including the South Sea Company. The capital of the South Sea Company, like that of the Bank, was to consist of a debt from the government on account of money owned by private individuals.

The extravagant speculations in joint stock companies and the stock-jobbing in their shares were very popular by the early part of eighteenth century. Anderson in his book "History of Commerce" (Vol. 1 (1st edition), 291) identified more than two hundred companies formed around the year 1720, for example, companies were formed for the prosecution of every kind of enterprise, including one for "insurance and improvement of children's fortunes", and another for "making salt water fresh". Most of the schemes were fraudulent and planned to defraud the unwary public. It is noteworthy, that the general opinion was essentially and mainly a governmental plan to use the companies for development and growth of the economy. So that the government view then was that the charters were granted only for the common good and public purpose. The charters were prohibitive in cost, and the processing is quite slow and subject to difficult bureaucratic formalism. The effect was that having seen the great possibilities, profits and advantages of Joint-Stock Companies, many do not care to apply for grant of charters, but proceed to invite the public to subscribe in various mostly dubious schemes. There was illegal sale and transfer of charters, while some acquire obsolete charters. The public was invited to contribute money to a company to make a wheel for perpetual motion, another one was for subscription of Two Million pounds for the melting of sand dust and ship coasting, subscription was invited for the suppression of thieves and armed robbers. The value of joint stock system was overrated, and large number of people were prepared to invest without knowing what the company was meant for; for example invitation for subscription in a “profitable venture to be later on promulgated”.

The South Sea Company which was chartered by the crown, went ahead to buy up the National Debt of about £31,000,000.00 with the plan to further extend its trade from the accruing interest expected. This was not to be, as the company failed, and would not meet the expectation of the subscribers. This caused a lot of embarrassment for the government as many members of the government and parliament subscribed huge sums of money into the company. There was panic and the parliament moved swiftly and on the 17^{th} April, 1720 the House of Commons passed a resolution, emphasizing the effects of rash speculations, numerous associations that acted without lawful authority. This was followed by the BUBBLE ACT of 1720, which simply went ahead and prohibited any association calling itself company. The section 18 of the Act provided that all such undertakings as were therein described, “tending to the common grievances, prejudice, and inconvenience of His Majesty subjects ‘should be illegal and void. These are associations “acting as a corporate body and the raising of transferable stock or the transfer of any shares therein without legal authority either by the Act of Parliament or Crown Charter, or acting or pretending to act under an obsolute charter.”

The Bubble Act in fact marks the end of an era. The parliament in 1720 felt the only solution was the outright ban on joint stock companies instead of a careful study of the system and proper legislation to check the excesses and regulate the companies. Holdsworth was of the opinion that “what was needed was an Act which made it easy for joint stock companies to adopt a corporate form and at the same time, safeguarded both the shareholders in such societies and the public against frauds and negligence in their promotion and management. What was passed was an Act which deliberately made it difficult for joint stocksocieties to assume a corporate form and contained no rules at all for the conduct of such societies, if, and when, they assumed it." (H.E.L. Vol. 8, 219 – 220). Gower sums up the effect of the action taken by parliament, that "where they seem most blameworthy is not for what they omitted to do, but for the vagueness of what they in fact did, and when the courts were called upon to interpret it they found it vague indeed."

SELF ASSESMENT TEST

Discuss the events that led to the promulgation of the Bubble Act

4. CONCLUSION

From the above, quite clearly the joint-stock system started from the very rudiments of commercial trading and helped by enterprise and the efforts at embarking on large scale business that could not easily be undertaken by individuals, and the intervention of government brought about the joint-stock companies. However, the failure of government to regulate and make proper laws to prevent abuse led to the problems and also the eventual collapse of the system.

5. SUMMARY

The Joint Stock Companies took its root from the eccelestical bodies in England. This was later expanded into the towns in the formation of the Borough and Guild of merchants. Due to the expansion of trade and international voyages, the merchants pulled their resources together and formed companies and at the end of which they share the profits. They were mandated to obtain charter from the crown. However, the development led to a lot of fraudulent activities which eventually led to the collapse of the system with the passing of the Bubble Act of 1720 by the parliament prohibiting the formation of joint stock companies.

6. TUTOR MARKED ASSIGNMENT

Identify the rationale for the enactment of the Bubble Act 1720.

7. FURTHER READING/REFERENCES

Gower,1979, Gowers Principles of Modern Company Law, 4th ed. Stevens and Sons, London, .

MODULE 1 - UNIT 2

HISTORY OF ENGLISH COMPANIES FROM 1720 UNTIL THE REPEAL OF THE BUBBLE ACT IN 1825

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION

Upon the enactment of the Bubble Act 1720 an Act which expressly prohibits the formation of Joint Stock Companies, the assumption is that this will mark the end of companies. But this was not to be, though the growth and development of Joint Stock Companies was seriously retarded, yet with the help of lawyers, the Joint Stock Companies system, continue to develop gradually and inevitably. In this list we shall continue to trace the historical development of companies from the Bubble Act of 1720 until 1825 during which significant charges was recorded.

2. OBJECTIVES

In this unit, the student will learn about the origins of memorandum and Articles of Associations, the Directors, shares, and influence of equity in company law.

3. MAIN CONTENT

3.1 EFFECT OF BUBBLE ACT ON COMPANIES

One of the main reasons for passing the Bubble Act was to protect the South Sea Company from total collapse. However, because of the revelations that later came on the fraudulent activities involved in the management of the company and deep corruption associated with the government itself, the company eventually collapsed, and with it a lot of companies and numerous investors lost their investments in these companies. Gower writes that,

> *"if the legislators had intended the Bubble Act to suppress companies they had succeeded beyond their reasonable expectations; if, as seems more probable, they had intended to protect investors from ruin and to safeguard the South Sea Company, they had failed miserably". (op. cit).*

Joint Stock Companies did not totally disappear. Many of the properly chartered companies survived and are allowed to continue to flourish, while others still applied for charters and were granted; though charters became very difficult and more expensive to obtain.

The official view at this time was aptly represented by Adam Smith (Wealth of Nations, V. Chap 1, Pt 111 art 1) writing in 1776 that Joint Stock Companies are only appropriate for trades such as banking, insurance and making and maintaining canals and that others will be contrary to public purpose. However this renewed the position of government until the introduction of gas-lighting into the larger cities and towns early in the 18th century, an later the laying of railways, created a wide-spread necessity for united capital.

UNINCORPORATED ASSOCIATIONS

The Government strict stand on the nature of Joint Stock Companies, and the very difficult procedure for obtaining a charter led gradually to legal minds coming together to explore ways of circumventing the Bubble Act. The lawyers discovered that the Act did not prohibit partnerships, but expressly permitted people to continue to operate partnerships as before. The idea was that since partnership permitted several individuals to pool their money together for profit. With the aid of equity and by the use of trust, lawyers recognizing the fact that the Bubble Act did not prohibit a group of people calling themselves a company so long as the company did not presume to be a corporate body dealing with shares, it was not against the law; and because these associations were not corporations they could not own their own property. The lawyers, therefore in order to circumvent that, vested the property of the association in the Trustees appointed by the association by the use of Trust Deed and the Trust Deed was known as Deed of Settlement. The trust deed could specify the purpose for which property was vested and the trading venture to which the property was to be applied.

The trust deed is what is now known as the memorandum and articles of associations. The Deed of settlement is structured in such a way that the associating members or subscribers would agree to be associated in an enterprise with a prescribed joint stock divided into a specified number of shares, management of the enterprise is normally delegated to a committee of persons now known as Directors, while the property is vested in separate set of people – the trustees; in some cases the trustees are also directors of the company.

The trustees being the legal owner of the property of the company owns for the benefit of the subscribers who are the beneficiaries under the deed of settlement. The trustees can be sued or sue on behalf of the company. In some of the deed of settlements the provision is specifically made, but since this is the position under the law, normally the courts of equity permits this in any case.

The members do not own property that is the beneficial owners got their benefits through the ownership of a share thorough which profits of the company were shared. There was therefore no difference between this company and the type prohibited by the Bubble Act and indeed after the panic brought by the Bubble Act many companies adopted the deed of settlement system. The Royal Exchange was evolved in 1790 by Royal Charter. Globe Insurance petitioned the House of Lords for a charter which was refused and used the trust deed system to form a company (see House of Common Journal (300) LXI 1590J). This system gave rise to many institutions known today like the trustees Savings Bank, Building and Friendly Societies. The system brought joint stock system under the influence of equity in company law till today.

REPEAL OF THE BUBBLE ACT 1720

The Bubble Act 1720 continue to be a dead letter law, as many companies sprang up using the deed of settlement system, and continue to do that very act which the Act prohibited. Many subscribers freely transfer their shares without hindrance. The profits are shared as dividends and the companies continue to draw a lot of public participation. The government could not do much about this. However, in November 1807 the Attorney General tried to prosecute some unincorporated companies that freely made provisions for easy transfer of its shares. The court as per Lord Elhersborough**(R v Dodd 1808) 9 East 516)** dismissed the applications because the Act had not been invoked for 87 years previously. Subsequently, when the court held two similar companies illegal **(R v Stratton (1809) 1 Camp. 549, Buck v Buck (1808) 1 Camp. 547).** Many continue to oppose the where concept of Joint Stock Companies while the vast majority had come to embrace it the to the many advantages that cannot be over looked. There was much debate on the merits and demerits of the system.

Finally, the government stopped into the matter and upon review of all the issues involved, the government sponsored a Bill before the House for the repeal of the Bubble Act of 1720. The Act was repealed in 1825 and this marks the beging of the active role of the Bovened of Trade in the development of company law.

4.0 CONCLUSION

From the foregoing account it is clear that the Bubble Act 1720 was a great ingredient to development of company law and for over 100years it held sharing effectively blocking an intelligent development of the law. Gradually however, lawyers with the aid of equity were able to systematically avoid the provisions of the law, and lay a solid foundation for the development of the law which is still opponent till today.

5.0 SUMMARY

The Bubble Act 1720 though prohibited joint stock companies yet with ingenuity of lawyers and with the help of trust, they devised the deed of settlement companies that was specifically structured use the companies prohibited under the Act, and was able to achieve the same commercial purpose. This deed of settlement companies actually brought about the concepts in company law today. It also caused equity to intervene in companies and since then the influence of equity cannot be divorced from company law.

6.0 TUTOR MARKED ASSIGNMENT

Since the Bubble Act 1720 there Joint Stock Company into the arms of equity, it has not been able to extricate itself discuss.

7.0 **REFERENCE/FURTHER READING**

MODULE 1 - UNIT 3

HISTORY OF COMPANY LAW FROM 1825 TILL TODAY

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION

After the repeal of the Bubble Act 1720 it would seem as if the position revents to the pre-Bubble Act days. The only form of authorization for company formation still remains the grant of a charter. However, the charter became very difficult and expensive to obtain, further, the difficulty of convincing the public of the many advantages of joint stock companies after the fraudulent era, and the total absence of any regulation led to a slump in use of the joint stock company system as a commercial vehicle at this time. In this unit we shall examine the developments of the joint stock system from 1825 till the present day.

2. OBJECTIVES

At the end of this unit the student will be able to learn the development of company law from 1825, particularly the different Acts enacted on company law till date.

3.0 MAIN CONTENT

3.1 TRADING COMPANIES ACT 1834

This Act, the Trading Companies Act was enacted in 1834 and was intended to extend the availability of corporate advantages. This Act actually empowered the crown to confer letters patent on companies without granting a charter, the companies can sue and be sued without a special Act to this effect, but they may only be sued in the name of their officers. The Act also made provisions for the registration of members of the company. There was however no limitation on the liability of the members but made further provision that the members continue to be liable for the debts of the company until three years after ceasing to be member of the company. In cases where the creditors obtain judgement against the company, execution may be levied against every member without leave of court.

In 1837, the Board of Trade instructed a chancery lawyer, H. Bellendenker to prepare a report on the law of partnership with particular reference to establishing limited partnerships. However, based on his report, the 1834 Act was re-enacted as the Chartered

Companies Act of 1837 but with the reliable clarification that personal liability of members might be limited by the letters patent to a specified amount per share. The great limitation had been the unlimited liability of the members and the difficult of every a large number of people who are fluctuating every day.

In 1843, Gladstone, was appointed the President of the Board of Trade and also the chairman of the committee on joint stock companies of the parliament. The report of the committee which was declared to be "epoch making" by Gower, led to the enactment of the Joint Stock Companies Act 1844, and this Act had been called the Gladstone Act.

GLADSTONE ACT 1844

By this time, the Industrial Revolution was gathering momentum, and this was exerting pressure on government for charges in the legal area to meet the needs of commerce. Restrictions were being gradually lifted to allow ordinary people to incorporate companies. This was the position taken in the Gladstone Act of 1844. The Act introduced these main principles which has helped in the development of company how till today. The first point was to drew a distinction between Joint Stock Companies and partnerships, as it provided that any partnership of more than 25 members must compare ity register as a invited company; or with shares transferable without the consent of the members. The second very important improvement was that it provided or registration of companies without the necessity of applying for charter or Special Act of parliament. This is done by filing of a deed of settlement which will specify the purpose for which the company is incorporated; when the deed of settlement is not filed, then the registration is only provisional only. The third principle is that of publicity. The major reason for this is that where there is full publicity of the activities of the company there will be less likelihood of fraud being perpetrated by the promoters. The Act also established the Registrar of companies with whom all the particulars of the companies are filed, including annual returns. The personal liability of members was till retained, but he law provided that their personal liability will cease after three years of registered transfer of their shares; however, the creditors must first proceed against the company before they can proceed against the assets of the members, where the assets of the company cannot satisfy the debt.

In 1845, based upon a Bill prepare by Gladstone but passed after he left office, the companies clauses Consolidation Act of 1845 was passed. The provisions of the law was to be incorporated by reference, but it materially slaughtered and cheapened the powers of statutory incorporation which was still necessary in case of public utilities requiring the powers of compulsory acquisition. Gladstone during his short stenre succeeded in putting Joint Stock Companies on a sound legal footing.

JOINT STOCK COMPANIES ACT 1856

The 1855 Limited Liability Act was enacted that year to confer limited liability on companies the struggle will be discussed in the next unit. It remained in force for a few months until it was repealed and incorporated in the Joint Stock Companies Act 1856. This Act contains 116 sections and a schedule of tables and forms and can be classified as the first of the modern Companies Acts. There was no more provisional registration. The deed of settlements was replaced by the memorandum and articles of associations, it also has provisions for counting up, which was hitherto had been subject of another Act. The manner of incorporation was simplified as any seven or more persons may join and informing a company by simply subscribing to the memorandum of and articles of associations. There was no more minimum paid up capital or stoke value. Directors were still to be liable if they paid dividends knowing the company to be insolvent, this is still the position today. The word "limited" must be added to the name of the company. There are also provisions for registration and publicity. The word "limited" is used as a wearing signal to alert unwanyoutsiders dealing with the company to dewore. All companies are required to add 'Ltd' as part of its name, and this practice is still followed till today.

SUBSEQUENT DEVELOPMENTS

In 1857, a Companies Act was enacted which now brought Joint Stock Banking Companies within the scope of the Companies Act. In 1862, the various enactments were consolidated, e.g. An Act dealing with frauds by directors. Directors Liability Act 1890, the 1862 Companies Act remained the principal act until 1908. The Companies Act 1908 consist of 212 sections and three schedules. It also for the first time introduced the companies limited by guarantee which was useful for clubs and charitable organizations.

In England, the practice began by setting up committee to review the Company Act periodically and the report later forms the essence of the company law amendments that normal follow. In 1948 a Comprehensive Act was passed in England which incorporated all the new developments and court decisions and updated the company law at that time. Nigerian Companies Act 1968 was based on the 1948 English Companies Act.

Another important influence on English company law was the passing of the European Communities Act 1972 upon the joining of the European Union, to comply with minimum obligations under the Rome Treaty and section 9 made substantial but inelegant revisions to the company law to comply with the First Council Directive on publicity, pre-incorporation contracts and the capacity of companies and the authority of directors.

Another landmark legislation in England was the Companies Act 1985 which incorporated all the EEC directives and modernized company law. This was followed by the Companies Act 1989.

The current comprehensive legislation in England is the Companies Act 2006.

4.0 CONCLUSION

The period from 1825 till today had been very rapid developments in company law. As the economic activities and commence generally improved through the use of technology, company law responds most admirably to new trends and manage to keep pace with the yearnings of the society. The innovations that was brought about within this period and the use of this innovation till today attests to the very important contributions of this period to company law today.

5.0 SUMMARY

After the repeal of the Bubble Act, there was a slump in economic activities. And as the Trading Companies Act 1834 was enacted and folloed by the Joint Stock Companies Act of 1844, and 1845 with innumerable innovations chief of which is the simple registration of companies. The road was cleared for more public participation and interest. The Joint Stock Companies Act of 1856 thereafter lay the foundation for the current position of the law. Virtually all the current principles and procedures were established firmly, and we can assertively say the 1856 Act was the begging of the Modern Companies Act we have today.

6.0 TUTOR MARKED ASSIGNMENT

Trace the historical development of company law from 1825 till the present day.

7.0 REFERENCES/FURTHER READING

MODULE 1 - UNIT 4

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION

Prior to the colonization of Nigeria by the British, there had existed some forms of economic activities within the region. On the local scale we have individuals trading within the towns and villages, and the articles of trade, were cloths, farm produce and other metal products. Gradually the won and village trade spread into inter-town and inter-village trade. Essentially, it was not beyond peasant setting, and revolves round the minimum needs for subsistence of the people. The mode of exchange had remained trade by barter. In the unit we want to examine how this largely subsistence and agrarian society transformed into the modern trade and how company law developed in the country.

2. OBJECTIVE

At the end of this unit the student must understand the historical evolution of company law in Nigeria. The period before 1912, and after.

3. MAIN CONTENT

MODULE 2 – UNIT 1

FORMS OF BUSINESS ORGANIZATIONS

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

At this early stage it will be helpful for us to loo0k at the various forms of business organization in order to have a comparative view of other business organization and company. Also important is that we will be able to draw comparative merits of each type of organization and set the criteria to assess them. All business organizations must be assessed from these basic levels. The first is that of money, does it facilitate easy investment in the business? The second question is to determine the risk factor, since there is always no total assurance of success in any business, does the business mitigates or minimize the risk involved in the venture, and thirdly, does the organization have such structure as to reduce friction or the disagreement amongst the investors and managers (see Allen Dignam and John Lowry, 2009, Company Law, Oxford University Press, London).

2. OBJECTIVES

At the end of this unit the student must understand the basic types of business organization – (1) the sole trader (2) the partnership

3. MAIN CONTENT

3.1 SOLE TRADER

The sole trader is the most elementary type of business organization; the business involves only the individual himself going into business on his own, without the involvement of any outsider. The sole trader may be assisted by members of his family, his wife, and children basically. He may employ assistants and other officers, and in most big one man business (as it may be refereed to) of many expand to a point that he needs professionals like accountant and prevalent craftsmen to assist in the business. it is most suitable and prevalent in crafts work like mechanic, teachers, petting trading and supple manufacturing business.

Sole traders usually provide their own capital with their personal savings andif they are lucky, may utilize bank loan. In most cases they rely on friends and family to raise the initial capital, and are indeed limited in their activities due to limitation of capital. The implements of their trade must be sourced by self-finance. They can only contract on their own with personal guarantee for all their dealings with third parties and their liability is personal. In effect, wherever, the business is indebted to anybody, they must pay not only from the business but also from personal savings, and the creditors are entitled to levying execution not only on the business but also on the personal assets of the sole trader. It is this lack of distinction between the personal assets of the sole trader and his business that makes this type of business organization unattractive. Legally, therefore, there is no distinction between the assets of the sole traders and that of the business.

As the business is just one individual there is absolutely no risk of any disagreement and so there is no need for any serious organizational structure to prevent frictions and disagreement. It is good for the sole trader to keep proper accounts, but where he does not, he is not responsible to anybody to keep proper accounts. However, for the purposes of tax he is taxed as a sole trader and nothing more, though he must obtain a business permit from the Local Government to operate as such within the cities.

The sole trader is therefore adequate for a single person with limited capital but is totally unsuitable for a large scale investment.

Registration

The sole trader, where he desires to adopt a business name for his business must register the business name with the Corporate Affairs Commission under Part B of the Companies and Allied Matters Act (Cap C20, LFN 2004) (CAMA). Section 573 of the Act provided that every individual, firm or corporation having a place of business in Nigeria and carrying on business under a business name shall be registered in the manner provided under the Part B of the Act. Where however, the sole trader merely uses his meal names he does not need to register the business under the Act, but where he adopts another name that is different from his real names then he must register under the Act.

While registering the business, the sole trader must supply the following information to the Registrar.

(1) he must fill the prescribed form.

(2) The business name proposed

(3) The general nature of the business

(4) The full postal address of the principal place of business

(5) Full postal address of any other place of business

(6) The names of the individual sole trader, nationality, the age, sex, residential address, and business occupation of the individual

(7) Date of commencement of business

(8) Passport photograph of the sole trader (see section 574 CAMA).

As soon as the sole trader has complied with the legal requirements the Registrar will issue a certificate of registration to him.

SELF ASSESSMENT TEST

Discuss the legal requirements for registration of sole trader as business under the Companies and Allied Matters Act 2004.

II. PARTNERSHIP

The sole trader may in order to further expand or raise capital may consider involving investors or partners, who may desire to join in the business by bringing their own money into the business and thereby form partnership business. This may of course facilitate expansion of the business by increasing the capital available for business. Section 1 of the Partnership Act 1890 defines partnership as “the relationship which subsists between persons carrying on business in common with a view to make profit.” The partnership may be formed either by oral agreement or by written agreement or it may be inferred from the conduct of the partners. Where there is a written agreement it will specify the terms and conditions of the partnership. There is therefore no particular formal process of forming a partnership as it may be inferred from the conduct of the parties. The minimum member of person that may form partnership is obviously two, while the maximum number where it is not firm of solicitors or accountants) is twenty. (section 19 CAMA)

The asset of the partnership belongs strictly to the partnership and does not delivery to the individual partners.

Where there is no partnershipagreement or where the partnership agreement does not exclude the Partnership Acts/Laws, the law will govern the partnership each partner is entitled to participate in the partnership business. A partner is entitled to equal share in the profits of the business. No partner can be expelled by the others unless there is agreement to the contrary. A partnership will determine on the death of a partner.

In order to avoid frictions and organizational problems, the partnership may modify Partnership Act with a more complex agreement that will govern the partnership. Each is liable for the debt of the partnership, as each partner is jointly and severally liable for the debt of the partnership business.

The partnership business may also be registered under Part B of the CAMA 2004, as a form, and by complying with section 593 of the Act.

SOME PRACTICAL AND LEGAL DIFFERENCE BETWEEN PARTNERSHIPS AND COMPANIES

1. Formation and existence of partnership depends on mutual trust and personal relationship. This is not required in the case of a company.
2. Partnership can be formed by oral agreement or from conduct, whereas you need, a lot of formalities to bring a company into being.
3. Every partner is entitled to take part in the management of the firms business whereas in a company ownership is separatedfrom management.
4. Death or withdrawal may terminate the partnership, while death or withdrawal of a major shareholder does not terminate a company. Joint stock companies have perpetual succession.
5. The liability of the partners is unlimited, and they are liable personally for the debts of the partnership jointly and severally. While the liability of the members of the company is limitedonly totheir investment in the company.

SELF ASSESSMENT TEST

Discuss the incidents of partnership business.

4. CONCLUSION

From the foregoing the two forms of business organization discussed above, the sole trader and partnership we discover that both are very popular, because they require little financial investment and they depend on the goodwill of the individuals involved. Most of the big industrial concerns today started from this modest level.

5. SUMMARY

The sole trader is one man business employing in some cases the family members to assist in the management of the business. It requires little financial involvement and the liability of the trader is unlimited and therefore his personal assets could be attached for the debt of the business. The partnership is formed by two or more persons but not exceeding twenty (except for a firm of solicitors and accountants) associated for profit motive. The partnership may be inferred from the conduct of the parties, or by oral agreement, or written agreement of the parties. Where the partners did not enter into an express agreement their affairs are regulated by the Partnership Act 1890, or the Partnership Laws of the respective states. The form like the sole trader may be registered under Part B of CAMA 2004. The partnership agreement may exclude the provisions of the law or adopt the Partnership Acts. The death of a partner terminates the partnership.

6.TUTOR MARKED ASSIGNMENT

Discuss the main differences between a sole trader and the partnerships

7. REFERENCES/FURTHER READING

MODULE 2 – UNIT 2

TYPES OF COMPANIES

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

In Unit 1, we learnt about two basic business organizations, the sole trader and partnership. In this unit we shall be studying An introduction to company as a business organization. The types of companies we have under the law, and importance of the classification of companies. We have different types of companies each one formed for a particular reason or purpose, for example, there are companies formed under on enable statute basically as an agent of Government for public purposes. While others may be formed by individuals but for nonprofit motives, though majority of companies are incorporated for purposes of profit making. This profit making companies are also sub-divided into public or private companies.

2. OBJECTIVES

At the end of this unit, the student must be able to discuss. The different types of companies the purpose for which each type of company is registered to fulfill.

3. MAIN CONTENT

Types of Companies and Functions

1. Statutory Companies

These are companies brought about by statute e.g. Power Holdings Company of Nigeria (PHCN). Their powers, purpose, management and functions are as stated in the enabling Act. Profit is not the major aim of setting up these companies but basically for government to provide an important social amenity. These companies major or only shareholder is the Government, the Directors and top managers are appointed by Government and they do not have share capital.

2. REGISTERED COMPANIES

There are three types of companies under this category,

- company limited by shares,
- company limited by guarantee
- unlimited liability company

(a) **Company Limited by Shares**: - these are companies incorporated under the Companies Acts. A company limited by shares is a company where the liability of the shareholders for the debts of the company is limited to the amount unpaid on their shares (see Sec A on 21 CAMA 2004).

(b) **Company Limited by Guarantee** :- In this case, the motivation is not to make profits, this is a company having the liability of the members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of the company being wound up (see Section 21, CAMA 2004) company limited by guarantee is appropriate for non-profit organization for the promotion of arts, culture, commerce, science, religion, education sports, research, charity or other similar objects and the income of the company are to be applied solely towards the promotion of its objects, and no portion thereof is to be paid or transferred directly or indirectly to the members of the company except as permitted under the Act; the company limited by guarantee shall not be registered with share capital (section 26) the company name must end with limited by guarantee (Ltd/Gty).

(c) **Unlimited Company:**- An unlimited company is a company where the liability of the members is unlimited. It follows that the members shall be personally responsible for the debts of the company. (See section 21(2).)

A company limited by shares may be further divided into two, the private company limited by shares, and public company limited by shares.

Private Company: A private company is (1) a company that restricts the right to transfer its shares and (2) limits the number of its members to 50, not including the persons who are in the employment of the company and persons who having been formerly in the employment of the company who were while in that employment and having continued after the determination of that employment to be members of the company and (3) prohibits any invitation to the public to subscribe for any shares or debentures of the company. Minimum share capital of private company is N10,000.00

Public Company: The Act namely declares that any company other than a private company shall be a public company and its memorandum shall state that it is a public company. We should note that public companies have the aim of securing investment from the general public and so they are free to advertise the offer of their shares to the public. The company also issues prospectus which gives a detailed and accurate report of all the activities of the company including the names of its directives and members, its share capital, the assets of the company and other important, information. Because the general public are involved and need to be protected, the initial capital requirements for a publiccompany, are more onerous than a private one. The minimum capital requirement of a public company is N500,000.00 (section 27(2), CAMA 2004). The application for registration for a public company must state that it is a public company and that the liability of its members is limited, the company therefore must end its name with "PLC" (Public Limited Company) section 29(2) CAMA 2004). This will notify the public that the member's liability is limited and that it is authorized to secure investment from the general public.

In order to facilitate the sale of its shares publicly, the public company may apply to be listed on the Stock Exchange. The Nigerian Stock Exchange may list any public company that applies to be listed on the exchange, and upon being listed, the shares of the public company may be sold on the floor of the market. This is not available to a private company. However, not all public companies are listed on the stock exchange.

We may also note the restriction as to the maximum membership of a private company is 50 members, whereas a public company is not so restricted, and may have as many as a million members or more.

A private company may be converted to a public company by complying with the provisions of the Act. The private company proposing to convert to a public company must,

(1) Pass a special resolution that it should be so re-registered

(2) Apply to the Corporate Affairs Commission (C.A.C) for re-registration with the following documents

(a) a printed copy of memorandum and articles of association as altered in pursuance of the resolution.

(b) a copy of written statement by the directors and secretary certified on oath that the paid up capital of the company is not less than twenty-five percent of the authorized share capital as at that date.

(c) a copy of the balance sheet of the company

(d) statutory declaration by the director and secretary that;

(i) the special resolution has been passed,

(ii) that the company's net assets are not less than the aggregation of the paid-up capital and undistributable reserves and ,

(e) a copy of the prospectus or statement in lieu of the prospectus (see section 50, CAMA 2004).

4. CONCLUSION

As we have pointed out, there are different types of companies, all incorporated for particular purposes and reasons. The most popular however from the point of view of business are those that arelimited by shares and having share capital. They are classified as being private and public companies. Private companies are restricted in terms of membership and ability to raise money from the public, and suitable for small businesses, while the public companies are big businesses with access to the general public for raising capital and also may be listed on the Stock Exchange for the purpose. The private company may be re-registered as a public company by simply complying with the provisions of section 50 of CAMA 2004.

5. SUMMARY

From the stand point of business and investment opportunity. The company provides an organizational structure that is designed to effectively meet this need. The shares enable the company to raise money from a very large number of people. The members have limited liability and are therefore not constrained with fears of any personal liability. Thus it minimizes risk. The company is also not hampered by the death of a member as it will not bring the business to an end like the partnership. Though the members are the ownership of the capital of the company, they appoint directors to manage the affairs of the company and therefore management is separated from ownership, the directors must however give account of their management periodically during meetings called the Annual General Meeting (AGM).

6. TUTOR MARKED ASSIGNMENT

Compare and contrast the private and public companies

7. REFERENCES/FURTHER READING

MODULE 2 – UNIT 3

PRELIMINARY REQUIREMENTS FOR INCORPORATION

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

Section 18 of the Act provides that any two or more persons may form and incorporate acompany by complying with the requirements of the Act in respect of registration of such company. In effect there are forms and requirements to be complied with, before a company can be incorporated. The promoter must ensure that he complies with all the legal requirements and therefore it is important for us to understand all these necessary requirements. The Registrar of companies is also permitted under the law not to register any company that does not comply. Where however the promoter has complied with the law and his application is refused, he is entitled to seek order from court to compel the Registrar to accept his application and register his company. In this unit we shall examine the mandatory preliminary requirements for incorporation of companies in Nigeria.

2. OBJECTIVES

At the end of this unit the student will be able to critically identify some preliminary requirements for incorporation.

3. MAIN CONTENT

1. MANDATORY INCORPORATION

No company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on business for profit or gain by the company or association or partnership, or by the individual members thereof, unless it is registered as a company under the Act or is formed in pursuance of some other enactment in force in Nigeria (section 19). There is a mandatory incorporation for any group of persons formed with the aim of profit or gain, and any such organization that is not incorporated is illegal. In the case of *Akinlose and Others v A.I.T and Others* **(1961) N.L.R 215**, the association was being managed by over 100 members and it was not registered at all. There was a quarrel amongst them and they went to court, the court found that they were more than 20 members associated for profit and was not registered association, the Court declared the association to be illegal. Section 19(2) permitted three exceptions to the rule ,

(1) where the association is a registered co-operative society, it need not be incorporated. We should note that this is not an entirely necessary exception because the cooperative society must be registered under the laws of the state on cooperatives, where this has been done, it does not operate as a company but as a society with its definite and defined objectives which is not basically for gain or profit but the welfare of its members.

(2) Any partnership formed for the purpose of carrying on practice as legal practitioners by persons each of who are legal practitioners. All legal practitioners in Nigeria are persons who have undergone the mandatory course in the Nigeria Law School, and have been duly called to the Nigerian Bar and registered to practice as Solicitors and Advocates of the Supreme Court of Nigeria. The law permits more than 20 of them to form a partnership for the purpose of their profession. The requirement is that they must not only be legal practitioner but they must be practicing as such and no more where they are not associated for the strict purpose of legal practice, they must incorporate their business.

(3) Any partnership formed for the purpose of carrying on practice as accountants by persons each of whom is entitled by law to practice as an accountant in Nigeria. The person must be licensed to practice as an accountant by any of the legally recognized association for the regulation of accounting practice in Nigeria (A.N.A.N and I.C.A.N)

These are the only recognized exceptions to the rule and where anybody or association exceeds twenty in contravention of the law, every person who is a member of the company association or partnership during the time that it so caries on business after fourteen days shall be guilty of an offence and liable on conviction to a fine of N25.00 for every day during which the default continues.(section 19(3))

2. RIGHT TO FORM A COMPANY

The minimum number of persons that may form a company in Nigeria is 2 (see section 18 CAMA 2004) under the companies Act 1968, the law makes a distinction between a private and public company. The law permits any two persons to form a private company but not less than 7 members are required to form a public company (section 377 of 1968 Act). However, under the CAMA 2004, the dichotomy between the private and public company has been removed and whether the company to be incorporated is private or public the minimum number is two members.

The pertinent question should be why "two members" what is the magic served by the number? And what good purpose is to be served with the number? And what is the practical importance of this number to companies? while arriving at this number, and after considering the position in other jurisdictions, the Nigerian law commission stated that it is not possible to fix the minimum number of persons to form a company to one member, because, the word company connotes of least two persons and that one person cannot be called a company. The position taken by the law Reform Commission seems illogical and at variance with modern practice all over the world and the practice of businessmen in Nigeria.

In the first instance we must recognize the fact that most businesses always start with one individual who wish to trade and expand his sole trading into a limited liability company he does not need any other person to form his company to effectively carry out his trade. In essence, the addition of another party in most cases is only to fulfill the requirements of the law, and the additional member most times do not even know anything about the business and does not even participate in it. In many cases in Nigeria, people add the names of their spouse and children (underage or not) and the second member had always been dormant and totally ineffectual and therefore an anomaly.

Prior to 1992 at least two persons had to subscribe to become shareholders in a private company in U.K. As a result of the Twelfth EC Company Law Directive (89/667) implemented in 1992, private companies could be formed with a single member but public companies still needed at least two members. The Companies Act 2006, the current Companies Act in U.K, section 7 thereof now provides for a single person private and public companies. Most of the civilized nations have adopted the one man company e.g. Canada, Europe, while countries like South Africa, Ghana and Kenya to mention a few have adopted the one man company structure. There is therefore an urgent need for reform to bring the law in conformity with modern trends.

3. CAPACITY OF INDIVIDUAL TO FORM A COMPANY

Certain categories of persons are prohibited from forming or joining in the formation of company. In effect not all persons are permitted under the law to form a company. The following are expressly prohibited from forming a company:

(a) A person that is less than eighteen years of age. However by virtue of Section 20(2), where two other persons who are not disqualified are subscribers to the memorandum then the person under eighteen years will not be so disqualified.

(b) A person that is of unsound mind and has been so found by a court in Nigeria or elsewhere or

(c) Anundischarged bankrupt

(d) He is disqualified under section 254 of the Act from being a director of a company

(e) A body corporate in liquidation shall not join in the formation of a company under the Act (section 20)

We may need to examine the above more closely

(a) An infant may not by himself form a company. This may seem discriminatory. If an infant could effectively understand what he is about to do there should be no reason why he or she should not be allowed to do so. However, in contract, though an infant is allowed to enter into contracts, but some and except for contracts for necessaries, the contract will not be enforceable against the infant. Under common law, the contract will remain voidable at the option of the infant. But under the Infants Reliefs Act 1874, all contracts except for necessaries are entirely void (section 1). The pertinent question is that, could we call or regard the formation of a company as contractual as to fall within the realm of contract? Registration of company is an entirely voluntary action taken by responsible citizens in furtherance of business venture to make profits, and the subscriber to the memorandum does not thereby enter into any contract with anybody except the other shareholders by virtue of the article of association which legally is a binding contract between them. The law in fact goes further to permit the infant to subscribe to the memorandum where two other adults are also subscribers. This exception only confuses the issues more. The other two adults are also subscribers in their own right and do not hold in trust for the infant. They are presumed to represent themselves and not the infant and so the infant holds his shares and exercise control over them. Having subscribed to the articles of association he has entered into a contact and may be subject to the law on the rights and privileges of members of a company and this is entirely outside the realms of general law of contract.

The reasonable option is to remove this prohibition and regard the infant subscriber as a reasonable responsible person capable of determining the propriety and reasonableness of his action.

5. The second prohibition as we have seen above is that a person of unsound mind is prohibited from forming or joins in forming a company. The person must have been so found by a court in Nigeria. In effect, if the person has not been so found or declared by a court in Nigeria then he could join in forming a company. The definition of unsound mind is not supplied by the Act, what level of unsoundness will qualify a person for disqualification under the section is not specified. The court referred to in the Act is also not specified. By virtue of section 650, the court is referred to as the Federal High Court, Court of Appeal or Supreme Court, could we then argue that where any other court apart from these three pronounce a person of unsound mind, such pronouncement may be disregarded in so far as it does not fall within the definition of court in the Act. Thereare no such proceedings in Nigeria, in which a court will pronounce on the state of mind of a person, so it may not arise. In criminal cases, where an accused person has put up a defense of insanity, and this has been certified by medical practitioners who had examined the accused person, the court may accept such plea and decide the matter, in such a case, such a declaration could be made but it is only limited to the defense for the crime alleged and at the time of the commission of the crime and no more, and does not stand for all time. And where such person has undergone treatment and is now medically fit, he could be allowed to form a company. The point being made here is that again this prohibition is of no use and should be removed entirely, as it is totally unworkable and ineffective.

(C) UNDISCHARGED BANKRUPT

A bankrupt is a person who cannot pay his debts of a specified amount and who has been so declared by a court of competent jurisdiction (see Bankruptcy Act Cap B2 LFN 2004) while being a bankrupt he is not qualified to stand for any elective office or act as a director of a company (section 253, CAMA 2004) see also section 126 Bankruptcy Act 2004). An undischarged bankrupt is not really expected to engage in any form of business until he has been discharged fully and properly. The Act do not specify if the undischarged bankrupt may engage in or join in the formation of unlimited liability company or company limited by guarantee which is no profit making organization and is not in fact a business strictly speaking.

Another problem is that the Bankruptcy Act is not being fully utilized by legal practitioners and businessmen probably due to the very technical nature of the law so that proceedings under the law is far and in between and therefore the provision in the section 20(1) (c) may also remain only a deed letter law, having no practical effect whatsoever.

(D) DISQUALIFICATION UNDER SECTION 254

Section 254 provides that where a person is convicted by a High Court of any offence in connection with the promotion, formation or management of a company, or in the course of winding-up a company it appears that a person has been guilty of any offence for which he is liable (whether he has been convicted or not under section 513 of the Act, or has otherwise been guilty, while an officer of the company, or any friend in relation to the company or of any breach of his duty to the company, the court shall make an order that person shall not be a director of or in any way, whether directly or indirectly, be concerned or take part in the management of a company for a specified period not exceeding ten years.

The important point to note here is that this prohibition will only last within the years as ordered by the court but it shall not exceed ten years. Secondly, the court may only make an order prohibiting the person from being appointed a director or be involved in the management of a company and does not extend to being a subscriber to a memorandum. The law does not prohibit such person from being a shareholder of a company, and the order does not extend to prohibition from forming a company. We should also note that even where such order has been made by the High Court, there is no facility for the Corporate Affairs Commission (CAC) to detect as to the person under this disability and thus prevent him or her form being registered as a subscriber to a company.

The prohibition also will only exist on paper and the practical value is doubtful.

CONCLUSION

Any two or more person may form a company by complying with the provision of the Act. The argument is why two and not one as it is now the practice all over the world. The capacity to incorporate a company is also important in Nigeria, as a person under 18years of age is not permitted to form a company unless two other adult joint him. The purpose of this provisions is not also clear and is not targeted at serving any useful purpose. Other categories of persons disqualified are persons of unsound mind,undischarge bankrupt and person found guilty of management or fraud in the formation and management of a company under section 254 of the Act.

SUMMARY

In Nigeria only two or more persons may form a company, while one man company is not yet recognized in the country. A person under 18 years of age is prohibited from forming a company unless he or she is also joined with two other adults. A person of unsound mind and who has been so declared by a court in Nigeria is also prohibited from forming a company. An undischarged bankrupt and a person already convicted or found liable for fraud or mismanagement in the promotion or management of a company is also prohibited from forming a company. We must also note that a company is liquidation is also prohibited from forming a company.

6. TUTOR MARKED ASSIGNMENT

(i) Critically examine the capacity of individual to form company in Nigeria

(ii) Make a case for a one man company in Nigeria

7. REFERENCE/FURTHER READING

MODULE 2 – UNIT 4

COMPANY INCORPORATION II

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

Having decided to incorporate a company the promoters must come to certain decisions as to the modalities of the type and size of the company. This is important in order to determine the type of document and other preliminary issues to be settled. The promoter must consult a lawyer who in turn must ask questions on the following:

(1) What type of company and size, whether it is a limited liability company or unlimited liability company. This in turn will depend on the purpose for which the company is to be formed. If the company is to be formed to hold land or properties, unlimited liability company may be appropriate, but if it is a trading company the limited liability company will be advisable due to the limited liability nature and the members liability will be limited to the unpaid value of the shares, and where they have fully paid for the shares allotted to them they are free of any inability. Within this choice, they must also decide on whether the company is limited by shares or guarantee. If the company is to be formed for a charitable purpose, then company limited by guarantee will be the most appropriate form to register. Where it is limited liability, the issue of size will come in, whether it should be a private company or public company. The latter is capable of raising capital from the public and the membership is knotless. In most cases, the promoters may plan to go public later, but may wish to start as a private company with the advantage of less publicity or limited membership and little share capital.

2. OBJECTIVES

At the end of this unit the student will be able to understand the preliminary requirements for incorporation, the essence of name of the company, the share capital, memorandum and Articles of Association and other documents that must be submitted to the C.A.C. before incorporation can take place.

3. **MAIN** CONTENT

Company Names

The company name is very important, as this is the only way to identify the company being or artificial person on its own and we shall learn later having its own being, and capable of exercising tall the powers of a normal human being, the name is important to the registration of the company.

Limited Liability Warning: The law stipulates that each company must end its name with the limited liability warning essentially to warn the general public as to the nature of the company they are dealing with. Where the company is a private company, limited by shares the word "limited (Ltd) shall end the name (section 29(1). Where the company is public company limited by shares it shall end with "public limited company" (Plc) (section 29(2) where the company is Limited by Guarantee, it shall end with the words "Limited by Guarantee" in brackets or Ltd/Gte. The name of unlimited company shall end with "unlimited or (Ultd) (section 29(4). In Nigeria there is no exception to this law, while in England some charitable organizations are exempted from the above, but it has to be a charitable organization having only its objects as promotion of arts, culture, education, commerce science, religion or any profession, the articles must forbid payment of dividends to member or any return of capital to members and require its assets on winding-up to be transferred to a body with like objects or to a charity. (Section 60 Companies Act 2006 U.K)

Prohibition of name already allocated: The name must not be identical with a name already registered in the Nigeria; or so resembles that name as to be calculated to deceive, except where the company in existence is in the course of being dissolved and signifies its consent in such manner as the commission requires. (section 30(1).

In the first instance, the promoters must first conduct a search of the company's index of names to determine whether the proposed name is still available for use by them. The procedure is to fill the necessary forms and pay the prescribed fees, and the database of the Registry will be searched, where the name is available it will be indicated, and the promoters may then proceed to the next stage. The C.A.C. should exercise all reasonable precaution to prevent double registration of names or names that are so identical or similar to each other as to be calculated to deceive the general public. In the case of *Nwosu v Lionfixed Odds Ltd* **(1967-69) 1** Digest of Western State Court of Appeal 84, the court held that for an action to succeed on this issue, the plaintiff must prove that the disputed name has become distinctive of his trade to the degree that the use of the name in relation to his goods or trade is regarded by a substantial section of the society as coming from a particular known or unknown source.

The plaintiff must also prove that the use of the name is calculated to deceive or to cause confusion and injury to the goodwill of the plaintiff's business. In the case of *Niger Chemists Ltd v Nigeria Chemists* **(1961) All N.L.R 171,** where the plaintiff company had carried on business as chemists for some years under the name of 'Niger Chemists'. It was later incorporated as a limited liability company. The business was well known in the East as 'Niger Chemists. The defendants formed a firm, carrying on exactly the same business under the name of 'Nigeria Chemists'. The plaintiff brought proceedings for an injunction to restrain the Defendants from using the name of 'Nigeria Chemists'. The Court per Palmer J granted the relief sought.

We may note further that the likelihood of identical or similar registration is now minimized due to the use of computer database having all the registered names in Nigeria including the Business Names.

A company cannot be registered if the words "Chamber of Commerce" is part of its name, unless the company is one limited by guarantee (section 30(1)(6). The commission is also given the discretion in the registration of company, where it is of the opinion that the name is capable of misleading as to the nature or extent of its activities or is undesirable, offensive or otherwise contrary to public policy or in the opinion of the commission would violate any existing trade mark or business name registered in Nigeria unless the consent of the owner of the trade mark or business name has been obtained. (Section 30(1) (c) (d). The section seems to have given the C.A.C. a wide discretion to refuse registering a name. The standard seems to be subjective, but quite clearly where the applicant feels that the refusal is unreasonable or unjustifiable he is entitled to challenge the refusal in court, of course the section can easily be abused and used as a ploy to extort money from applicants. In the case of *Lasisi v Registrar of Companies* **(1976) 7 S.C. 7b** where the Registrar refused to register a company on the ground that the objects of the proposed company were ultra vires the business activities allowed the company on the Business Permit, the court held that the C.A.C. have discretion to refuse incorporation of a company. If it determines under the provisions of section 36(1) that a proposed company should not be incorporated. Where however, a court finds that the objects of a company are lawful and there is compliance with the requirements of the Act and any other law pertaining to the incorporation of a company, the commission may be ordered to incorporate the company.

Names requiring approval: Names which may suggest government patronage or interest are prohibited from being registered without the consent of the commission. Such words like "Federal", "National", "Regional", "State", "Government" cannot be used without approval.

Also companies using words like “municipal”, or “chartered” as part its name is prohibited as this will suggest or is calculated to suggest connection with a local government council. The words “cooperative” a Building Society ,or “Group” or “holding” are also prohibited. The modality for giving consent is not disclosed. However, in England, upon application for consent to use a prohibited words, the secretary of state is empowered to require the person asking for permission to seek comments from the government department or other body which is thought to have an interest in the matter, and in particular as the body whether it objects and if so, why (see Names Regulations reg. 5 and section 65(1) Companies Act 2006 U.K.)

Where a name is registered that is similar to an already registered name by mistake or inadvertence, the commission has the power to request that the latter company change its name within weeks of the discovery.

Reservation of Name: The promoter intending to register a company name may apply that the name be preserved for it pending the registration or a change of name. This is important provision, because due to some unexplained reasons, company registration takes time to process and may last up to and beyond two months sometimes. If while during the registration process another company is registered with that name, the company name may be refused. In practice, as soon as the name is declared available for registration the name is preserved for the company for a period of sixty days within which the registration ought to have been done. If in the almost likely event that the registration could not be done within the sixty days, there is no provision for extension of time. The practical step should be to apply for another availability to ensure extension for a further sixty days.

Registration Documents: The next step is to prepare the registration documents, of which the most important are (1) the articles of association (2) memorandum of association (3) the notice of address of the registered office of the company (4) list of the first directors and consent to act as directors (5) statement of the authorized share capital (6) statutory declaration in the prescribed form by a legal practitioner that all the requirements for registration has been complied with. (section 35).

(1) Articles of Association: The articles of association contain the regulation, rules and procedure for the smooth running of the company. The articles of association must be signed by the subscribers to the memorandum of association. The articles in form and contents may be in accordance with the Table in the first schedule to the Act. The company is entitled to adopt the Table or modify it to suit their purpose. The article shall be printed, and divided into paragraphs and numbered consecutively, and signed by each subscriber in the presence of a witness who shall attest to the signatures. The articles must bear the stamp duty before it can be registered. See section 33 and 34.

(2) Memorandum of Association: The memorandum of association of the company must state the following:-

a. the name of the company

b. the registered office of the company shall be situated in Nigeria

c. the nature of the business or businesses which the company is authorized to carry on, and if it is not formed for the purpose of business, then, the objects for which it was formed.

The company may adopt the style in tables B,C,D in the first schedule to the Act. The company is of course allowed to modify the model article in the table to suit their particular purpose except that the statutory requirements must be complied with.

d. the memorandum may contain any restriction on the powers of the company if there is any.

e. the memorandum must state if the company is private or public company

f. it must also state if the liability of the members is limited by shares or by guarantee or is unlimited as the case may be (see section 27(1)

g. where the company is a private company the memorandum must state the share capital which must not be less than N10,00.00 while for a public company the minimum share capital allowed must not be less than N500,000.00 and must state the division thereof into shares of a fixed amount.

h. the company must allot not less than 25 percent of the share capital to its subscribers and who must write opposite his name the number of shares he takes.

The allotment will be stated on the last page of the memorandum duly signed with date and attested to by witness.

Where the company is limited by guarantee, the memorandum shall state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member. The total amount guaranteed must not be less than N10,000.00

Finally the memorandum must be stamped as a deed, and all necessary stamp duties must be paid (see section 27(2) (3).

The documents, prescribed forms and the lawyer's attestation in form COI will be filed alongside the memorandum and Articles of Association. The forms must be duly signed by a Director and Secretary of the company and upon payment of the filing fees which is calculated based on the share capital, will now be lodged at the C.A.C. in Abuja or submitted through any of the state branches of the C.A.C, where the C.A.C is satisfied with the documentation, that it has complied with the law, the commission will issue a certificate in the name of the company. The certificate of incorporation shall be prima facie evidence that all the requirements of the Act is respect of registration and of matters precedent and incidental to it have been complied with and that the association is a company authorized to be registered and duly registered under the Act.

CONCLUSION

Upon compliance with the law, on preliminary requirement for incorporation the Registrar will issue the certificate of incorporation, the effect of which is that "the subscribers to the memorandum, together with such other persons as may from time to time become members of the company becomes a body corporate by the name stated in the certificate of incorporation: (section 37). We must note that the Registrar is not a rubber stamp as he may refuse registration of a company, if the objects are illegal or contrary to public purpose, or that the subscribers are incompetent and disqualified. See *R v Registrar of Companies, Exp.HM's Attorney General* **(1991) B.CL.C 476** where a prostitute seeks to register a company with the object of carrying on the business of prostitution", the registrar in fact registered the company but on the application of the Attorney General for a judicial review, the court nullified the decision of the registrar to register the company on the ground of public policy.

SUMMARY

An individual who wish to incorporate a company in Nigeria must decide on the type of company and size of the company. It must also decide on the subscribers as only one person cannot incorporate a company in Nigeria. He must carefully choose a name that is not in conflict with any other name or likely to or so similar to another already registered company as to deceive the general public. He must not also add any word that portrays government patronage without the consent of the registrar. He must prepare the memorandum and Articles of Association and fill all the necessary forms, thereafter submit the memorandum and articles with the statement of share capital for stamp duties, and the necessary stamp duties paid. All the forms are now filed with the C.A.C and upon payment of the filing fees, the commission if satisfied with the documentation that it complies with the law, will register the company and issue a certificate signed by the Registrar. The certificate is the prima facie evidence that the company has complied with the preliminary requirements for incorporation and from the date on the certificate the company becomes a body corporate.

6. TUTOR MARKED ASSIGNMENT

Critically examine the preliminary requirements for company incorporation in Nigeria.

7. REFERENCES/FURTHER READING

MODULE 3 – UNIT 1

CORPORATE PERSONALITY

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

We shall explore the concept of corporate personality and the related issue of limited liability. These concepts are of great importance in company law. A good understanding of these concepts is essential to understanding what company law is all about. We may have to explain that due to the artificial or metaphysical nature of corporate personality it may cause some problems in understanding, but this is quite a simple issue that you must come to terms with in company law. Human beings are normally regarded as legal persons; they are subject to the legal systems within which they find themselves. The legal system not only imposes obligations but also confers rights.Human beings are capable of so many activities. Like getting married, having children, becoming sick, dying, sleeping, being happy, committing crime, going to jail etc. while, when we look at the company, we may begin to wonder how a company can get married, and whether the company is male or female etc. This in fact had always been the point of misunderstanding by students about the concept of corporate personality. We must in order to have a better understanding of the concept keep human beings legal nature and the artificial concept of companies separately. In essence humanity is a state of nature and legal personality is an artificial construct which may or may not be conferred.

2. OBJECTIVES

At the end of this unit the student should be able to understand the doctrine of corporate personality and limited liability.

3. MAIN CONTENT

Nature of corporate personality:

A company is a separate entity separate and district from the shareholders who compose it. Akanki was of the view that the distinction between the company as a body corporate and its shareholders described are "corporate personality": is "the most pervading of the fundamental principles of company law" (Akanki, O, 1980, The Relevance of the Corporate Personality Principle" (1977-80) N.L.J. 9 at p. 10

Section 37 states, "As from the date of incorporation mentioned in the certificate of incorporation, the subscriber of the memorandum together with such other persons as may, from time to time become members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the powers and functions of an incorporated company including the power to hold hand, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as mentioned in this Act."

Legal personality is a creature of statute, the law may grant legal personality to any group or persons, being a creation of law, it is artificial, and it may therefore be conferred on groups of people in order to achieve a particular purpose. Historically, the corporate personality had always been used and conferred on religious groups in England. The head of the group is the custodian of all the properties of the group, after his death, property of the group must pass to the successor, the best way to surmount any succession issue is to regard the group as a corporate person and its properties belong to it, and therefore, the current headship does not have any personal right to the property of the group. This was the beginning of the corporation The religious group was regarded as the 'person' and is therefore conferred with the power to hold land and property and also defend same in its own name and does not in any way affect the personal properties of the members.

The doctrine that company is a legal entity, existing separate and distinct from its shareholders is a legal theory established upon an expedient theory. The fiction has been introduced for the convenience of the company in making contracts, in holding property, in suing and being sued, in management of its affairs and to preserve the limited liability of its shareholders. It is chiefly for the purpose of clothing association of natural person with characteristic of a distinct entity at law that corporations were invented and are in use (see Kiser D. Barnes, 1992, Cases And Materials On Nigerian Company Law, O.A.U Press Ltd, Ile-Ife, Nigeria, p. 62.

Traditionally, a corporation being a person in law is separate and distinct from its members. But it was not clear whether this also applies toincorporated Joint Stock Companies until the House of Lords decision in the case of *Salomon v Salomon and Co.* **(1897) A.C. 22.**

We will try and explain the facts of the case and the decision and it is important that we understand exactly what happened that led to the important decision in company law and understanding of this decision will enable us have a quick grasp of the fundamental basis of company law.

Mr. Solomon carried on business as a leather merchant. In 1892 he formed the company. Salomon and Co. Ltd, Mr. Salomon, his wife and five children holding one share each in the company. The members of the family did not intend taking an active role in the business but rather only held the shares because the Companies Act requires at that time that there be seven shareholders. Mr. Salmon was also the managing director. He thereafter transferred his original business to the company. He did this by valuing the original leather business at £39,000. The company paid for this by £10,000 worth of debentures giving charge over all the company assets, £20,000 in £9 shares and £9,000 in cash. Mr. Salomon paid off all the creditors of the business in full. Mr. Salomon now owns 20,001 shares and his family owns the six shares. He was also the owner of the secured debenture. A debenture is simply a document creating or evidencing debt of a company. The name of the business has charged with the addition of the word "Ltd" also the legal status has also changed. Almost immediately after the incorporation, the company had some difficulties, its customers did not buy its products and therefore the company ran into debts, owing its creditors Mr. Salomon had to sell his debenture to raise money for the company. After another year, the problem persisted, and the debenture holder now forced the company to go into liquidation in order to realize his money. There was however enough assets to pay off the debenture holder and so the debenture holder Mr. Broderip, sought to challenge the validity of the transaction to convert the legal status of the business into a company and sought to make Mr. Salomon personally liable for the debts of the company.

Mr. Broderip alleged that the company was a sham and is mere 'alias' or agent for Mr. Salomon. The Court of Appeal in England upheld his claim and held Mr. Salomon personally liable. Mr. Salomon appealed to the House of Lords and the Liquidator took over the matter on behalf of all the creditors against Mr. Salomon. The House of Lords held,

(1) that the company was validly formed according to the Joint Stock Companies Act 1844, which only required that there be seven members, holding one share each.
(2) There was nothing in the act about good faith of the members.
(3) The motives of the shareholders were irrelevant unless there is fraud, Salomon was an agent of the company, not the company his agent.

Land Machaughten, stated this in explaining the position,

"the company is at law a different person altogether from the subscribers and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers and the same hands receive the profits, the company is not in law

the agent of the subscribers or trustee for them. Nor are the subscribers, as members liable, in any shape or form, except to the extent and in the manner provided by the Act.

Lord Hailsbury in his own judgment emphasized the distinction between the company and the subscribers, when he said

> *"either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon. If it was not, there was no person and nothing to be an agent at all, and it is impossible to say at the same time that there is a company and there is not."*

From the decision, the separate legal entity of the company is quite clearly acknowledged. The most important fact is whether the company has complied with the Act in the incorporation, if this has been done and it is properly registered with certificate of registration as evidence, then, clearly, it is not the same as the subscribers but has itsown separate legal entity. This decision has far reacting implication in company law. It is quite realistic and reasonable interpretation of the Act. Some have criticized it as being fraught with danger, and seems that the creditosr of the company are left unprotected (se Professor Kahn Freud in 1944 7 MLR).

This decision has been followed in series of decisions. In the case of **British Thompson- Houston Ltd v Sterling Accessories Ltd (1924) 2 Ch. 23 at 38 Tomlin J** said

> *"it has been made plain by the House of Lands that for the purpose of establishing contractual liability, it is not possible, even in the so-called one man company to go behind the legal corporate entity of the company and treat the creator and controller of the company as real contractor, merely because he is the creator and controller. If he*

is to be fixed with liability as principal, the agency of the company must be established substantially and cannot be inferred from the holding of directors office and the control of shares alone (see Salomon v Salomon) any other conclusion would have nullified the purpose for which the creator of limited company was authorized by the legislature."

From the decision in *Salomon v Salomon*, the following may be deduced (1) the principle that members do not have proprietary right in the assets of the company. The are not part owners of the company assets. *See Macaura v Northern Assurance Company Ltd* **(1925) A.C. 619.**

The owner of a timber estate sold the whole timber thereon to a timber company in consideration of fully paid up shares in the company. Subsequently by policies effected in his own name with several insurance companies, he insured his timber against fire. The greater part of the timber was destroyed by fire; he sued the Insurance Company to recover the loss. The claimant was the sole shareholder of the company and was also creditor of the company to a large extent. It was held; (1) that the claimant had not either as a shareholder or creditor any insurable interest in the goods. (2) "Now no holder has any right to any item of property owned by the company for he has no legal or equitable interest therein. He is entitled to a share in the profits while the company continues to carry on business and a share in the distribution of the surplus assets when the company is wound up."

Lord Wrenbury stated the position beyond doubt, that a member, "even if he holds all the shares is not the corporation and … neither he nor any creditor of the company has any property legal or equitable in the assets of the corporation."

It follows that, just as corporate personality facilitates limited liability by having the debts belong to the corporation and not the members it also means that the company's assets belong to it and not the shareholders se also *Mrs. Shonibare& Others v Probate Registrar (1966) All N.L.R.*

A company may make a valid and effective contract with one of its members. It is possible for a person to be at the same time wholly in control of a company (as its principal shareholder and sole director) and a servant employed by that company. In the case ***of Lee v****Lee Air Farming co. Ltd* **(1950) 3 All C.R. 420.**

Lee held 2,999 of the company's 3000 shares and was the governing director and Chief Pilot on a salary. Whilst working for the company he was killed in an air crash, and his widow claimed compensation from the company on the ground that he had been an employee under a contract of service with the company. It was held by the Privy Council that the company and Lee were separate persons in law. That a man may be acting in one capacity give orders to house of in another capacity and that a man acting in one capacity can make contract with himself in another capacity.

(3) The company is regarded in law as a person separate and distinct from its members. It makes no difference to the rule that one member owns all or substantially all of the shares. See *Gramaphone and Typewriter co. Ltd v Stanley* **91908) 2 KB 89.**See also *Dunlop Nigerian Industries Ltd v Forward Nigeria Enterprises Ltd and Fafore* **(1976) 1 ALR. Comm. 243.**

The Plaintiff employed the first defendant company as custom clearing agent. The second defendant was the managing director of the defendant company and owned 90% of its shares. The plaintiff paid money to the second defendant for the payment oft custom duties on its behalf, this was not paid. The plaintiff thereafter claimed the money from the company and the Managing Director jointly and severally. It was held that the managing director was not liable, because, the fact that he holds 90% of the shares does not make him the same with the company because at law, the company is a different person altogether from the shareholders.

(4) The debts of the company are not the debts of the members**. *Banque De L'Afrique***Occidentale v Habu, Illiasu and Savage in re Northern Nigerian Marketing Board* **(Ganishees) (1964) N.N.L.R. 30.**

4. CONCLUSION

The principle of corporate personality is a very important principle in company law. It is at the bedrock of all other doctrines and in the basis of limited liability of companies. The principle simply is that the company is a separate legal entity from the members capable of holding property in its name, can sue and can be shed, and having a common seal. The principle was laid down and explained in the case of *Salomon v Salomon & Co. Ltd***. (op. cit)** and series of other cases have been decided based on this principle of company law.

5. SUMMARY

The principle of company law as enunciated in the case of Salomon v Salomon is simply that the company is a separate and distinct person from its members. It can sue and be shed in its name. its debts are not the debts of the members, the directors or employees are not the same with the company, and so even if the managing director has substantial shares in the company it does not mean he ceases to be an employee of the of. the company has all the powers of a natural person.

6. TUTOR MARKED ASSIGNMENT

Salomon's case has been described as a "calamitous decision' (e.g. kahn-freud (1944) 7 MLR 54) would you agree?

7. REFERENCES/FURTHER READING

MODULE 3 – UNIT 2

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

As we have seen the House of Lords decision in the case of Salomon v Salomon & Co. Ltd has far reaching effect in company law. The case firmly established the doctrine of corporate personality. The consequence of incorporation therefore is firstly to create another legally recognized entity capable ofexercising all the powers of a natural person. In this unit we shall probe further to understand the consequence of incorporation and corporate personality enjoyed by the company.

2. OBJECTIVES

In this unit the student will be able to understand the consequences of incorporation of companies.

3. MAIN TEACHING

Upon satisfying the preliminary requirements the registrar is obliged to register the company and issue a certificate evidencing the registration and by virtue of section 37 of the Act, the effect of this is that, "*As from the date of incorporation mentioned in the certificate of incorporation, the subscriber of the memorandum together with such other persons as may, from the to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the powers and functions of an incorporated company including the power to hold land, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned inthe Act.* Wewill therefore discuss the consequences of incorporation or the advantages and disadvantages of incorporation hereunder.

1. Limited Liability

It follows from the fact that a corporation is a corporate person that its members are not as such liable for its debts (Kerr L.J in *Raynor (Mincing lane) Ltd v Department ofTrade* **(1889) Ch. 72 at 176**. it follows that the members are completely free from any personal liability. Companies registered under the Company Act may be registered as an unlimited liability company, in which case the members will be personally liable for the debts of the company without any restrictions on the amount involved. The company may be registered as one limited by guarantee, or by shares. Where it is limited by guarantee the member guarantee that he will contribute a specified amount to the assets of the company in the event of its being wound up while he is a member or within one year after he ceases to be a member. While a company that is limited by shares, each member is liable to contribute when called upon to do so tothe full nominal value of the shares held by him in so far as this has not already been paid by him or prior holder of the shares. The company therefore is responsible for payment or meeting its own obligations and not the individual shareholders. The creditors do not pursue the members, as the liability for the debts and other obligations of the company is strictly that of the company to bear. This has been a great advantage and consequence of incorporation where the company is an unlimited company, the members will be liable personally, and where it is a company limited by guarantee, they contribute only to the extent of their guarantee and this is at winding up. Compared to partnership, the partners are personally liable for the debts and other obligations of the partnership. In order to enjoy limited liability, the Limited Partnership Act 1907 (UK) was enacted for partnership to enjoy limited liability without necessarily registering as a limited liability company. You may see also the Limited Partnership Law of old Western Region now adopted by the states of the old

Western Region, for example see the Lagos State, Limited Partnership Law (Laws of Lagos State).

2. Suing and Being Sued

A very important advantage of an incorporated company is the ability to sue in its own name or being shed. The company being a legal person can take action to enforce its legal rights and can be sued for breach of its legal duties. This continues to be a problem for incorporated companies and other social groups. The problem of suing a large number of persons especially where the membership is not static. This problem has been solved in case of partnerships as they can now sue in the firm's name, except that the court may order the names of the partners to be disclosed. In case of registered associations the only way out is to sue the trustees, or the trustees may sue on behalf of the association. In case of incorporated societies the only solution is to sue them in a representative capacity, that is, if it is possible to identify their officers or leaders. For instance in case of a family under customary law, the law is that the head of family and other principal members of the family are sued or may sue on behalf of the entire family. This problem however as we have noticed above does not exist in case of incorporated companies.

3. Property

On incorporation, the property of the company belongs to the company and not the members, as they do not have any proprietary interest or rights but merely in their "shares". A change in the membership which normally will cause problems for a partnership will leave the company intact, the membership may change, the shares may be transferred, the property of the company will remain intact. The bankruptcy of the members will not affect the property of the company. While the personal liability of the members to third parties will not also affect the property of the company. The company may lease, mortgage, sell or otherwise dispose its property without affecting the members' interest in the company. The creditors also look up to the property of the company in case of default.

4. Perpetual Succession

One of the obvious advantages of an artificial person is that it is not susceptible to "the thousand natural shocks that flesh is heir to". It cannot become incapacitated by illness, mental or physical, and it has no allotted span of life, in the words of Grear L.J in **Stepney Corporation v Osofsky (1937) 3 All E.R. 289 at 291,** a corporate body has "no soul to be saved or body to be kicked". The death of a member leaves the company unharmed. Members may come and go but the company remains forever. The death of a Managing Director does not mean the death of the company, the company will simply appoint another Managing Director. This is not the case for partnerships, as the death of a member means the end of the partnership. The sickness of a partner may affect the business adversely, in fact there is no other business association that has perpetual succession.

5. Transferable Shares

Incorporation separates the member's interests from that of the company. The only identifiable interest of a member in a company is the value and volume of the shares such member holds in the company. These shares are freely transferable without affecting the company's existence. The company can be incorporated with its liability limited by shares, and these shares, constitutes items of property which are freely transferable in the absence of express provision to the contrary, and in such a way that the transferor drops out. The position of the partner in a partnership is different. The partner may assign his interest in a partnership only with the consent of the other partners, even that the partner continues to be liable for existing liabilities as a partner unless the creditors agree expressly or impliedly to release him. We must realize that a private company even by the definition is a company that restricts transfer of its shares, in spite of this restriction ,the shares may still be transferred subject to the articles of associations, while the public company do not have any restriction whatsoever. Whilst, in a partnership, transfer of interest is not only restricted but where it is allowed, is subject to the consent of the partners, contrary to the position obtainable in incorporated companies.

6. Borrowing

The ability to raise large amount of money by borrowing money from commercial institutions is a great advantage. One would have expected that the sole trader would find it easier to raise money by borrowing due to its unlimited liability status, but this is not so, the company through the devise of a floating charge may raise money by executing a debenture and charging all its assets, and the charge operates over all the assets of the company. The company is allowed to continue using its assets and the money is not due until the charge crystallize and it becomes fastened to the property of the company. Individuals are not capable of doing this, and may need to convert the business to a limited liability company mainly for the purpose of raising enough capital for the business.

7. Taxation, Formalities

Incorporation is necessarily attended with formalities, loss of privacy and expense greater than that which would normally apply to a sole trader or partnership. A sole trader is a persos who already exists. A partnership cannot exist without some form of agreement but this can be written, or oral agreement. An unincorporated firm may conduct its affairs without any formality and publicity. An incorporated company however, must involve much expense in terms of complying with the formalities of incorporation, the regulation of the company under the law involves much publicity, and all its officers are open for public scrutiny, anyone dealing with the company is entitled to check its file in the company registry to determine the type and nature of the entity he is dealing with. Where it refuses or neglects to comply with the law it may be sanctioned. The position of the firm or sole trader is not so. It is not required to file any returns; it only needs to comply with the Part B of the Act, for those that need to use a name apart from their real names.

In terms of taxation we need to mention that the company is subject to a different regime of taxation under the Company Income Tax Act Cap LFN 2004, while the sole trader is taxed as such. The company pays its tax as an entity based on its profits and other parameters.

4. CONCLUSION

The company in deed upon incorporation will enjoy numerous advantages of incorporation, this is so because it is now an entity on its own different and distinct from the members, and is capable of exercising all the powers of a natural person. A next important reality is the separate nature of the company as an entity, though artificial. The company is not subject to any disability unlike a human being, it becomes on adult immediately on registration and is not subject to disabilities as an infant is, the company cannot become insane, or travel or go on holidays, but it nevertheless acts through human agents and officers, but the death of the officers do not affect the life of the company.

5. SUMMARY

In this unit, we examined the consequences of incorporation. We have seen that the company upon incorporation is given powers of natural person, all the powers and advantages stems from the recognition of the company as a separate legal entity from the members. It has limited liability in the sense that the liability of the members is limited to the shares they own in the company, and if they have paid for the shares, they are not liable for the debts of the company and the company is not liable for the personal debts of the members. It has the power tohold its own property in its own name, it can sue and be sued, and it has the power to borrow much more money from the commercial institutions and the general public. The company shares are freely transferable without affecting the company and the company enjoys perpetual succession, and may only be brought to an end by deliberate act of the members.

6. TUTOR MARKED ASSIGNMENT

Discuss the advantages and disadvantages of incorporation of company.

7. REFERENCE/FURTHER READING

MODULE 3 – UNIT 3

LIFTING THE VEIL OF INCORPORATION

LIFTING THE VEIL BY COURTS

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCES/FURTHER READING

1. INTRODUCTION

The doctrine of Corporate Personality is fundamental and by and large it is adhered to strictly and rigidly when there is no compelling reason to the contrary. There are cases when the courts and the legislature have allowed the veil to be lifted in order to determine the natural persons behind the corporate veil. This is important because just as the concept of corporate personality may and is being used to achieve lofty and great purpose; it may also be used to defeat some important value in law. It has been used for various nefarious and unwholesome reasons which are basically to evade the law or to use the concept to defraud and to avoid legal obligation. If it is impossible to lift the veil and see the very personsbehind the corporate veil, then it becomes impossible to check these negative practices. The court have over the years, though reluctantly, but nevertheless devised some reasons for lifting the veil, or evading the concept of corporate personality and to ensure that it is not used as an instrument for evading the law. In this unit we shall examine the circumstances when the courts will lift the veil of incorporation, while in the next unit, we will look at occasions where the legislature has allowed that the corporate veil be lifted.

2. OBJECTIVES

At the end of this unit the student must be able to explain circumstances when the courts will lift the veil of incorporation of a company.

3. MAIN CONTENT

There is no general theory indicating when the court will ignore the rule in *Salomon* **v** *Salomon* and lift the veil of incorporation and ascribe liability to the directors or promoters of the company, however some broad classifications may have arisen over the years, we may note that there is no hard and fast rule as the current position is that the cases may have developed on their individual merits. We may look at this from the following perspectives.

AGENCY – the court will apply the agency rule when the corporate personality, principle is being used in order to avoid legal obligation. In the case of*Smith, Stone and Knight Ltd* **v** *Birmingham Corporation* **(1939) 4 All E.R. 116.** The company sought to acquire certain premises compulsorily. The premises were occupied by a subsidiary of the plaintiff company. The subsidiary was wholly controlled by the plaintiff. It employs no separate staff, kept no separate books and was treated as though it were a department of the plaintiff. Under the legislation giving the corporation power to make compulsory purchase order, an occupier could not claim for compensation unless it enjoyed tenancy for a period longer than one year. The subsidiary tenancy was a yearly one. The plaintiff, the parent company argued that it was really the person in occupation. It was held that while the subsidiary was a separate legal entity, it might be acting as the agent of its shareholders in this case, the plaintiffs company. Furthermore, the occupation by the subsidiary of the premises was technical only and solely for the purpose of the parent company. The plaintiff could therefore maintain a claim for compensation.

This decision may be contrasted with *Tustall v Steigman* **(1962) 2 Q.B. 593** where the court refused to treat a proposed occupation of premises by a company wholly owned by the plaintiff as an occupation by the plaintiff herself even though she had formed the company to carry on an existing business. The result is that an application by the defendant, a tenant of the premises for a new tenancy prevailed.

Also in the case of *Re FG films Ltd* **(1933) 1 W.L.R. 483**.The company was incorporated in England by an American based company, United States Film Company. The President of the U.S Company holds 90% of the British company, while the 10% were held by another director – a British citizen. The company intended that as the maker of a film which should therefore be registered as a British film under the Cinematograph Films Act 1938. The court refused to agree that the film was made by the British company whose participation in it was so small as to be practically negligible. The company was merely the nominee or agent of the U.S. Company which had brought the British company into existence for the sole purpose of enabling the film to qualify as a British film. The share capital of the British company and the shareholding were treated by the court as evidence that the British company had been formed with a view to evading the legislation.

Similarly, a court will not allow members of a company to evade their legal obligation or to perpetuate fraud under the cloak of Salomon v Salomon. If such happens, it will be regarded as a “sham” that is, the company is not real but formed to perpetrate fraud. In the case ***of Jones v Lipman*** **(1962) 1 All E.R 442.**The 1st defendant agreed to sell freehold land with registered title to the plaintiffs pending completion of the agreement, he sold and transferred the land to the defendant company (company incorporated by himself and the cleark of his solicitors) and both of them are the shareholders and director. The court held that in the circumstance of this case, the defendant company was a cloak for the first defendant the court accordingly ordered specific performance of the original agreement. In another case, the court refused to allow the defendant who had entered into an agreement not to compete with his employer. He later resigned and formed another company which he now used to compete with his former employer, the court lifted the veil of incorporation to discover the person behind the new company, that the company was a cloak or ‘stratagem’ to avoid the legal obligation. You may see also the case *of Re Darby* (1911) 1 KB 95,and*Re Burgle Press (1961) Ch. 270.*

Group Enterprise Theory

A large company may own a chain of other companies known as . subsidiaries, if the doctrine of Salomon v Salomon were to be applied, these other companies would be treated separately. But for economic convenience and justice both are allowed to be treated as an entity. In the case of *DHN Food Distributors Ltd v Tower Hamlets* **(1976) 1 WLR 852** Lord Denning had argued that a group of companies was in reality a single economic entity and should be treated as one. Previously, in the case of*Littleweeds Mail Order Stores v IRC* **(1969) 1 WLR 1241.**He stated thus,

"the doctrine laid down in Salomon case has to be watched very carefully. It has often been supposed to cast a veil over the personality of a knitted company through which the courts cannot see. But that is not true. The courts can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest and the courts should follow suit.

In the case of *DHN Food Distributors Ltd v Tower Hamlets* **(1976) 1 WLR 852** Lord Denning argued that a group of companies was in reality a single economic entity and should be treated as one. However, this position will seem to avoid the doctrine laid down in*Salomon v Salomon* and therefore two yeasr later the House of Lords was able to specially disapprove Lord Deming's position and ruled in the case *of Woolfson v Strathclyde RegionalCouncil* (1976) SLT 159, that the veil of incorporation would be upheld in cases of group of companies structures unless the group structures was being used as a facade.

The Court of Appeal in England had the opportunity of setting the record straight and declared the position of the law in the case of *Adams v Cape Industries Plc* **(1990)1 Ch 433**. The key issue before the court was whether cape industries could be regarded as falling under the jurisdiction of a US court and therefore is subject to its jurisdiction. This could only occur if Cape was present within the US jurisdiction or had submitted to such jurisdiction. In 1979, Cape, an English company, mined and marketed asbestos. Its worldwide marketing subsidiary was another English company, named Capaso. It also had a US marketing subsidiary incorporated in Illinois, named NAAC. In 1974, some 462 people sued Cape, Capasoand NAAC in Texas for personal injuries arising from the installation of asbestos in a factory. Cape protested that the Texas court had no jurisdiction over it but in the end it settled the action. Between 1978 and 1979, further 206 similar actions were commenced and default judgments were entered against Cape and Capaso. In 1979 Cape sold its asbestos mining and marketing business and therefore had no assets in USA. The claimants thus sought to enforce the judgment in England where Cape had most of its assets. The issue therefore was to decide whether the Cape was present in the US by virtue of its subsidiaries. The only way to do this was to lift the veil of incorporation, theCape treatingthe group as a single entity, or finding the subsidiaries were mere façade or that the subsidiaries were agents of Cape. The court examined all the possibilities, and after examining all the old cases, the court held that Cape group cannot be treated as one, the court stated;

> *"save in cases which turm on the wording of particular statutes or contracts, the court is not free to disregard the principle of Salomon v Salomon & Co. Ltd (1897) All 22namely because it considers that justice so required."*

The court therefore left only three options for lifting of veil of incorporation.

1. The first is if the court is interpreting a statute or document. This exception to maintain corporate personality is qualified by the fact that there has first to be some lack of clarity about statute or document which would allow the court to treat a group as a single entity. See also *Samego –Turner v J & H March & McLennan(Services)Ltd* **(2007) EWCA Civ.** 723 where the Court of Appeal in England treated a group of companies as a single entity on the basis of their single economic interest in interpreting the application of an EU Regulation.

2. Secondly, the court will lift the veil of incorporation where the corporate entity was namely formed for the purpose of avoiding legal obligations, or where "special circumstances exist indicating that it is a mere façade concealing the true facts." Where the court finds that to maintain the veil of incorporation will lead to a form of injustice or facilitate a deliberate injustice, like the case *of Jones v Lipman (supra*)**.**
3. The third exception is where the Court finds that there is an express or implied agency between the parties. In the group structures, there may not be a document indicating or pointing to this fact,, but it may be inferred from their conduct, this may be in cases where there is a very strong control exercised by the parent company over the subsidiary, where this cannot be proved, the agency option may not be easy option. In *Adams* case, the court has ruled that the group has every legal and legitimate right to organize its affairs according to the law, and the court cannot infer impropriety to the company as a result of this exercise of legitimate right.

Clearly, the court can no longer lift the veil of incorporation merely "to achieve justice irrespective of the legal efficacy of the corporate structure." See the case *of Ord vBelhaven Pubs Ltd* **(1998) 2 BCLC 447.**

4. CONCLUSION

The courts are obviously extremely very reluctant to lift the veil of incorporation or to depart from the principle laid down *in Salomon v Salomon.* Under the old dispensation there are 5 classifications under which the court will lift the veil of incorporation, based on the decided cases. These are: (1) Agency (2) Trust (3) Determination of residence in order to knowthe actual country of incorporation (4) fraud or illegality (5) public policy in time of war. However since the *Cape* case, the occasions for lifting the veil seems to have been limited to only three, these are

(1) where the court is construing a statute, contract, or other document

(2) when the court is satisfied that a company is a 'mere facade' concealing true facts.

(3) When it can be established that the company is an authorized agent of its controllers or its members, corporate or human.

5. SUMMARY

A company upon incorporation becomes a legally recognized person capable of exercising all the powers of a natural person. The law will no longer 'see' the promoters but the 'company as a person. However, the courts will lift the veil of incorporation in certain cases. Though the court had been very reluctant in doing this, but the fact remains that the veil must be lifted to avoid the corporate nature of the company from being used to perpetrate fraud or hide the facts, in the words of Sambam J in the US case of *US v MilwaukeeRefrigeration Transit Co*. **142F (1906) 247 at 255,**

"A corporation will be looked upon as a legal entity as a general rule, but when the notion of legal entity is used to defeat public convenience justify wrong, protect fraud, or defend crime, the law will regard the incorporation as an association of persons."

6. TUTOR MARKED ASSIGNMENT

Discuss circumstances when the courts will lift the veil of incorporation of a company.

7 References/Further Reading

1. Gallagher and Zeigher (1990), 'Lifting The Veil In The Pursuit Of Justice' 1990 JBL, 292.

2. Lowry, 1993, 'Lifting the Veil'1993, ‚JBL 180

3. Rixon, 1986, 'Lifting the Veil of between Holding and Subsidiary Companies' 1986, LQB 415.

MODULE 3 - UNIT 4

LIFTING THE VEIL OF INCORPORATION 2

BY LEGISLATURE

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION

The term lifting the real as we learnt in unit 3 is simply the term applied to situation when the separate legal entity of the company cannot be maintained. The courts have sometimes referred to this as lrifting the veil', "peeping behind the veil 'pircing, 'parting' or 'penetrating' the corporate veil,there are two aspects of lifting the veil, the judicial and the legislative aspects. We have discussed the judicial aspects in unit 3, we now turn to the situation when the corporate veil will be lifted by the legislature. This means where the legislature has made specific provisions in the law that allows the corporate veil to be lifted.

2. OBJECTIVES

In this unit the student will learn circumstances when the veil of incorporation will be lifted by legislative provisions or statutes

3. MAIN CONTENT

It has always been recognized that "the legislature can forge a sledge hammer capable of cracking open the corporate shell" (per Delvin J in *Bank VoorHandelenScheepvaat* **N.V.** *v Slatford* **(1953) 1 QB 248 at 278.** While agreeing that the veil of incorporation may be lifted under certain circumstances as provided in the law, it must be made clear that it is not as if for all times the company affairs and the people behind the company are totally shielded from public view. The legislature had always made it an essential aspect of corporate existence and limited liability that it should be accompanied by wide publicity, though third parties may not be allowed to proceed against the members of the company, but they are entitled to know the members of the company and their interests in it, they are also entitled to know who the officers of the company are, the constitution of the company, the capital of the company the accounts of the company, and generally all the registered documents of the company.

However, apart from the information that the law permits must be revealed to the public, third parties may not be entitled to know beyond this, and therefore, it is as if a curtain is drawn over the affairs of the company that blocks access of outsiders to its internal affairs. Some authorities have distinguished between lifting the veil and lifting the curtain of incorporation, the fact is that at all times the legislature permits the veil to be lifted it is always for particular purpose in order to enforce the law or prevent the company from being used to deceive, perpetrate fraud or avoid legal obligation by those behind the incorporation.

We shall now turn our attention to examples of when the legislature by express and implied provisions allows the veil of incorporation to be lifted.

1. Reduction in Number of Members

Under section 93 of the CAMA 1990, *'if a company carries on business without having at least two members and does so for more than six month, every director or officer of the company during the time that it so carries on business after those six months who knows that its carrying on business with only one or no member shall be liable jointly and severally with the company for the debts of the company contracted during that period.*

This section does not operate to destroy the separate personality of the company, it will continue to operate as a separate legal entity even if there are no more members or the membership was less than the legal minimum. It is only the members that remain after six months that the creditors may sue personally for the debts of the company and not those that have withdrawn, and this is only if he knows that he is carrying on business with less than the required minimum and he is only liable for the debts contracted after the six months that he carried on business and incurred the debts. The effect of the section is that the liability attaches only to a member and not the director or officers of the company who is actually in control of the management of the company and who may be the one responsible for carrying on the business and who actually incurred the debt.

This section may be difficult to apply today basically because of the very many huddles one has to summon in its application. More so in modern times, since the only step to take to avoid the section is to ensure that the minimum membership do not fall below two for six months, the company will simply appoint a nominee to fill the vacancy. In the word of Gower "it constitutes an exception to the general rule of theoretical interest rather than practical importance."

2. **Fraudulent or Wrongful Trading:** Another important example of statutory lifting the veil is offered in the provisions of section 506 of CAMA which was formally section 309 of the 1968 Companies Act. The act provides that,

> *"if in the course of the winding-up of a company, it appears that any business of the company has been carried on in a reckless manner or with intent to defraud creditors of the company or creditors of the company or any other person for any fraudulent purpose, the court, on the application of the official receiver, or the liquidator or any creditor or contributory of the company, may if it thinks proper so to do, declare that any person who were knowingly parties to the carrying on of the business in manner aforesaid shall be personally responsible, without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct."*
>
> *See also section 993 of the Companies Act 2006 U.K for the current English provision.*

The provision recognizes that the separate personality can be used for fraudulent purposes. The ability of businessmen to use the company for fraudulent purpose is acknowledged, and therefore in order to prevent and or bring perpetrators to justice the legislature has allowed the veil to be lifted to enable the law see the persons behind the corporate veil.

What constitutes fraud: under the section, we must first determine what constitutes fraudulent trading, and what class of persons may be held liable for fraudulent trading. To establish intent, it has to be shown that the business of the company was being carried on in a reckless manner or with intent to defraud creditors of the company or creditors of any other person for any fraudulent purpose. Where it cannot be established that the trading was reckless or fraudulent the veil cannot be lifted, and the persons involved cannot be held liable. In the case of *Re Williams Leitch Bros. Ltd* **(1932) 2 Ch. 71 at 77**, Maugham J explained the position of the law thus: "if a company continues to carry on business and to incur debt at a time when there is to the knowledge of the directors, no reasonable prospect of the creditors ever receiving payment of those debts, it is generally a proper inference that the company is carrying on business with intent to defraud.

Therefore, in his view, mere recklessness on the part of the persons concerned in carrying on the company's business at the material time is sufficient to constitute fraud. Fraud therefore may be inferred where there has not been a clear and deliberate intention to defraud in a particular case. But in *Re Patrick & Lyon Ltd* (1935) Ch. 786 at 790-1, the same judge gave a more rigid interpretation to the word fraud when he said, "there must be actual dishonesty, involving, according to the current notions of fair trading among commercial men, real moral shame." This shows that the standard of proof may be inferred from the facts of each case and therefore the standard here is subjective moral blame, and there is no objective standard. In the Australian case *ofHardie v Anson* **(1900) 105 LLR 451,** the court held that the fact that a company continues to trade and to obtain goods on credit and to incur other liabilities without any reasonable prospect of being able to pay or provide payment therefore will not of itself show that the directors of the company have carried on the business with intent to defraud creditors. The intent to defraud must be express and not constructive or imputed.

The attitude of the Nigerian courts on the construction of this section is not yet clear, especially in view of the conflicting interpretations in the English and Australian decision. The interpretation in the *Re Williams Leitch Bros* case though is likely to be preferred because such interpretation makes it more difficult for anyone to involve himself in fraudulent trading without being caught; in fact the Jenkins Committee in 1962 had recommended the introduction of a remedy for reckless trading which was not accepted by government in England. The Cork committee was to successfully promote the amendment under the name of "wrongful trading".

In Nigeria, the law still remains the same, and the section do not apply unless the company is in liquidation or winding-up also, the class of persons who may apply to the court are limited to (1) the official receiver (2) the liquidator (3) any creditor (4) contributory of the company. This helps in cases where the creditor or member feels aggrieved, without waiting for the official receiver, may sue the officers involved whether directors or not, and the section seems to cover all persons whether they are officers of the company or not who are involved in the fraud. In spite of all the very strict conditions precedent, it is an avenue to lift the veil of incorporation to strike at the persons behind the corporate veil afforded by legislation.

3. Misdescription

(1) Liability by company agents: On ordinary agency principles the officers of the company will make themselves personally liable, notwithstanding that they are in fact acting for the company, that is, if they chose to contract personally by failing to disclose that they are acting as agents of the company.

(2) The Companies And Allied Matters Act 1990, had gone further to provite that if any director or manager of the company or other person acting on its behalf, must have the name of the company properlty described and painted on the outside of the offices of the company, also, have its name and registration number mentioned in legible characters in all business letters of the company and in all notices, advertisements and other official publications of the company, and in all bills of exchange, promissory notes, endorsements, cheques and order for money or goods purporting to be signed by or on behalf of the company and in all bills, parcels, invoices, receipts, and letters of credit of the company, failure of which the director or manager who knowingly and willfully authorizes or permits the default shall be liable personally. The result is that if the correct and full name of the company does not appear, the

signatory will be personally liable to pay if the company does not, and it seems clear that it makes no difference that the third party concerned has not been misled by the description. See section 631 CAMA, see also section 349(4)Companies Act 1985 UK. The 2006 Companies Act U.K did not retain the section.

The rules on trading disclosures are linked to the doctrine of limited liability, the law ensures that the company status is sufficiently disclosed to outsiders dealing with it, in the words of Company Law Review Group, it is essential that the company's legal identity… is revealed to all who have, or may wish to have, dealings with it so that they are warned as to its status and can discover all the other information which the company is required to reveal about itself." (see Final Report J Para 11.52)

In essence, there are two aspects of the liability. The officer who knowingly misdescribes the company is liable both criminally and in civil proceedings. The holder of the bill of exchange, promissory note cheque or order for money or goods has the option to sue the officer for the money involved unless the company has paid for the loss.

4. **Holding And Subsidiary Companies**: It is now accepted as part of growth, that companies may develop by incorporating other companies in which it may have substantial or whole beneficial interest in the other companies, these new companies are better referred to as 'subsidiaries'. While the parent company is regarded as a holding company, section 338 gives the meaning, of subsidiaries. A company is regarded as the subsidiary of another if (a) the company –

(i) is a member of it and controls the composition of its board of directors

(ii) holds more than half in nominal value of its equity share capital or

(b) the first-mentioned company is a subsidiary of any company which is that others subsidiary

Section 336 of CAMA provides for the preparation of group financial statements by the holding company. The section provides, that “if at the end of a year a company has subsidiaries, the directors shall, as well as preparing individual accounts for that year, also prepare group financial statements being accounts or statements which deal with the state of affairs and profit or loss of the company and the subsidiaries.”

The effect of this provision is that the subsidiary is no longer regarded as a separate entity but the veil of incorporation is lifted when it comes to the issue of subsidiary as it treats the group as a whole and not as a district entity as it ought to be.

5. Power of Inspection: The Corporate Affairs Commission may appoint one or more competent inspectors to investigate the affairs of company and to report on them in such manner as it may direct. (section 314). While section 315 also empowers the commission to appoint inspectors to investigate the affairs of any company in Nigeria pursuant to the order of court.In the exercise of the powers conferred on the inspectors, the Inspector is invested with immense powers of investigations which will have the effect of lifting the veil or curtain of the corporation. Amongst other powers, the inspector may:-

(a) where he thinks it necessary for the purposes of his investigation to investigate also the affairs of another body corporate which is or at any relevant time has been the company’s subsidiary or holding company or a subsidiary of its holding company or a holding company of its subsidiary. See section 316.

(b) he may request for all documents relevant to the investigation from the agents of the company being investigated.

(c) the inspector may, if he has reasonable grounds for believing that a director or past director of the company had maintained an account into which his emoluments are paid, ask for the details of the accounts of the directors or officers involved. See section 318

6. **Miscellaneous Statutory Examples:** Many statutes made provisions when the corporate veil may be lifted if without doing so, the promoters or directors may avoid the provisions of the act, by the use of corporate personality principle, where for instance, corporate entity is used for the avoidance of tax. See Company Income Tax Act 1967, Income Tax Management Act 1961. In order to determine whether the Enterprises Promotion Act is complied with, with reference to sections 4,5,10 and 12 or whether Nigerians are being used to defeat the purpose of the Act, it would be necessary to look into the company to find out the real membership of the companies.

4. CONCLUSION

It is the responsibility of the legislature to ensure that the principle of corporate personality should not be allowed to enable any person use the corporate entity to avoid legal obligations and break the law by the use of companies. The Companies Act itself has led the way by making provisions that seeks to lift the curtain of incorporation to make the officers of the company personally liable for the liability of the company. The occasions for doing this are scattered throughout the Act, but we have examined a few of them.

5. SUMMARY

The corporate veil may be lifted by the legislative in a variety of circumstances. The corporate veil will be lifted where it is discovered during liquidation that the directors of the company had operated the company in a fraudulent or reckless manner (section 506 CAMA where the company had traded below the legal minimum of two and has done this for six months, then any member who knowingly did this will be personally liable for the debts incerred during this period. Section 93 CAMA. Another instance is misdescription. Where the company had been misdescribed or where the officers had failed to use the proper names of the company in transacting business, with third parties they will be personally liable to the third parties if the company refuse to pay, and they will also be criminally liable personally. Section 631 CAMA. Another important example of lifting the veil is in the area of Holding Companies. The law is that the holding company must prepare not only individual accounts giving a true and fair account of the entire group of companies. This effectively will lift the veil as to the persons behind the subsidiaries. See section 236 and 338 . We must also mention the fact that many statutes make provisions for lifting the veil of incorporation e.g. the Tax Laws.

6. TUTOR MARKED ASSIGNMENT

Discuss occasions when the legislature will permit the veil of incorporation to be lifted.

7. REFERENCE/FURTHER READING

MODULE 4 - UNIT 1

PROMOTERS

INTRODUCTION

1. OBJECTIVES
2. MAIN CONTENT
3. CONCLUSION
4. SUMMARY
5. TUTOR MARKED ASSIGNMENT
6. REFERENCE/FURTHER READING

1. INTRODUCTION

In this unit we turn our attention to an important aspect of company law. There are some set of people referred to as promoters who actually perform an important role in the company but prior to its formation. They represent different things to different people. In many cases they are sometimes regarded as fraudulent people who only take advantage of an yet to be incoporatedcompany to make money and to the detriment of the company. This is because, they stand in an advantageous position and the members of the company may not have any option than to accept whatever the promoters pass to them. Here, we will look at the definition of a promoter and their duties to the company.

2. OBJECTIVES

At the end of this unit the student must be able to explain the meaning of the word promoter and their duties.

3. MAIN CONTENTS

MEANING OF "PROMOTER"

The word promoter was first used in the Registration Act of 1844 to describe those engaged in the formation of companies. In the modern context however, the word is not only used to mean those engaged in the formation of companies, the promoters work does not end with formation of company alone. The courts have refused to define the term "promoter", they merely describe it occasionally to fit the facts of the case before them, in order words, there is no fixed judicial definition of promoter.

However, in the case of *Twycross v Grant (1877*) **2 CDD (36TCR 812) 469 at 541,** Cockburn C. J. explained the term thus, "A promoter I apprehend is one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose." In that case, plaintiff sued to recover the amount paid on shares by him in the company on the ground of fraud of the defendants (promoters of the company) in omitting from the prospectus two contracts entered into by them as promoters. One, is a contract between the defendants and one person for the purchase of certain foreign concessions for the construction of a tramway, the other, a contract between the defendants and G. as to certain payment to be made by G. & P to G. in consideration of his obtaining for them a contract from the company for the construction of the tramways by means of which fraud the plaintiff had been induced to take the shares which proved worthless. The jury found that these contracts were material and should have been disclosed to the intended shareholders of the company. It was held, that the contract ought to have been specified in the prospectus and that the defendants were liable. That the shares taken by the plaintiff being worthless he was entitled to recover the amount paid by him to them.

In view of the very many avenues for a promoter to defraud the company he is promoting, the courts have actually deemed it fit to leave the definition as elastic and flexible as possible in order to "catch the next ingenious rogue" (L.S. Seally, 1992, Cases and Materials in CompanyLaw, 5^{th} ed. Butterwoths, London. P. 22).

A 'promoter' is the person responsiblefor forming the company. , in most cases however,, only one individual may not single handedly form the company, he needs others including professionals to assist him, the world may therefore be limited to those who take active role in forming the company. This brings to fore the individual roles played by each person in order to determine who actually took active role in the promotion . A typical promotion process involves incorporation of the company with the Corporate Affairs Commission (CAC), thus of course will entail instructing lawyers to prepare all the necessary documents of incorporation, paying for their services and incorporation costs, negotiating pre-incorporation contracts, appointing the initial directors, and shareholders, in the case of public company, the promoter will be responsible for the preparation, registration and issuing of prospectus. The promoter will also be involved in introducing vendors, agents etc and the raising of the initial capital of the company. The lawyers or accountants and other professionals engaged by the promoter are not regarded as promoters merely on that account. *Re Great Wheel Polgooth Co*. (1883) 53 LJCH. 42.

Obviously, their work is quite enormous, this is why Bowen J declared in the case of *Whaley Bridge Calico Printing Co v Green (1880)* **5 QBD 109** that,

> *"they term promoter is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence."*

The courts reluctance in not formulating a general definition of the term is as a result of the old cases where the promoters are largely fraudulent persons with only one intention, and that is, to create schemes to defraud unwary investors. This was done by a person selling to a new company that is being floated his own property or property acquired for the purpose at a grossly inflated price, in return for fully paid up shares. Therefore, it is better to leave the definition flexible in order to include as many fraudsters as possible.

What constitutes a promoter is a question depending on the facts of each situation. In the case ***of****Emma Silver Mining Co. Ltd v Lewis* ***(*****1878-79) LR 4. C.P.D. 396,** Lindley J at page 407 explained that, 'with respect to the word 'promoter' we are of the opinion that it has no definite meaning." As used in connection with companies, the term 'promoter' involves the idea of getting up and starting a company or what is called floating, and also the idea of some duty towards the company as posed by or arising from the position which the so-called promoter assumes towards it. The courts have also developed a range of specific fiduciary duties aimed at setting exemplary standards of behavior for promoters.

In England, the word promoter has not been judicially defined apart from the above instances. Also, the legislature has not deemed it fit to offer a solution as well, except in section 762(1) (c) of the Company Act 2006 U.K. in relation to obtaining a trading certificate, where they are required to be named. However, in Nigeria, the Companies and Allied Matters Act 1990 has offered a solution by simply adopting the description of Cockburn CJ *in Twycross v Grant* ***(supra)***. *Section 61 of the Act states 'Any person who undertakes to take part in forming a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose or who, with regard to a proposed or newly formed company, undertakes a part in raising capital for it, shall prima facie be deemed a promoter of the company."* The proviso to the section exempts persons acting in professional capacity engaged as such persons engaged in procuring the formation of the company shall not be thereby be deemed to be a promoter. We should note that the section adds the words, "who, with regard to a proposed or newly formed company, undertakes a part in raising capital for it". It is not clear whether the words added by the Act is of any use, or may only create further confusion to the law. The issue of who raises capital for the company may not be too clear, does it include the Bank or Finance house that grants credit for the company, or creditors who supply goods to the company on credit, or exactly what is capital,it would have been better to retain the definition given by Cockburn C.J without any addition thereto. This is the first time promoter is defined in the Act, it was not defined in the Companies Act 1968, we will still await judicial interpretation in Nigeria.

SELF ASSESSMENT TEST

Define The Term 'Promoters'

2. DUTIES OF PROMOTERS

Promoters occupy a unique position in the formation of a company which position can be used to secure for themselves some benefits at the expense of the investors and creditors. Their position can be easily abused because the promoters have a fore knowledge of the company, and can decide the nature, constitution, object and founding members of the company. Pre-incorporation agreements are entirely in the hands of the promoters. Lord Cairns in*Erlanger v New Sombrero Phosphates Co. Ltd* **(1878) 3 A.C. 1218** explained the position thus: Promoters have in the their hands the creation and moulding of the company, they have the power of defining law, and when and in what shape and under what supervision it shall start into existence and begin to act as a trading corporation.” In view of their very important position in the company, the law regards the promoters as standing in a fiduciary relationship to the company. Land Cairns LC made the point in Erlanger case. This is so because a promoter, being a person who ‘undertakes to act for and on behalf of another in some particular matter, is viewed as a fiduciary and therefore subject to the severityof a number of fiduciary duties. Generally, fiduciary duties are obligations ‘owed to a third party to act with loyalty and good faith in dealings which affect that person.” (seePenner, 2008, The Law of Trusts, Butterworth, London). As Penner points out, the duty to act with loyalty and good faith means more than just acting honestly or fairly but rather the fiduciary must act solely with the interests of his principal in mind; the fiduciary must act to secure his principal’s best interests and must not allow his own self-interests, or the interests of others, to govern his behavior in any way that could conflict with the principals interests.

We may therefore safely conclude that the promoter stands in a fiduciary position to the company, and the duty starts immediately the promoter commences the preliminary steps towards the incorporation of the company and throughout the incorporation process.

FIDUCIARY DUTIES OF PROMOTERS

Due to their position in the company as we discussed above, the promoters may easily use their position to benefit themselves to the detriment of the company. These can be done in the following ways;

1. They may for instance decide to form a company, simply to sell their own property to it at a price highly in excess of its value or the price they paid for it **(See Salomon v Salomon & Co. supra).**
2. A secret bargain may be made with vendors of property of the company to pay them back part of the purchase price which had been inflated for this purpose.
3. The promoters may inflate the promotion expenses and demand to be paid for by the company.
4. Investors may be misled into subscribing for bubble companies as we saw before the Bubble Act.

Some of the usual fraudulent activities have been judicially summed up by Cockburn CJ in *Twycross v Grant* **(supra)** when he said.

> *But in this vast undertaking caused on by United Enterprise and capital of hundreds perhaps thousands of shareholders. The individual shareholder is more or less at the mercy of those who invite him to join the company, as the facts on which he may be led to invest his money, experience has shown that shareholders may be induced, not only by being led to invest in bubble companies, but also where the undertaking is intended to be carried out from the resources of the company being impoverished by clandestine agreements from which failure of the enterprise results or by the company being made to pay more than the real value of their shares largely in excess of the value of what it gets by the capacity of those who set it going, and that shareholders may be victimized by being made to pay more than the real value of their shares owing to dishonest or improvident bargaining made at the inception of the undertaking and not disclosed in the prospectus.*

The fiduciary duties applicable to promoters principally arise from the nature of the transactions entered into by them in the cause of bringing the company into existence. The duties may be divided into two.

(1) where the promoter has recovered reward or commission from the vendors of the property by inflating the price of the property sold to the company.

(2) Where the promoters reaps excessive profit by selling the property at an excessive sum.

The two situations are treated as secret profits made by promoters. The court treats promoters as fiduciary of the company so it is easy to compel them to restore to the company any gain made from any of the two ways. Where the promoter sells property to the company in which he has a personal interest and so the law requires promoters to make a full disclosure of any profit derived therefrom **(see** *Re Lady Forest (Muchinson) Gold Mine Ltd*(1901) 1 Ch. 582. In the case of *Hudson v Congrave*(1828) 4 Russ, 562**.** The vendor agreed to sell for £10,000 property to the company, but the promoter asked that the agreement should state £25,000. It was held on discovery by the company. That the company is only bound to pay the actual price. It is possible for the promoter to argue that inspite of the inflated price, the price is fair, if it can be proved that it is lower than the market value. This argument will not be accepted because a trustee is not supposed to profit from the trust. The reason is that once it is established that the promoters from the purchase price, the court will accept that the promoter has acted to the detriment of the company. (*See Re Hereford &South* (1876) Ch. 62).

Where a promoter offers a secret reward, the company has a right to recover the secret reward and the company has the right to rescind the contract.*See Bagnall v Carlton*(1877) 6Ch. 371**.** In the case, the court recognized the double remedy of rescission of the contract and also, an action for money had and received to the use of the company. It is not necessary that the contract should be rescinded before the promoter is made liable. It was held in*Emma Silver Mining Co. vLewis*40 LTR 749that the defendants were in a fiduciary relation to the company and they were liable to refund the secret profits even though the contract of sale was rescinded. The right to recover the profit made is not a condition precedent for rescission of the contract. In the case *of Lindsay Petroleum Company Ltd v Hurb* **(**1874) LR 5 P. Ch. 243,A and Bown parcels of land which was supposed to contain crude oil. They formed company with C and sold the land to the company. A and B did not disclose their interest. They made substantial profit. The plaintiff company that bought the land having discovered the fraud sued for rescission of the contract, it was held, that the contract must be wholly rescinded, the price repaid and the land reconveyed.

Where the reward has not been paid, it can be recovered straight from the third party. The third party cannot say that because the transaction is fraudulent, it is void and cannot be enforced against him. You may *see Grant v Gold Exploration Development Syndicate Ltd*(1900) 1 QB. 233**.** In this case, the plaintiff owner of a mine agreed to give X 10%commission if he sells it unknown to him, X was the director of the company buying the mine. The director arranged for a sale to the defendants but before the contract was entered into or the commission payable, the plaintiff became aware of the director's position with regard to the transaction with the defendant. Held, that the plaintiff having completed the contract without disclosing the defendants as purchasers, the agreement to pay commission to the agents, or any part of the agreed commission remaining in the hands of the plaintiffs could be recovered from him by the defendants.

LEGISLATIVE INTERVENTION

For the first time, the Companies and Allied Matters Act, 1990, by virtue of section 62 made provisions on the duties of the promoters. The sections states,

(1) A promoter stands in a fiduciary relationship to the company and shall observe the utmost good faith towards the company in any transaction with it or its behalf and

shall compensate the company for any loss suffered by reasons of his failure so to do.

(2) A promoter who acquired any property or information in circumstances in which it was his duty as a fiduciary to acquire it on behalf of the company shall account to the company for such a property and for any profit which he may have made from the use of such property or information.

The law is far more encompassing than the common law position. The law now includes use of corporate information and is no longer restricted to a financial or property transactions. Where the opportunity was not utilized by the promoter or where it was utilized for the benefit of the company, he incurs no liability. He will not also incur any liability where he discloses his interest to the company. Full disclosure is required by the promoter before he can escape liability. This will be our focus in the next unit.

4. CONCLUSION

The promoter stands in a precarious position to the company. He is recognized as the person who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose: while the courts also recognized the term promoter as … a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence. See Bowen J *in Whaley Bridge Calico* case, supra. The fact is that a businessman is more interested in profit and ought not to be penalized for making profit. But the position of the law is clear, that is if the promoter is allowed to escape with ill-gotten gains in the name of business, the company will be put to serious disadvantage.

5. SUMMARY

The promoter is the person responsible for forming the company. He is the one that plans, organizes and sets in motion all the necessary steps to ensure that the company comes into being. In doing all these, the law regards the promoter as standing in a fiduciary relationship to the company. The fact that we do not have any accepted definition for the term shows the reluctance of the common law courts to close the ways by which the fraudulent promoters may be caught. The Nigerian CAMA, has however, defined the term, by slightly expanding the definition of Cockburn CJ in *Twycross v Grant* (See section 61). The promoter being a fiduciary is not allowed to make any secret profit from his promotion, he must not use his position to benefit himself by either obtaining commission or any advantage.

6. TUTOR MARKED ASSIGNMENT

Define the term promoter, and examine the duties of the promoters

.7. REFERENCES/FURTHER READING

Renner, 2008, The Law of Trusts, Butterworths, London

MODULE 4 - UNIT 2

PROMOTERS II

INTRODUCTION

1. OBJECTIVES
2. MAIN CONTENT
3. CONCLUSION
4. SUMMARY
5. TUTOR MARKED ASSIGNMENT
6. REFERENCE/FURTHER READING

1. INTRODUCTION

From unit 1, we have learnt the meaning of promoters and how it is possible for them to use their position to enrich themselves at the expense of the company. The promoters are also businessmen and are in business to make money, how this can be done is the focus of this unit. The law does not totally foreclose the avenue for making money against the promoters, but in most cases the promoters still refuse to follow the proper legally approved guide and in which case if caught they will be held responsible for their actions. The company also must act in order to be able to hold the promoter responsible and to recover any ill-gotten gains from the erring promoter.

2. OBJECTIVES

At the end of this unit the student will be able to understand the remedies available to the company and the disclosure by promoters and also how the promoter may recover the legitimate remuneration.

4. MAIN CONTENT:

REMEDIES

In *Salomon v Salomon*, it was held that though the price Salomon got for business was inflated, but the court still held that since the members knew all the facts and acquiesced there was no fraud or breach of duty committed by Salomon. It therefore follows that disclosure will relieve promoters of liability to the company. The profit thereby made is no longer a secret profit once a full disclosure of all the fact is made to the company.

Where a promoter fails to make the requisite disclosure the principal remedies available to the company are rescission and an accounting of the secret profits. In effect the pertinent question is how can the promoter make an effective disclosure that will effectively absolve him of any wrong doing? The answer becomes necessary because of the interpretation of the court's decision in the case *of Erlanger.* From the decision it may be interpreted to mean that atall times, the promoter must provide an independent Board of Directors before disclosure is made, in the case, Lord Cairns in the Erlanger case said:

> *"if they are doing all this in order that t the company may, as soon as it starts to life, become, through its managing directors, the property of themselves, the promoters, it is in my opinion, incumbent upon the promoters to take care that in forming the company they provide it with an executive, that is to say, with a board of directors, who shall both be aware that the property which they are asked to buy is the property of the promoters, and shall be competent and impartial judges as to whether the purchase ought or ought not to be made."*

However, in the case *of Lagunas Nitrate Co. v Lagunas Nitrate Syndicate*(18899) 2Ch. 392 in the case a company was formed for the purpose of purchasing property from the syndicate consisting of nitrate works. The company was promoted by the syndicate who became its first directors. Notice was given in the company's article of the directors' interest. Two years later after formation, the company brought an action for rescission and damages on the ground of misrepresentation and breach of trust, it was held, that;

(1) The mere fact that the company did not have an independent board was not sufficient ground for rescission since the company has notice that its directors were also vendors.

(2) There had been no misrepresentation, where promoters make full disclosure to all members of the company, they are not liable to account for profits made on the formation of the company.

(see Lord Lindley at page 425-6)

The law is clear; the disclosure to directors will be enough provided it has an existing board quite independent of the control of the promoters. If there areno such board then disclosure to the shareholders will be enough either in a general meeting or in prospectus (see Lord Davy in*Salomon v Salomon*(supra) at 57).

A promoter who wishes to escape liability must make sure he discloses to the board of directors totally independent of his own control. In the case of *Gluckstein v Barns* **(**1900**)** AC 240, Lord McNaughton **(**at p. 249),explained the position of the law, that "disclosure is not the most appropriate word to be used when a person who plays many parts announces to himself in one character what he has done and he is doing in another." In the case, a syndicate (4 people) bought the Olympia company with the intention of selling it to their company to be formed. They formed the company and were the directors. They sold the property to the company and made two different profits. The prospectus issued only disclosed one of the profits. The company later went into liquidation and the liquidator claimed the latter amount as an undisclosed secret profit, it was held, by the House of Lords, that the syndicate were promoters and as such had a fiduciary duty to disclose all profits made while forming the company. It was not sufficient for the syndicate, as promoters to disclose the profit to the syndicate as directors. Lord Hailsbury was very frank when he said,

> *It is too absurd to suggest that a disclosure to the parties to this transaction is a disclosure to the company. They were there to do the work of the syndicate, to cheat the shareholders; and this forsooth, is to be treated as a disclosure to the company, when they were really there to hoodwink the shareholders.*

The disclosure to directors will be enough provided it has an existing board quite independent of the control of the promoters. Where there is no independent board then disclosure to the shareholders will be enough either in a general meeting or in the prospectus. *See Re Leeds & Hanley Theatre of Varieties Ltd* (1902) 2 Ch. 809**.**

Promoters are not regarded as agents or trustees of the company in all cases. Where the promoter sells his own property to the company, he is not bound to disclose the price he paid for it*. Re Cape Breton CO. (1885) Ch. 1795,* contrast with the decision of Jessel MR in the case *of Erlanger New Sombrero Phosphate CO* (supra). The law is however clearly stated in the *Re Cape Breton* case, that a promoter is not bound to disclose the price he paid for his property, all he needs to do is to say he is the owner. *See also,Omnium Electric Palaces Ltd v Baines (1914) 1 Ch. 332.*

Some cases do suggest that only in clear cases in which the promoter actually sells his property to the company that he keeps his profit. The court tries to draw a distinction between a case where a vendor acts on behalf of the company by buying and selling a property to it, from a case where he sells his property to the company, property which he acquired without anticipating that the company will buy it from him.

EFFECT OF BREACH OF DUTY

The promoter must make a full disclosure of all the material facts, to the Board of Directors or the general meeting as the case may be, half disclosure will not avail him. *Glusckstein v Barnes. (supra***)** where the promoter fails to make the appropriate disclosure the principal remedies available to the company are rescission and an account for profits. The effect of the breach of duty by the promoter is to render the contract voidable at the option of the company. See *Erlanger v New Sanbrero Phosphate Co***.** supra. The company may decide affirm or rescind the contract.

Rescission will only be available to the company if it acts promptly without delay, as delay may mean that the company wishes to affirm the contract, or if the company shows an intention to affirm the contract, rescission will not be available. *See Re Cape Breton supra***.** Since the contract is voidable and not void, it means that the contract is a valid contract until set aside. Where a third party acquires interest in the contract subject matter before it is rescindeded rescission may no longer be available.

Delay in rescinding the contract will operate as a bar to the remedy. *See Long v Lloyd (1958) 1 WLR 753.*

Leaf v Internatioanl Galleries (1950) 2 KB 86, Re Leeds and Hanley Theatres ofVarieties Ltd (supra). It is also important to note that rescission will also not be available remedy if *restitutio* in *integrum*, that is, it must be possible to restore the parties substantially to their original position, unless, due to the fault of the promoter, this possibility has been lost.*Lagunas Nitrate Co. v Lagunas Nitrate Syndicate (*supra).*In Erlanger*, Lord Blackburn observed that it has always been the practice of the court of equity to grant relief by way of rescission whenever by the exercise of its powers it can do justice by directing accounts, awarding equitable compensation and making allowances, even though it cannot restore the parties exactly to the position they were in before the contract. While agreeing with the equitable relief that may be offered to the company where rescission is no longer possible, Lord Porter explained further that it is actually possible for the company to recover damages for negligence when he said *in Jacobins Marler Estate Ltd v Marler (1930) 35 PC 107,*

> *"if the transaction to one of sale by the agent to P, the principal must in order to avoid it, be able to restore the agent to his original position. If he has resold the property, or cannot restore it to the agent in its original condition, the right to avoid the transaction will as a general rule, have been lost. But even so, it does not follow that the principal is without remedy. He may be able to recover damages from the agent for negligence in the performance of his duty. In such a case, the measure of damages will be the principal loss in the whole transaction, if he has suffered no such loss, there can be no damages. The equities governing, the relationship and in particular to that which exists between a company promoter and the company which results from the promoters and its shareholders."*

LEGISLATIVE INTERVENTION

Section 61(1) of CAMA 1990 confirms the fiduciary position of the promoter to the company and the section merely declared the common law position as explained above. However, section 62(2) states as follows:

> *'A promoter who acquired any property or information in circumstances in which it was his duty as a fiduciary to acquire it on behalf of the company shall account to the company for such a property and for any profit which he may have made from theuse of such property or information.'*

The section does not cover circumstances when the promoter sells his own property to the company. In cases where the promoter acted as agent of the vendor of property he may argue that in so far as he did not acquire any property or information but merely acted as an agent the section may not be applicable in such a case. Also, the section may not be applicable in case of inflation of incorporation expenses by the promoter. We submit therefore, that the section is too narrow and does not cover all the issues already covered under the common law.

The section 62(3) also allows the company to rescinded any transaction entered into on its behalf by the promoter unless all the material facts known to the promoter is fully disclosed. Ratification can be ;

(a) by the company's board of directors independent of the promoter,

(b) by all the members of the company, or

(c) by the company at a general meeting at which neither the promoter nor the holders of any shares in which he is beneficially interested shall vote on the resolution to enter into or ratify that transaction.

The difference between (b) and (c) above is not too clear or fundamental. This is because members of the company are not different from company at general meeting, if the proviso to the third option is not available in the second option, it follows that there could be possibility of the promoter voting where he has disclosed to the members of the company. Disclosure to the members of the company could be in the prospectus and this may not need any voting or ratification, in so far as the disclosure is full.

Time does not run against the liability of the promoter (see section 62(4), we must note that where rescission may not be available as we discussed above, the section 62, may not be applicable as well.

REMUNERATION

A promoter is not entitled to recover any remuneration for his services from the company unless there is a valid contract to that effect between the promoter and company. In fact, the promoter is not entitled to recover promotionexpenses from the company. *See ReEnglish & Colonial Produce Co. Ltd*. (1900) 2 Ch. 439**.** Until the company is formed it cannot enter into any contract.see*Kelner v Baxter* supra**.**

A promoter being a business person will certainly not be contented with merely recovering promotion expenses, but also interested in making handsome profits from the promotion, this is not unreasonable, this is due to the extensive services being rendered by the promoter. Lord Hatherly explained the position thus;

> *"the services of a promoter are very peculiar; great skill, energy and ingenuity may be employed in constructing a plan and in bringing it out to the best advantages""* **see***Touche v Metropolitan Railway Warehousing Co. (1871) L.R 6 Ch. App 671 at 676*

It is perfectly normal for the promoter to be properly rewarded for his services, provided he makes a full disclosure of all material facts of the contract.

5. **CONCLUSION**

The position of thepromoter seems to be precarious. The company until it is incorporated cannot contract with anyone neither can it enter into any binding agreement with third parties. The promoter comes in to effect all the preliminary contracts and later submits the expenses to the company to be reimbursed. The problem is, he is at the mercy of the directors, who may decide not to ratify the contract. Upon full disclosure he is entitled to be paid all preliminary expenses, but if he is not paid he continues to be personally liable to third parties. While it is possible for the company to benefit from the preliminary contacts, it will be unconscionable for them to refuse to ratify the contract, and the law ought to state clearly that in cases where the company had benefitted from the contract the company must ratify the contract or the act of benefitting should be tantamount to ratification.

6. SUMMARY

The promoter can only escape liability by making full discourse of all material facts of all preliminary contracts entered into on behalf of the company. The company on being aware of any anomaly in the promotion may rescinded the contract and demand for their money if they had invested any money, or refuse to honor the contract, in which case, the promoter will be personally liable. Rescission must be done immediately the company becomes aware of the anomaly and must not delay, if not rescission will no longer be possible. Where a third party bona fide without notice acquires interest in the contract, the company cannot rescind and where *restitutio* in*integrum* has become impossible, the company can no longer rescind. The company may also claim for damages, or recover any secrete profit made by the promoter. Upon full disclosure (see section 62) the company may then ratify the contract and before which the promoter continues to be personally liable.

6. TUTOR MARKED ASSIGNMENT

Discuss the current position of the law on duties of promoters, and howa promoter may recover his promotion expenses.

7. REFERENCES/FURTHER READING

1. Joseph Gold (1943) 'Liability of Promoters for Secret Profit in English Law, 1943, 5 Toronto L.J 21
2. Joseph Gross, 1970, Who is a Promoter, 1970, 86 LQR 493.

MODULE 5 UNIT 1

PRE INCORPORATION CONTRACTS I.

8. INTRODUCTION
9. OBJECTIVES
10. MAIN CONTENT
11. CONCLUSION
12. SUMMARY
13. TUTOR MARKED ASSIGNMENT
14. REFERENCES/FURTHER READING

1. INTRODUCTION

It may be difficult to set a company going after incorporation without making adequate arrangement before its incorporation. Issues like consulting and paying for incorporation expenses, renting or buying of office space, raw materials and other initial requirements for the smooth take off of the newly incorporated company. Therefore certain preliminary agreements have to be made pending the formation of the company. The company having not being formed is not yet a legal personality and so cannot enter into any contract. The issue we have to look at in this unit is to discover how the promoter may legitimately enter into a contract on behalf of a non-existent company, i.e. before incorporation, and how the company may be bound by the said pre incorporation contract. In this unit we shall examine the common law position and in the unit 2 we shall look at the legislative intervention.

2. OBJECTIVES

At the end of this unit the student must be able to discuss the common law position on pre-incorporation contracts.

2. MAIN CONTENT

A company comes into existence only after incorporation and after its certificate of incorporation has been issued by the Corporate Affairs Commission. Prior to that date like a child its not yet born, it is not alive, so nothing can be done on its behalf, and if done cannot be binding on it since it does not exist. As we explained above, as part of its incorporation process the promoters may need to enter into contracts that will assure a smooth take off of the company upon incorporation. The issue therefore is whether the promoter can avoid being held responsible personally for these pre-incorporation contracts since it was contracted on its behalf and for its benefit. Common law simply applied the well-known principles of agency and contract to the issue.

In the law of contract, it is a fundamental principle of offer and acceptance that a party must be in existence in order to enter into an agreement. You cannot pretend to contract with a non-existent person. See Rover International Ltd v Cannon Film Sales Ltd (No. 3) (1989) 1 WLR 912. We may argue that after incorporation the company should be bound by the pre-incorporation contract made on its behalf, but the fact is that since at the time of pre-incorporation contract, the company does not exist, upon its incorporation it remains a stranger to the contract, and the doctrine of privity of contract will operate to prevent rights and liabilities being conferred or imposed on the company. *Kelner v Baxter* (1866) 2 QB 174.

Under the Laws of Agency a person cannot be an agent of a non-existent principal and so a company cannot acquire rights or obligations under a pre-incorporation contract. These two principles were used and applied in the decision in Kelner v Baxter supra.

A company was being formed to buy a hotel from K. At a time when all concerned knew that the company had not been formed, a written contract was made "on behalf of the proposed company by A, B & C for the purchase of wine from K. the company was incorporated and the wine handed over to it and it was consumed – but before payment was made, the company went into liquidation. The company had ratified the contract before it went into liquidation. The promoters, as agents, were sued on the contract. They argued that liability under the contract had passed by ratification to the company. Erle C. J rejecting this argument and holding the promoters personally liable said that:

'I agree that if (the hotel) had been an existing company at this time, the persons who signed the agreement would have signed as agents of the company. But as there was no company in existence at the time, the agreement would be wholly inoperative unless it washeld to be binding on the defendants personally … and a stranger cannot by subsequent ratification relieve (them) from that responsibility. When the company came afterwards into existence it was totally a new creature, having rights and obligations from that time, but no rights or obligations by reason of anything which might have been done before. There must be two parties to a contract and the rights and obligations which it creates cannot be transferred by one of them to a third person who was not in a condition to be bound by it at the time it was made." at p. 183.

It follows therefore, and as Erle C.J explained, that where a contract is signed by one who professes to be signing "as agent" but who has no principal existing at the time. The contract will be altogether be inoperative, unless binding on the person who signed it, he is bound thereby, and a stranger cannot by subsequent ratification relieve him of that responsibility. Similarly in the case *of Caligara v Giovanni Satori & Co. Ltd* (1961), 1 All N.L.R 534, in the case, S obtained a cheque of N800 from plaintiff as loan in the name of and before the defendant company was formed and incorporated. The plaintiff now sue the company for recovery of the loan and interest arguing that the company had ratified the loan agreement. In a regrettably short judgment, Sowemimo J (as he then was) held that a company is not bound by contracts purporting to be entered into on its behalf by its promoters or other persons before it's incorporation. The company cannot, after incorporation, ratify or adopt any such contract because there is in such cases no agency and the contract is that of the parties making it."

Neither the person who purports to make a contract on behalf of a proposed company, nor the company after its formation, have any contact rights under a pre-incorporation contract. A company cannot ratify or adopt an agreement entered into before its incorporation. *See Shonibare and the National Investment and Properties Company* v *Mansour* (1963) LLR 1*, Stephen v Buildco (Nigeria) Ltd* (1968) 1 All NLR 188.

Moukarim Metal Wood Factory Ltd v Durojaiye (1976) ALR (Comm) 264. In fact, there are cases where the promoters who entered the pre-incorporation contracts are the same people constituting the board of directors of the company, the company will still not be bound by the pre-incorporation contract.*Stephen v Buildco Nig. Ltd* (supra). There is authority for saying that a company may be bound by pre-incorporation agreements. In the case of *Firgos Nig. Ltd v Zetters Nig. Ltd* (1965) All N.L.R 113 where the company adopted a running account covering goods supplied before and after its incorporation, it was held that the company was estopped from denying their liability on the pre-incorporation transaction. The only rationale for the decision would be because the expense accounts had been for both pre-incorporation and afterwards, the accounts had been mixed up and part payments had been made leaving only an outstanding balance. In the case of *Natal Land Colonisation Co* v *Pauline Colliery Syndicate* (1904) AC 120. The court adhered to the rule laid down in Kelner v Baxter and held in an action to enforce an agreement for lease made before the company was incorporated between Natal company and Mrs. Colliery acting on behalf of the company. The company cannot enforce a contact made or its behalf before incorporation. The company wish to ratify the contact in order to obtain the benefit of a contract purporting to have been made on its behalf before the company came into existence and there was no new contract made with the company after incorporation on the terms of the old contract .

In effect, the company cannot adopt or ratify a pre-incorporation contract, in as much as it was not in existence as at the time the contract was made. The company cannot therefore claim any right or benefit on the contract neither could it be sued on it. However, the company is free to make a new contract in the same terms as the pre-incorporation agreement. In this case, the court will enforce the new contact; even if it was the same as the pre-incorporation contract. *See Edokpolo& Company Ltd v Sem-Edo Wire Industries Ltd* (1984) 7 S.C. 119.

The promoter will only be held personally liable where he had entered the pre-incorporation contact on behalf of the yet to be incorporated company. Where the promoter entered a contract in the name of the non existent company the contract will be void and a nullity. *See Newborne v Sensolid Co. Ltd* (1954) 1 QB 45.

In this case, Newborne was forming a company but before it was formed, a contract was signed which purported to be made by the company for sale of goods to the defendants. It was singed "Leopold (London) Ltd" and underneath it was the signature of Leopold Newborne: when market fell the buyers refused delivery and writ was issued by the company , but when it was found out that as at the time of the contract the company had not been registered, the name of Leopold was substituted as plaintiff. It was held, that the company cannot enforce the contact as he had not purported to sell as principal or agent. As the company was not in existence as at the time of the contract, and it was not signed by the promoter, the signatory was not in existence and unknown, therefore the contract was a nullity.

After incorporation a company may effectively enter into a new agreement to carry out its pre-incorporation agreements. See *Re Northumberland Avenue Hotel Co* (1886) 32 Ch. 16.

Edokpolo& Company Ltd v Sem-Edo Wire Industries Ltd (supra)

4. CONCLUSION

The rule on pre-incorporation contracts is consistent with the law on privity of contract and agency principles. The rules forms the underlying basis for the rule laid down in Kelner v Baxter that the company cannot adopt or ratify a pre-incorporationcontract made on its behalf; that any such contract can only bind the parties to it as the company is not yet in existence and therefore is not a party to the transaction. The company could not ratify or adopt it simply because as at the time of the contract it could not have authorized it. Where the contract was made in the name of the company, then the contract is a nullity.

5. SUMMARY

The rule laid down in Kelner v Baxter originated from two different principles of law, these are from contract, that anyone who is not a party to a contract cannot enforce such contract, while the principle of agency adopted is that on agent cannot represent a non-existent principal. It follows that where a contact is entered on behalf of an unregistered company, it is the parties to such contact that will be held liable on it and no more. The company cannot be held liable for pre-incorporation contract neither can it enforce it. The result is that the common law position may work hardship not only on third parties who had contracted with the promoters with an assurance that they will be paid by the company upon incorporation. In cases where the company has taken the benefit and refuse to pay, the law had remained rigid, that in as much as there was no company in existence at the time of contract, the contract is only enforceable against the parties. This rule will work hardship also on the company, as it cannot enforce the contract that had been made on its behalf and which is beneficial to it. So also the promoter who entered the contact to benefit the company will also be placed at a disadvantaged position, as he may have innocently done everything in order to ensure that the company is starting on a good footing. The position of common law is totally rigid as we have seen. In some cases we may argue that we should be able to appeal to equity to intervene but equity is not allowed to intervene. See Karibi – Whyte JSC in Edokpolo Ltd. (p. 613). See also KunleAina, 2006, "The Statutory Status of Pre-incorporation Contracts in Nigeria Resolved and Unresolved Issues, U.I.J. P.L, Vol. 5, 2006 page 154.

The stage is therefore set for the legislature to intervene in order to ensure equitable solution to the injustice that the principle has occasioned.

6. TUTOR MARKED ASSIGNMENT

Discuss the common law position on pre-incorporation contracts.

7. REFERENCES/ FURTHER READING

1. KunleAina, 2006, The Statutory Status of Pre-incorporation contracts in Nigeria: Resolved and Unresolved issues, N.I.J. P. L, Vol. 5, 2006 page 154.

MODULE 5 UNIT 2

1 1 INTRODUCTION

2 OBJECTIVES

3 MAIN CONTENT

4 CONCLUSION

5 SUMMARY

5.TUTOR MARKED ASSIGNMENT

6 REFERENCE/FURTHER READING

1. INTRODUCTION

The common law position has remained unchanged since the over 100year old rule was laid down in the case *of Kelner v Baxter* which seemed not only to declare and uphold the common law position but also retarded the development of the law in this area. The rule as we have seen has worked untold hardships both in the company and to outsiders, or unwary third parties who may have innocently contracted with promoters of the company with the assurance that they are actually contracting with the company. It also works hardship on the promoter who had assisted the company to enter into pre-incorporation contract with the third party on behalf of the company with the aim of getting the company to ratify the pre-incorporation contract. The obvious solution is for the legislature to intervene and make the necessary amendments.

2. OBJECTIVES

At the end of this unit students should be able to critically examine the position of the law on pre-incorporation contract under the Companies and Allied Matter Act.

3. MAIN CONTENT

The law obviously does not help businessmen and does not accord with current economic realities. Only the legislature is capable of effecting any change in this area of the law. The wind of change started moving all over the world and most jurisdictions have changed their laws to accord with social and economic realities. Section 13(1) of the Ghana Companies Code 1963 has abolished the rule laid down in Kelner v Baxter and has made ratification possible contrary to the position under common law which do not allow the company to ratify pre-incorporation contracts.

In Europe, Section 9(3) of the European Committees Act 1972 (see also Article 7 of the First Company Law Directive, and Section 36 of the Companies Act 1985 UK, and now section 51 of Companies Act 2006 UK. which provides that,

> *"A contract which purports to be made by or on behalf of a company at a time when the company has not been formed, has effect, subject to any agreement to the contrary, as one made with the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly."*

Davies is of the opinion that the aim of the provision, which is in line with the first directive, is to increase security of transactions for third parties by avoiding the consequences of the contract with the company being a nullity. See Davies, 1997, Gower's Principles of Modern Company Law, Sweet and Maxwell International London) p. 142 see also section 72(2) of Companies and Allied Matters Act 1990.

In Nigeria the legislature took the opportunity of the global trend to reform the law. This is that by enacting section 72(1) of the CAMA which provides.

Any contract or other transaction purporting to be entered into by the company or by any person on its formation may be ratified by the company after its formation and thereupon the company shall become bound by and entitled to the benefit thereof as if it has been in existence on the date of such contract or other transaction and had been a party thereto.

Section 72(1) has finally abolished the over one hundred year law as laid down in *Kelner v Baxter*, and has also made some improvements which needs to be examined. In the first instance, the law acknowledged the common law distinction between the rule laid down in *Kelner v Baxter* and that of *Newborne v Sensolid (Great Britain) Ltd*. The party contracting may have contracted on behalf of the unformed company or he may contract by himself as an agent to the unformed company. In the Newborne's case, it was held that where the promoter singned on behalf of the proposed company, the promoter will be personally liable, but where the promoter merely wrote the name of the unincorporated company as the contracting party and signs for it, then, the contract is a nullity and unenforceable. In the case *of MoukarimMetal Wood factory Ltd v Durojayie (1976) 1 A.L.R (Comm). 264, the court held inter alia.*

"In the present case, it is clear that the plaintiffs believed at the time of the negotiation and up till the time of the sale and delivery of the goods in question, that the real purchasers were Messrs. Durmaking& Co. Ltd… on the other hand, it is equally clear that the defendant entered into the contract for the purchase of the goods in question, M.A. Durojaiye& Co. Ltd before the incorporation of that company. In the circumstances the company is not bound by the said contract and cannot therefore be sued on it unless a new contract to the effect of the previous agreement is established."

The distinction which hitherto has introduced some difficulties in this area of the law has now been resolved. There is no distinction again between the two situations. At common law, if the parties intend to contract with non-existent company, the result will be a nullity, the third party is left without remedy. Under the statute, a contract which purports to be made with the company will only render the promoter personally liable.

Ratification

Ratification has been used interchangeably with adoption, see((1976) 1 ALR (Comm) 264.) The effect of ratification will be to make the company adopt as its act, or authorized act something that was done before its incorporation. This we must note is not possible under the common law, as the only option available under the common law is for the company to enter into a fresh agreement on the same terms with the pre-incorporation contract, failure to do this; the company cannot enforce the contract and is not binding on it. As we have explained, this works injustice on the parties as well as the company. The statutory modification now allows the company to ratify the pre-incorporation contract which will have the effect of not only rendering the contract enforceable by or against the company, it now becomes the act of the company and dates back to the period when the company has not been incorporated.

The company must first ratify the contract before it becomes binding on it. How this is to be done is not specified in the Act. However, in contract, ratification may be express or in writing or by implication. In the case of companies, ratification may come in various ways, and therefore there is no specified method, each company is allowed to adopt its own style so far as the intention is clear and unambiguous. The directors may simply write a letter to confirm and ratify a pre-incorporation agreement. The company may pass a resolution at a meeting regularly convened by the company. It may be done by the Board of Directors resolution communicated to the parties ratifying the contract. In order to streamline the position and remove ambiguities, the law ought to specify a particular method. Where for instance the articles allow and even ratifies the pre-incorporation contract, will this amount to proper ratification under the law?. We may need to await judicial interpretation.

Another issue we may need to clear is the apparent conflict in the provisions of section 37 and provides that the company comes into existence only after its incorporation and cannot acquire contractual liability until then. However, section 72(1) makes ratification to date back to pre-incorporation period. The conflict must be resolved in order not to render the good legislative motives useless. (C.K. Agomo, the Status of Pre-incorporation Contracts, in Akanki (ed) Essays on Company Law p.73 at 87 has suggested and I agree with her, that the addition of the phrase, "and notwithstanding any other provisions to the contrary in this or any other statute." To section 72(1) to clear the conflict between the two sections.

The time frame within which the ratification by the company should be done ought to have been clearly specified in the law. Ratification ought to be done within a reasonable time and if the transaction is not ratified by the company then the promoter will be held personally liable. This is important, as, if the company is allowed to ratify at any time, it will work injustice on the third party and may lead to uncertainty as to who to be held liable. The position of the law is that until the company ratifies, the promoter will continue to be personally liable, and immediately the company ratifies the personal liability of the promoter terminates.

Further, the concept of corporate personality is well entrenched in the law. Section 72(1) provision is capable of being used for fraudulent purposes. If the promoter enters into a transaction on behalf of a yet to be incorporated company and later incorporates a company which thereafter ratifies the pre-incorporation contact, the promoter will cease to be liable and the company assumes liability, and at the end of the day if it turns out to be a shell, it leaves the third party with nothing to rely upon. In cases like this the only option is for the court to lift the veil of incorporation in order to strike at the people behind the company.

Section 72(2)

The sub-section provides,thus,

Prior to ratification by the company, the person who purported to act in the name of or on behalf of the company shall, in the absence of express agreement to the contrary be personally bound by the contract or other transaction and entitled to the benefit thereof.

The sub-section has removed any ambiguity as to who will be liable on pre-incorporation contract pending a formal or proper ratification by the company. The promoter will continue to be bound thereby. The only saving grace provided in the exempted from personal liability where there is an express agreement entered into for this purpose. The meaning and scope of this provision was subjected to considerable scrutiny by the Court of Appeal in England in the case *of Phonogram Ltd v Lane* (1982) QB 938 Lord Denning MR, with whom Shaw LJ agreed, that the phrase "subject to any agreement to the contrary" (in the section 51 of the 2006 Companies Act UK) means that in order for a promoter to avoid personal liability the contract must expressly provide for exclusion of his liability. The court also held that it is not necessary for the putative company to be in the process of creation at the time the contract was entered into.

We must note that since the company is yet to be incorporated, the contract can only be with the third party contracting with the promoter on behalf of the unincorporated company. However, unless there are other guarantees practically, it may be difficult for a contracting third party to enter into an agreement excluding the promoter from liability. A welcome provision in our law is that section 72(2) clearly makes it possible for the promoter to enjoy the benefit of the contract. This is how it should be, where the promoter is personally bound by the contract, then he should also be able to enjoy the benefits of the contract. It follows that the promoter may also sue to enforce the contract with the third party notwithstanding that his initial intention was to contract on behalf of the yet to be incorporated company. In the case *of Braymist Ltd v Wise Finance Co. Ltd* (2002) 1 BCLC 415 a firm of solicitors contracted as agents on behalf of a company yet to be incorporated in which the promoter agreed to sell land to property developers. Subsequently, the developers changed their minds and the solicitors sought to enforce the contract. The issue before the Court of Appeal was whether a person acting as agent of an unformed company could enforce a pre-incorporation contract under section 51 (Companies Act 2006 U.K) the court, affirming the decision of Eherton J, held that although the terms of the first directive referred only to liability and not to enforcement, it did not follow that section 51 was similarly limited in scope so as to prevent enforcement of contracts made by persons on behalf of unformed companies. The majority found that the words in the section, 'and he is personally, liable on the contract accordingly' did not operate to negative this view, but rather the phrase merely serves to emphasize the abolition of the common law distinction between agents who incurred personal liability on pre-incorporation contracts and those who did not. The provision is therefore two edged, the party that is personally liable for the contract is also capable of enforcing it, The Nigerian position is therefore preferableand removes every ambiguity, while the section 51 of the 2006 U.K Act does not specify whether the promoter can enforce the contract or not, the Nigerian legislation by virtue of section 72(2) clearly states that the promoter is entitled to the “benefit thereof”. In effect the promoter continues to enjoy all the beneficial interests in the contract; he may even assign or sell the benefits to another company. The resultant effect is that it becomes a double edged sword, the third party cannot withdraw from the contract as well, and it is binding on them. In the words of Latham L.J in *Baymist Ltd v Wise Finance Co. Ltd* (supra)

> *“I would accordingly hold that the solicitors are entitled to rely upon section 36c (now section 51) in order to enforce the contract in the present case. In my judgement, this produces a just result in that there is no good reason why the defendant should be entitled to resile from their obligations under the contract as a result of a pure technicality when in truth they wish to do so because it proved a bad bargain.”*

4.CONCLUSION

The objective of section 72 is to protect third parties who contracted with the promoters in the belief that they were contracting with the company, by making the promoters personally liable for the contract unless there is express exclusion of liable. The common law position is now substantially modified and amended. The promoter will not only continue to be personally liable but he is also entitled to the benefit of the contract.

5. SUMMARY

A pre-incorporation contract has for long suffered under the old rule laid down in *Kelner v Baxter*. This type of contract, instead of being treated as sui generis was regarded as any other contact, so it was difficult to understand its peculiar nature. As the law stands today, the section 72 was introduced in Nigeria to modernize our law and the section has successfully changed the common law position and brought the Nigerian law on pre-incorporation contracts to the position now widely accepted all over the world.

6. TUTOR MARKED ASSIGNMENT

Examine critically the current position of the law on pre-incorporation contract.

7. REFERENCES/FURTHER READING

1. KunleAina, 2006, "The Statutory Status of Pre-incorporation contracts in Nigeria Resolved and Unresolved Issues, U.I. P. J. L. VOL. 5, p. 154.
2. Gross, 1971, 'Pre-incorporation Contracts' LQR 367
3. Green, 1984, 'Security of Transaction after Phomogram MLR 671
4. Digman& Lowry, 2009, Company Law, Oxford University Press, 5th ed.
5. Davies.

MODULE 6 UNIT 1

MODULE 6 UNIT 1

ULTRA VIRES DOCTRINE 1

1. **INTRODUCTION**
2. **OBJECTIVES**
3. **MAIN CONTENT**
4. **CONCLUSION**
5. **SUMMARY**
6. **TUTOR MARKED ASSIGNMENT**
7. **REFERENCE/FURTHER READING**

1. **INTRODUCTION:**

The company being an artificial person must act through its designated officers and human agents. If the argue of the company (the general meeting and directors) make a decision we can say that the decision is an act of the company.

However, the decision must be warned out by the individual human agents of the company. Where this agent perform their duties within the scope of their authority. It is possible that the company is not empowered to do the act in the memorandum of association. The memorandum is the document that specifies the type of businesses or activities that the company may legitimately embark upon, where the company therefore does any other business or actively not within the objects clause of the memorandum it is regarded as ultra vires of the company and the law regards such act as a nullity. There has been much modification and amendment to the human law position by legislation. In this unit therefore we shall discuss the common law position on ultra vires doctrine.

OBJECTIVES

At the end of this unit the student should be able to discuss the common law position on ultra vires doctrine.

MAIN CONTENT

Memorandum of Association can be described as the constitution of the company at the company is required to state the name of the company, its objects (known as the object clause) the share capital, the location of the company. The memorandum of association like other documents of the company, must be registered with the corporate Affairs Commission (CAC) before incorporation, once registered the memorandum becomes a public document and may be viewed by anyone who wish to find out about the activities and powers of the company; the business nature of the company and its powers. (See 1 section 35(1) CAMA).

In terms of the relationship between the memorandum and the Articles of Association, the articles are subordinate to the Memorandum of Association, where there is a conflict between the memorandum of Association and the articles, the provisions of the Memorandum will prevail. In effect the articles cannot modify the Memorandum of Association. *In the words of Anyaegbunam C5 in the case of Kehinde v Registrar of Companies (1979) 5 F.R.C.R. 100 at 106.*

There are some fundamental differences between the Memorandum and Articles of Association. The Memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions for the protection of creditors, the outside public and also for the regulations of the company.

The <u>ultra vires</u> doctrine.

Anybody planning to deal with a company must be interested in the capacity and powers of the company. The capacity and powers of the company are spelt out in the

Memorandum of the company. Anything outside the object clause cannot be done by the company as the company exist only for the matters within the object clause, whatever therefore is not within the objects of the company as stated in the objects clause is therefore ultra vires the company or it is beyond its powers and it is illegal for the company to do it. This doctrine was laid down in the case of *Ashbury Railway Carriage &Imen Co. v Riche (1875) LR7 H.L.* in the case, the objects of the company are to make and sell or lend or hire railway carriages and wagons, and all kinds of railway plants, fittings, machinery and rolling stocks, to carry on the business of mechanical engineers, and general contractors, to purchase, issue, work and sell, mines, minerals, or other materials and to buy any such materials on commission as agents. A contract to finance the construction of a railway in Belgium was entered into by the directors, subsequently, the company repudiated the contract and pleaded it was ultra vires when sued, the court held that the company was not liable the contract was ultra vires the directors and the company and since it was therefore void and not voidable the whole body of shareholders could not ratify it. Lord coirns in his judgment said;

"This contract was entirely, beyond the objects in the Memorandum of Association….it is not a question of whether the contract ever was ratified or was not ratified. If it was a contract void at its beginning, it was because the company could not make the contract. If every shareholder had said "that is a contract which we desire to make, which we authorize the directors to make, to which we sanction the placing of the seal of the company; the case would not have stood in any different position from that in which it stands now, the shareholders would have been attempting to do the very thing which the Act of Raiment, they were prohibited from doing".

BASIC OF THE RULE:

The rule existed before the House of Lords decision in the *Aslibury Railway Carriage* ***and Iron Co. v Riche (supra)*** **but it was only applicable to statutory corporations. These are corporations established under their specific legislations. In the case of** ***Coleman v Eastern Countries Railway Co. (1846) 10 Beaver 114*****.**

The directors of a railway company for the purpose of increasing the traffic proposed to guarantee certain profits and secure the capital of an intended steam packet company who were to act in connection with the railway. Plaintiff sued on behalf of himself and all other shareholders restraining the directors from committing a breach of trust. It was held, that such a transaction was not within their powers and they were restrained by injunction. That in such case, one of the railway shareholder was entitled to sue on behalf of himself and all the other shareholders except directors who were defendants although some of the shareholders had taken shares in the steam packet company.

See also <u>Salavah</u> v <u>laing</u> (1847) 12 Beaver 339.

The rule was not applied to incorporated Joint Stock Companies because they were then regarded as partnership when Joint Stock Companies became limited liability companies, the court found the need to apply the rule to Joint Stock Companies. Section 2 of the 1862 companies Act under which companies were registered then prohibited alteration of the Memorandum of Association. The point is that since the legislature particularly provided that the object clause cannot be altered, it follows that you cannot do what the law has prohibited.

The doctrine was said to be necessary for the protection of investors who might be investing in the company, so that someone who invested in a food company will not found himself in hotel business. The second rationale had been that it is necessary in order to alert and notify third parties dealing with the company to know the scope of the business of the company. In short, the rule is necessary for the protection of both investors and creditors. Lord coirns in the Ashbury Railway case, explain the position at p. 667-8,

"The provision under which that system of limiting liability was inaugurated were provisions not merely perhaps, I might say not mainly, for the benefit of the shareholders for the time being in the company but were enactments intended also to provide for the interests of two other very important bodies. In the first place, these who might become shareholders in succession to the person who were shareholders for the time being, and secondly, the outside public and more particularly these who might be creditors of the companies of this kind".

Lord Rarker in the case of *cot nan v Brougham (1918) A.C. 514* also explain the rationale for the ultra vires rule, when he said,

"In the first place, it gives protection to subscribers, in the second place, it gives protection to persons who deal with the company and who can infer from the companies object the extent of the companies powers"

How Does the Rule Really Protect the Two Classes Persons?

It is not easy to demonstrate how the rule protect these two classes of people the reason may well be that in an allegation of ultra vires, it is not necessary to prove that investors and creditors will be injured if the act is not prevented . But in cases where ultra-vires activities only come to light especially during Inquisition may lead one to suggest that ultra vires transactions may contribute to problems in the company. However as we will learn later, the so called protection offended these closes of persons are not really protection but has became a nuisance to the company and mainly a trap for the third parties dealing with the company.

In relation to the internal management of companies, application of the rule can prevent abuses that is, the doctrine provides sufficient control of directors powers. There is a distinction between an act that is ultra vires the company in which case there can be no ratification and an act that is ultra vires the directors and within the powers of the company to execute, in which case the company may ratify if the director goes beyond his powers under the memorandum and articles of association in other words, an act which is ultra vires the director can be ratified but that which is ultra vires the company cannot be ratified. A company may have the capacity to do something but the doing of that thing may be ultra vires the director.

It is important to also note that there is a different between powers of the company and the objects of the company. The powers of the company is common to all companies and is recognized as the enablement offended by law in order to achieve the objects of the company instance, in the case of *introduction Ltd. v National Provincial Bank Ltd. (1969) 1 All ER 337.*

The company was formed for the purpose of providing facilities for overseas visitors to Festivals in Britain. The Memorandum contained diverse objects and powers. One sub-clause empowered the company to borrow money at it deems fit.and in particular by the issue of debenture. The company began pig breeding as its only business and borrowed money from its Bankers on security of debentures. The bank before taking the security was given a copy of the memorandum and article of Association and know that the sole business of the company was pig breeding. The company unit into compulsory liquidation. The Bank contended that its only obligation was to satisfy itself that there was an express knowledge that the activity on which the money was spent was ultra vires the company. It was held, that borrowing money was a power not an object since it could not stand by itself and powers could be exercised only for purpose intra vires the company, the company was then not entitled to borrow money for ultra vires purposeof pig breeding and as the bank know the purpose of borrowing, it could not rely on its debenture.

CONCLUSION

Historically, where there was some debtors to whether or transaction was authorized, two questions arose, first, was the act within the power of the company? If the answer was yes then we more to the second question, if the answer is no, the transaction was void and unenforceable – this could have very serious consequences; as we will see later. Second if the act was within the power of the company was the individual who contracted with the on behalf of the company authorized to do so? If they were, the transaction was valid but if not it was voidable at the instance of the company. As a result the area was full of uncertainly and danger for people who deal

with companies. The distinction between powers and objects may lead to a lot of injustice as we see in the introductions Ltd. case.

MODULE 6 UNIT 2

ULTRA VIRES DOCTRINE 2

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION:

Further to our discussion in unit I, the ultra vires doctrine as we have seen is simply that the company is not allowed to do anything that is not included in its object clause as it is not permissible for the company to engage in such business. It follows that whenever the company engages in any business not included in its objects clause it is regarded as ultra vires the company. The rule no doubt works severe hardship on the company as well as third parties. The rule itself has been said to be a protection for both the third parties and investors of the company, but exactly how this is done is not clear. In this unit we shall explore ways the companies have utilized in the past to avoid the rule and the response of the courts.

2.OBJECTIVES

At the end of this unit, the student should be able to explain the constructive notice rule and the attempts made by the companies to evade the ultra vires doctrine.

2. MAIN CONTENT

CONSTRUCTIVE NOTICE RULE

The constructive notice rule was established even before the ultra vires doctrine. It was based on the fact that the law made provisions for the registration of the memorandum and articles of associations of the company and other important documents. Once registered, this document constituted notice to the whole world. It followes that anybody dealing with the company must first take steps to inquire from the registered documents of the company, not only the permitted activities of the company but also the power exercisable by the organs of the company. The rule was clear that anyone dealing with the company was deemed to have notice of the registered documents which were regarded as public documents. This rule was evolved to protect the company shareholders and innocent investors, how this is done is doubtful. However, from the authorities, the rule only works hardship on third parties especially those dealing with the company in good faith.

The adverse effect of the constructive notice rule is exemplified by the case of *Re JonBeauforte (London) Ltd* (1953) Ch.131 ,the objects of an insolvent company was the manufacture of dresses but it deviated into the manufacture of veneered panels. The claims of the creditors of the company who supplied the raw materials for the panels were declared ultra vires because they have constructive notice of the objects of the company. Even the claim of a supplier of fuel which would have been used for intra vires activities, failed since the fuel was ordered on the company's note paper which read "veneered panel manufacturers." The court held that on that basis, the supplier had actual notice of the present business of the company.

The complication is that when the articles of association place certain limitations on the powers of directors, or where certain acts ought to be done by the General Meeting and it was not done such irregularities will be held void as it is contrary to the company's registered regulation and the third party is presumed to be aware of these self-imposed conditions.

"The result, therefore, of this constructive notice rule was that where the business being carried on by the company is known to the other party and whether he actually knew it or not, it is ultra vires,and he would be unable to sue the company. This rule worked injustice on third parties who deal with the company without reading the public documents of the company. To mitigate the injustice occasioned by the rule, the court introduced the rule in the case *of Royal British bank v Turqand*. By this rule, a person dealing with a company is bound to ascertain the public document of the company to see that the proposed transaction is not ultra vires. Having done that, he is entitled to assume that all matters of internal management have been complied with. This general rule is subject to some exceptions. The rule would not apply-

1. Where the third party knew or ought to have known of the irregularity.

2. When the irregularity results in the third party relying on a document which is a forgery.

3. When the third party has failed to make any investigation after being put on enquiry by unusual circumstances.

It is important to note that constructive notice rule has been abolished both in Nigeria (section 68 CAMA,) and the United Kingdom. The effect of the abolition of the constructive notice rule is discussion below.

EVASION THE ULTRA VIRES DOCTRINE

In view of its effects, the ultra vires rule could hardly be said to protect the creditors and shareholders of the company. Instead, it worked untold hardship on them and prevented the company from exploiting good business opportunities and advantages which might present itself to the company in the course of its business. (see O.O. Oladele, 1996, Reform of Ultra Vires Rule In Nigeria, Nigeria Current Law Review, 141).In effect just as the rule is beneficial to the company; it also works severe lordship On it, and if there is a profitable business opportunity which was not included in the object clause, the company will only be doing the illegal if it should do it, and the court may if called to do so nullify the action of the company should it embark or such business. If a creditor gives a loan or supplies any good to the company on ultra vires business, the creditor cannot recover his money if the company refuses to pay, and so it works against the company as well.

We must note however, that probably in realization of this hardship the courts have explained the rule that it is also a rule of construction of the objects clause of the memorandum of association and therefore if cannot be inherently rigid. Therefore the court created a relaxation to the rule. In the case of *A.G. v Great Eastern Railway* (1880) 5 AC 473. Here the House of Lords in England ruled that the ultra vires doctrine would be applied reasonably so that whatever may be regarded as reasonably incidental will be intra-vires to the carrying on of the company. In this case, the LTS Railway co. was authorized by statute to make Railway. The G.E. Rly Co. entered into a contract with the LTS to supply rolling stock to them. The contract was adopted by the shareholders of both companies. An injunction was claimed to restrain the G.E Rly from executing the contract as ultra vires. By statute both companies might enter into any contract or agreements for effecting all or any of the purposes of this Act", or any objects incidental to the execution thereof and every such contract might contain such covenants, clauses etc. as might be mutually agreed upon by the parties. It was held, that the contract was expressly authorized by the statute and was not ultra vires. Lord Selborne, said, "the doctrine of ultra vires ought to be reasonably and not unreasonably understood and applied. Whatever may fairly be regarded as incidental to or consequential upon, those things which the legislature has authorized ought mot (unless expressly prohibited) to be held by judicial construction to be ultra vires."

You may see also the decision of Bowen L.J *in Hutton v West Cork RailwayCompany* (1883) 23 ch.D. 654.

The law is that the act must be strictly incidental to the carrying on of the business as a going concern. In the Hutton's case, the court held thatwhere the company in liquidation passed a resolution to pay compensation to directors for their past services, that since the gratuitous payment were not incidental to and connected with the winding up nor the carrying on of the company's business as the company was no longer a going concern the transaction was ultra vires the company in the winding up and the resolution was invalid.

See *also Deuchar v Gas Light and Company*. (1934) All 720

In the case of *Evans v Brunner Mond& Co. Ltd. (*1921) 1 Ch. 359. The defendant company was in business of a chemical manufacturing. Its objects clause gave an express power to do "all such business and things as may be incidental or conducive to the attainment of the above object or any of them. The company by resolution gave the directors authority to make a research grant out of the company's fund, to scientific institutions. A shareholder brought on action claiming that the payment was ultra vires. The court held that , The proposal was incidental or conducive to the attainment of the main object of the company, as the evidence was that the advantage to the company was substantial and not too remote and the expenditure was necessary for the continued progress of the company as chemical manufacturer. The resolution was not ultra vires.

The problem was how to decide what is reasonably incidental. This is more difficult when the company decides to stretch this liberal interpretation to justify gratuitous payment to employees, in the Hutton's case, Lord Bowen explained the position of the law when he said,

"the law does not say that there are to be no cake and ale, except such that are required for the benefit of the company. It is not charity sitting in the Board of directors qua charity. There is however a kind of charity dealing which is for the interest of those who practice it and to that extent and in that garb charity may sit at the board but for no other purpose"

Such payment is a gift and if allowed will amount to gratuitous payment of the assets of a company which will be unfair to creditors. Even if the directors have powers to expressly or impliedly make such payment, it will be ultra vires unless he can prove that it is reasonably incidental to the objects of the company or to achieving them.

see Re Lee Brechens& Company Ltd. (1932) 2 Ch. 46.

In this case, there was a power in a memorandum to make provision for the welfare of employees including former employees, their widow and children. Five years after the death of a former director, the company entered into a deed with his widow to pay pension to him annually. The company later went into voluntary liquidation. The widow asked for capitalization of the pension. The liquidator objected. The court upheld the liquidator's objection that the grant was ultra vires, it was a gratuitous payment and was not for the benefit of the company. Eve J. observed that there is no doubt that the company has power to make such arrangement but it must be reasonably incidental to the carrying on of the business of the company, and it being not provided for in the memorandum. EveJ, thereafter gave three tests that must be observed before the payment may be approved as intra vires, these are;

1. Is the transaction reasonably incidental to the carrying on of the company's business?
2. Is it bonafide?
3. Is it done for the benefit and to promote the prosperity of the company.

This case was followed in *Re Roith Ltd. (1967) 1 All ER 427*. The attitude of the court in those cases is rigid. *see also Parke v Daily News* (1962) 2 All ER 429. In the case such gratuitous payment was refused as it was not incidental to the carrying on of the business.

However, in the case of *Continental Chemist Ltd. v Dr. Ifeokandu (1966) 1 All NLR 1.*

The plaintiff company memorandum gave as its objects:

1. To import and export drugs
2. To buy and sell drugs
3. To manufacture drugs
4. To compound drugs
5. To enter into any business which the directors think will increase the profit of the company.

The memorandum also confers powers to borrow money; adding that the company can do all such business and things as may be incidental and conducive to the attainment of the above objects and powers or any of them."

The parties made a contract whereby the company agreed to educate the defendant to become a medical doctor and he agreed to serve and to practice under them on a certain salary. After he qualified, he practiced in their clinic. The parties fell out, and the defendant resigned and the company sued for breach of contract. The judge found the company was running hospital business which they had no power to do under their objects and dismissed their claim. They appealed on the ground that the contract was intra vires paragraph (v) and the final ancillary paragraph of the company objects. It was held, that the fair meaning of the duty to “serve and practice under the company was to practice as a doctor, paragraph (v) of the company’s objects (which spoke of any business which the directors thought would profitable was indefinite and useless. The objects do not include the employment of a Doctor to examine patients so there is no basis for using the ancillary powers in the final paragraph of the company’s objects. Appeal dismissed.

Though the rule is that the objects clause must be given a liberal interpretation, and a reasonable application of the doctrine, so that all matters that may be incidental to the objects, even if not specified may be allowed. In spite of the liberal interpretation, the courts are not prepared to allow anything that is not reasonably referable to the original objects. The businessmen refused to allow this kind of uncertainty. The practice grew that, instead of an incidental and reasonably interpretation, they will load the objects clause with all conceivable objects and powers. In effect, the objects many as possible, and the company may not even attempt some of the listed businesses, but it was to avoid the ultra vires doctrine. However, the courts provided a counter measure by providing what is known as the “**main object rule of construction**” out of a multiplicity of objects in a memorandum, the court will pick out the main objects and strike out others which do not fit in, this approach works fairly well in this way,

1. When the court discovers that the main object of the company is gone and the company had practically come to an end, the court applying the main object rule of construction will declare that the substratum of the company is gone.
2. The court might allow the company to be wound up on the ground that it is just and equitable that it be wound up.

The idea was that the investors and creditors put their money in the company for the purpose of the main object. This is due mainly to the old law in the 1862 Act which made the objects clause impossible to alter. Since it cannot be altered , then it was approved for the singular purpose in the objects and no more; this was done with the aim of protecting creditors and investors, so that they will know exactly the kind of company they are investing in, and not be taken by surprise.

See Re Crown Bank (1890) 44 Ch 684,

Re German Date Coffee Co. (1882) 20 Ch.D;

Re Kitson& Co. Ltd. (1946) 1 All ER 436.

The second way in which the main object rule of construction works is by applying the *ejustem generis rule* of the construction. Where a specified word is followed by a general word, the latter is deemed to be limited to the things of the kind already specified. In short; what the courts say is that subsidiary clauses that follow main object will be treated as incidental object which are meant to facilitate the carrying on of the main object.

The companies aided by lawyers, are not satisfied with the position and sought to evade this rule by the use of *"Independent Object Clause*." In the case of *Cotman v Brougham (1918) A.L 514,* a company's memorandum contained about thirty clauses dealing with a variety of businesses it will engage in. the clauses were drawn in such a way that the company could engage in anything at all e.g. it has power to acquire, hold and deal in shares, and what could be regarded as the main object was contained in the first paragraph and it merely authorized the company to develop Rubber Estate. To forestall the application of the rule, the memorandum concluded that 'each clause shall not be restricted or limited by the name of the company and that no clause shall be treated as subsidiary to the first clause." The House of Lords in England upheld the clause though general, as valid, and therefore any act based on it is valid.

In the case of *Anglo-Oversees Agencies Ltd. (1960) 3 All ER 344,* it was made clear that each clause as drafted in the *Cotman v Brougham* case is to be regarded as independent clauses and cannot be read together with other clauses.

Another way companies tried to evade the rule is by the use of *subjective clauses*." This clause gives the directors opportunity to decide on any type of business and whatever business they engage in, is within the objects of the company. In the case of *Bell Houses Ltd. v City Wall property Ltd (1965) 3 All ER 127.*, it was found out that the main object clause of the company according to the memorandum was the development of housing estate, three of the inflated objects clauses authorize the company.

1. The carry out any other trade or business which can in the opinion of the Board of directors be advantageously carried on by the company in connection with or ancillary to the general business of the company..
2. To acquire any of the property and assets for the time being of the company for such consideration as the company for such consideration as the company may think fits.
3. To do all such other things as are incidental or incidental to the above objects or any of them.

The Board of directors delegated management of the company to the chairman who thereby acquired substantial knowledge and skill in the sources of financial property developments projects. The company agreed to pay the chairman for his services, but refused to pay eventually, the chairman sued, and the company insisted that the agreement was ultra vires the company. At lower court, Mokatta J, agreed that the contract was ultra vires the company, and that the subjective clause was not useful.

On appeal, the court of Appeal in England, reversed the lower court's decision and the Ifeakandu'is case. The rationale for following the Mokatta J's decision with respect to the court is faulty. This is because, the fact that it is an independent clause that is being considered, the court ought to have considered the strict interpretation of the clause relied upon by the companies, and the only issue ought to be whether the agreement is permissible under the objects clause or not, if it was, then it cannot be ultra vires.

Wedderbun is of the view however, that the position taken by the court of Appeal is correct based on the proper interpretation of the objects, and inevitably the court has destroyed altogether the vitality of the ultra vires rule with a well drafted sub-clause permitting the company to engage in any business which in the opinion of the its director is advantageous and or profitable no one "need to worry about the doctrine any longer (wedderbum, 1966, Death of ultra vires, M.L.R 637).

The Jenkins committee was of the opinion that, "in consequence the doctrine of ultra vires is an illusory protection for the shareholders and yet may be a pit fall to companies, the ultra vires doctrine serve no positive purpose but is on the other hand, a cause of unnecessary prolixity and vexation." (Report On The Reform Of The Companies Law In England. Cwwd. 1749 p.10).we cannot agree more, the reason for so much effort in awarding the doctrine is simply because it has become an impediment to business and a trap to third parties; even before the legislative intervention, the doctrine has almost been rendered useless.

4. CONCLUSION

The doctrine of ultra vires has become a burden on the company, and trap to creditors and investors, the very parties the doctrine was said to have been laid to protect. There is now no other options than that the legislature use intervene to abolish the doctrine.

5. SUMMARY

We have learnt of various ways and means through which the businessmen aided by lawyers had tried to evade the doctrine of ultra vires. The courts too have ensured that the companies do not evade the rule. It is left for the legislature to intervene and streamline the position of the law.

6. TUTOR MARKET ASSIGNMENT

Discuss the various ways companies had tried to avoid the ultra vires doctrine and the position taken by the court.

7. REFERENCES / FURTHER READING

MODULE 6 UNIT 3

ULTRA VIRES DOCTRINE 3

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION:

Virtually all jurisdictions within the common wealth had at one time for the other amended the ultra vires doctrine, some had out rightly abolished the doctrine. In Nigeria, the law reform commission in its report on the reform of company law in Nigeria recommended abolition of the doctrine, but the law did not ultimately do so, but seemed to take a half way reform, which we will examine in this unit and discuss the position of the law under the Companies and Allied Matter Act.

2. OBJECTIVES

At the end of this unit the student must be able to discuss

1. Effect of provisions on alteration of the memorandum of association or ultra vires doctrine.
2. Effect of abolition of the constructive notice rule.
3. Effect of the provisions of CAMA on the ultra vires doctrine.

4. **MAIN CONTENT**

Alteration of the company's objects clause

As pointed out above, the foundation of ultra vires doctrine is the law prohibiting absolutely any alteration of the company's objects. However, the law has since changed in England and elsewhere. In Nigeria, for instance, Section. 45 and 46 of CAMA specifically allows a company to alter its objects by special resolution. In England, the now repealed Companies Act 1948 made provisions for the alteration of company's objects, while sections. 16 and 17 of the English Companies Act 1985 also permit, alteration of the memorandum of association by special resolution (subject to certain conditions).

The practical effect of all this in relation to the ultra vires doctrine is that in situations where the company decides to engage in seeming ultra vires transaction, and any party object's in court, and it isa transaction the majority intends to pursue they will simply ask for adjournment to regularize, their position, and pass a special resolution to this effect and therefore validates the action. In the event that the transaction is executed the issue is closed and cannot be set aside or invalidated.

The ability to alter the memorandum of association by special resolution therefore deals a devastating and serious blow on the efficacy of the Ultra Vires doctrine.

Effect Abolition of Constructive Notice Rule on Ultra Vires Doctrine

The constructive notice rule that those having dealing with the company are deemed to have notice of its public documents by reason of their registration has been abolished. See section 68 CAMA. Though under the common law, the rule was subject to certain limitations under the rule laid down *in Royal British Bank. V Turquand,* the rule was still in effect until the reforms in England, by virtue of Section 9 (1) of the European Communities Act 1972, which was later re -enacted as Section 35 of the Companies Act 1985, Section 711A of the Companies Act 1989 emphatically declares that;

"(1) A person shall not be taken to have notice of any matter merely because of its being disclosed in any document kept by the Registrar of Companies (and thus available for inspection) or made available by the company for inspection"

See also section 39 and 40 of the Companies Act 2006 UK.

While in Nigeria, Section 68 also specifically abolish the constructive notice rule and made a provision almost in pari material with the position in England, Section 69 of CAMA went on to declare that any person having dealings with the company is entitled to presume that the company's memorandum and articles have been duly complied with.

The result of all this is that those dealing with the company are no longer deemed to have notice of the contents of the registered documents of the company merely because it is one of the company's documents available for inspection at the companies registry. They are thus not disturbed with notice of any special conditions in the memorandum and articles of association. Section 68(6) of CAMA goes even further to state that third party dealing with any officer of the company is entitled to presume that such officers have "authority to exercise the powers and perform the duties customarily exercised or performed" by such offers. This provision in Nigeria is much more far reaching than the position in England, which limits the presumption to such parties dealing with the company in good faith, clearly, the abolition of the constructive notice rule is an expressway to the death of ultras vires doctrine.

Effect Of The Legislative Reforms On Ultra Vires Doctrine

S. 9(1) of the European Communities Act 1972 which was reenacted in England as S.35 of the Companies Act 1985 states. “infavour of a person dealing with a companies in good faith, any transaction decided on by the directors is deemed to be one which it is within the capacity of the company to enter into and power of the directors to bind the company is deemed to be free of any limitation under the memorandum or articles”

While the second subsection relieves the other party of any obligation to inquire about any internal matters.

One may criticize this section as being limited in scope and not courageous enough to out rightly abolish the Ultra Vires doctrine. Professor Dan Prentice who was commissioned to carry out a review, of the doctrine in England submitted a document referred to as, “Reform of the Ultra Vires Rule: a Consultative Document” had recommended that companies “should be afforded the capacity to do any act whatsoever and should have option of not stating their objects in their memorandum”. This position was not adopted. Rather the Department of Trade in England, by Section 110 of the Companies Act 1989 inserted a new S.3A as follows.

a) That statement that the company’s object is to carry on business as a “general commercial company’ means that its object is to carry on any trade whosoever, and.

b) That the company has power to do all such things as are incidental or conducive to the carrying on of any trade or business by it.

It also includes a new section which allows the company to alter its memorandum with respect to the object clause.

The effect of the above provision is to enable the company enter into transaction with outsiders without any limitation by the stated objects. In fact, all general commercial companies may carryon any business, and so may not state any object incidental or conducive to the carrying on of any trade or business by it. It follows that English jurisprudence may have progressively done away with the ultra vires doctrine without really making a declaration to this effect. However, the 1989 Act substituted a new S. 35A and 35B for S 35 of the 1985 Act, and states that,

"the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum."

This has been replaced by section 39 of the 2006 Act which is a verbatim replacement of the 1985 provision.

The effect of this provision on ultra vires rule is devastating, as there could be no challenge or opposition to ultra vires acts, neither could the company or third party dealing with the company be trapped or prevented from entering into any transaction merely because it was not included in the objects clause. Sub-section(2) however allows a member of the company to bring proceedings to restrain the doing of an act which but for subsection (1) would be beyond the company's capacity, but no such proceedings shall lie in respect of an act done in fulfillment of a legal obligation arising from a previous act of the company"

The ultra vires rule now operates internally and subject to the condition that the act was not in fulfillment of a legal obligation arising from previous act or contract by the company. It follows that an individual member may apply to the court to restrain the company from embarking on ultra vires Act, provided that such Act is not concluded? The question that may ensue is when is an Act concluded? We may say that when the agreements are signed, or where there has been part-performance for example supply of raw materials by a supplier to the company, and where the act is pursuant to a concluded contract the member cannot maintain on action. The section will seem to preserve the second exception to the Rule in Foss v Harbottle in this case the member may need to survive a lot of obstacles, which include the Rule in Foss v Harbottle itself. As it is, the rule will remain an internal rule in England until it is finally discarded.

In other parts of the Commonwealth, efforts have been made to review the law in Canada, by S.15 of the Business Corporation Act 1975, ‘a corporation is given the capacity of a natural person and vested with all the rights, powers and privilege of a natural person subject to the provisions of the Act. In the case of the Caribbean countries, the Caribbean Company Law provides that the objects and powers need not be, and are not included in the articles, and ‘a third party dealing with the company will always be put on his notice that he has to make further enquiries as to the business actually being carried on by the corporation, if he has any doubt. The ultra vires rule no longer has an effect in the Caribbean Countries. In Ghana, section 25 of the Ghana Company Code Bill prepared by Professor Gower, states’,

“A company shall not carry on any business not authorized by its regulations and shall not exceed the powers conferred upon it by its regulations or this code…” The law validates any ultra vires act in favour of a third party and the company.”

In Nigeria, the law Reform Commission, on the Reformation of Company law in Nigeria, recommended unambiguously that the rule be abolished. However, curiously, S. 39(1) provides.

(1) A company shall not carry on any business not authorized by its memorandum and shall not exceed the powers conferred upon it by its memorandum or this Act.

While Section 38(1). Provides that "every company shall, for the furtherance of its authorized business or object have all the power of a natural person of full capacity.The law settled the issue of power, but seem of have made contradictory provision in Section 39(1). It is submitted that Section. 39(1) is unnecessary, and a wrong assertion of a position that no longer exist. Though it is true it may be trying to save an exception to the rule in Foss v Harbottle, which in itself may not really be attainable given the conditions in the Section. 39 itself , but also under the Rule in Foss v Harbottle. Section 39(3) of the C.A.M.A states:

"Notwithstanding the provisions of subsection(1) of this section, no Act of the company and no conveyance or transfer of property to or by a company shall be invalid by reason of the fact thatsuch act , conveyance or transfer was not done or made for the furtherance of any of the authorized business of the company or that the company was otherwise exceeding its objects or powers".

Subsection (1) is therefore subject to subsection (2), subsection 4 allows only

(a) any member of the company or

(b) holder of any debenture secured by a floating charge over all or any of the company's property or by the trustees of the holders of such debentures, to maintain an action to restrain Ultra Vires Acts, just like the position in England, in Nigeria, Ultra Vires acts may now be restricted to only proposed actions, not executed or concluded acts, where they are concluded, no one can raise an objection on the ground of Ultra Vires again. The greatest hindrance to the member or debenture holder who wish to restrain the company in this case the majority from embarking on Ultra Vires action is power to amend by special resolution its objects to include the proposed act, and therefore the action by the company many not really be blocked by minority shareholders or debenture holder.

Unlike the position in England subsection (S. 39(5) allows the court to set aside and prohibit the performance contract that is Ultra Vires, while this subsection may seem to help the member of debenture holder opposing the proposed act, we submit that it does not prevent the company from embarking on any act, so far as it is able to summon the required majority to amend the objects. The subsection is however useful, as it enables the court to quantify any loss or damage to any party who may have suffered as a result of Ultra Vires Act, and so Ultra Vires Acts are no longer a nullity , and the company or the third party can no longer escape just obligations by hiding under the Rule.

5. CONCLUSION

Though s. 39(1) of CAMA will seem to preserve the Ultra vires Doctrine in Nigeria the combined effect of S. 39(3) and S 38 have destroyed totally its effect, and the rule may only be raised by a member and debenture holder, so that third parties and even the company may no longer contend that the act is Ultra vires and so avoid legal obligations. It is also very instructive to note that all executed acts are saved and shall remain unchallenged, under the Rule; while the Acts being challenged remains executory could be challenged on the ground that it is Ultra vires, but the company may regularize its position immediately and negative the objection, and where the company had used the subjective clause however, the action shall remain valid.

From the above analysis one may conclude that it may now be impossible to successfully use the doctrine of ultra vires to avoid legal obligations or trap anyone.

MODULE 7 UNIT 1

ARTICLES OF ASSOCIATION 1

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

INTRODUCTION:

The article of association are a set of rules governing the running of the company or rules framed by the members themselves regulating the way business of the company as defined in the memorandum of association shall be managed. The article of association must be read in conjunction with the memorandum so as to clear any ambiguity in the memorandum, promoters are free to decide the nature of thearticle the company shall adopt provided they did not include anything contrary to the general laws and the articles comply with the requirements of section 33 and 34 of the Act. In this unit we shall examine the position of the law on the effect of articles of association, the inter-relationship between the members and the company under the law.

3. OBJECTIVES

At the end of this unit the student will be ask to explain the effect of the articles of association.

4. MAIN CONTENT

A complete article of association of a public company must include the following:-

1. The way shares are to be issued and transferred
2. The way shares are to be forfeited
3. The way company meetings shall be conducted
4. Deal with appointments, power, and duty of directors and other officers.
5. Declaration of dividends, accounts, and winding up.

A form of articles of association is in the first schedule, Table A, part I of CAMA. Like the current position in UK, where there are separate form of articles for private and public company. In Nigeria there is a format for articles of association of both private and public companies (part I and part II).

Those setting up the company are free to draft their own set of rules but if they do not provide such a set; then the model articles will apply. In practice the model articles are generally adopted with some slight amendments. As a result, even though Table A is only a default set of rules its almost universal adoption has meant that it forms the core of organizational structure of Nigerian companies.

The most important function of the articles of association is to allocate the power of the company between the board and the general meeting. Historically this made the old Table A at 70 (1968 Act) the most important article as it provided that *, subject to the provisions of the Act, the memorandum and the articles and to any directives given by special resolution,* *the business of the company shall be managed by the directors who may exercise all powers of the company.*

This delegation of power is now found in section 63 of the CAMA.

The Effect Of Articles Of Association

Section 16 of the 1968 Companies Act, provided that*, subject to the provisions of this Act, the memorandum and article shall when registered bind the company and the members thereof to the same extent as if they respectively had been signed and sealed by each member and contain covenants on the part of each member to observe all the provisions of the memorandum and of the articles.*

The section 16 has now been replaced by section 41(1) which now provides as follows:

"Subject to the provisions of this Act, the memorandum and articles, when registered, shall have the effect of a contract under seal between the company and its members and officers and between the members and officers themselves whereby they agree to observe and perform the provisions of the memorandum and articles, as altered from time to time in so far as they relate to the company, members or officers as such."

It follows that the article and the memorandum when registered becomes a contractual document that is bindding between the members and the company. It also follows, that the business of the company must be conducted in conformity with the articles of association.

See Hicknan v kent or Romney MarshSsheep Breeders Association (1915) 1 Ch.881

The contract of membership

An important effect of the registered article is that if binds the members of the company and the company, and also created a contractual relationship between the members themselves and between each member and the company. The first point to note here is that the contract may be altered or amended by special resolution at any time by the members. It follows that, new members are immediately bond by the articles once they join the company. Since they can be altered at anytime by special resolution, they may not be in control of the articles of association. The articles therefore bind those people who are not privy to it, as it binds future shareholders. The reason for this unusual contract was that the law tried to bridge the changeoverbetween the deed of settlement companies and the new registered company formed under the joint stock companies Act 1844. The practical problem for the legislature at the time was that, while the old Deed of Settlement company created a contractual relationship between the members who sealed it; the new constitutional default documents would not. The answer was to create an artificial contract which would automatically bind all the members of the company. The section, apart from binding the members and the company together allows shares to be freely transferable by avoiding the need for each member to formally agree to be bound by the constitution each time shares are traded. This avoids the difficulties of having to renegotiate the contract each time shares charge hands.

A Contract Between The Company And The Members.

The history of the effect of article has remained unchanged from the Act of 1844 to section 16 if the companies Act 1948 which is in parimateria with the S16 of the companies Act (U.K) which is almost uncharged in terms and its effect in the S33 of the companies Act 2006 (U.K). The Nigerian provision is section 41 of the companies and Allied Matter Act

1990 which has introduced some innovations into the law, which we will examine later. The original section did not take cognizance of the fact that the company is an entity when it provided that the article forms a contractual document between the company and the members of the company. The courts have interpreted the section in series of cases that the company is a party to the contract. The classic case on this point is *Hickman v Kent or Romney Marsh Sheep Breeders Association (supra)*in thecase, by the article of association of the company, any dispute between the members of the company must be referred to arbitration in the first instance. Dispute arose and he commenced an action in court.

The company applied to the court for a stay on the grand that they were both bound to refer the matter to arbitration in the first instance. The court ordered a stay. That the true interpretation of the apparently conflicting decisions and dicta on the section are that "*though the article of association can neither constitute a contract between a company and an outsider nor give any individual member special contractual rights beyond those of the members generally they in fact constitute a contract between a company and its members in respect of their ordinary rights*." The article was therefore, contractually binding between the members and the company.

4.CONCLUSION

The contract in the articles of association is binding on the company and the members of the company. While it may be understandable as between the current members or subscribers who actually signed the memorandum and articles of association it may be difficult to understand why it should bind those who are not originally privy to the contract. The article is enforceable by the member against the company, and the company on the other hand can insist on it being obeyed by the members, even if it was not directly signed and sealed by them.

5 .SUMMARY

The article of association is a document regulating the way the company is managed. It contains provisions on issues like shares, voting, meetings, appointment and reveal of directors, powers of the directors, etc. the article is drafted by the promoters and may adopt the model article in part A of the schedule to the Act. The article represents a contract between the company and the shareholders and is enforceable by either of them to ensure that the provisions of the article must be complied with.

TUTOR MARKED ASSIGNMENT

Critically examine the effect of the article of association as between the company and the members.

REFERENCES/FURTHER READING

MODULE 7 UNIT 2

ARTICLES OF ASSOCIATION II

1. INTRODUCTION
2. OBJECTIVES
3. MAIN CONTENT
4. CONCLUSION
5. SUMMARY
6. TUTOR MARKED ASSIGNMENT
7. REFERENCE/FURTHER READING

1. INTRODUCTION:

The article of association is binding between the members and the company, and between the members inter se; i.e. between the members with each other. We may need to look closely at this peculiar contractual obligation and determine to what extent and what basis will this be practicable we also have to look closely at the position of outsiders to the contract and who exactly are the outsiders? In circumstances where the members wish to enforce an article of association, what form of legal proceedings could be permitted under the law?

2. OBJECTIVES

At the end of this unit the student must be able to discuss, (1) the contract between members, (2) outsider rights, (3) who can maintain an action on the article of association.

3. MAIN CONTENT

i. *A contract between the members*

It is not clear whether the articles are binding as between members inter se,most pre-Hickman's case says the article binds members inter se. in the case *of Eley v PositiveGovernment Security Life Assurance Company* (1876) 1 Ch.D. 88. The articles of the defendant company provided that the plaintiff be appointed as its solicitor.Eley worked in this capacity for a period of time before the company ceased to employ him. In an action for breach of contract, the House of Lords held that there was no contract between Eley and the company. The articles were binding between members, and although Eley was a member of the company, he was suing the company in his capacity as a solicitor. There was therefore no contract which Eley could enforce.

This case established quite a few principles, the fundamental issue resolved is that the article of association is only binding on the members and the company, and that no outsider is entitled to claim any right on the article. It follows that notwithstanding the fact that the solicitor was also a member of the company, the capacity in which he was instituting the action will determine whether he can enforce the articles or not.

Stirlin J in the case of Wood v Odessa Water Works Company (1889) 42 Ch.D. 636 at page 642, explained thus,

"that the article of association constitute a contract not merely between the company and the shareholders, but between each individual shareholder and every other."

Lord Hershell however holds a contrary view when he said,

It is quite true that the articles constitute a contract between each member and the company, and that there is no contract between the individual members of the company, but the articles do not any less, in my opinion, regulate their rights inter se. such rights *can only be enforced by or against a member through the company, or through the liquidators representing the company, but I think that no member has, as between himself and another member, any rights beyond that which the contract with the company gives*.

In *Salmon v Quin&Axtens Ltd* (1909) AC 442, Farwell L.J considered Stirling J's statement *In Woods vOdessa Water Works*and stated,' I think that is accurate subject to this observation, that it may well be that the court would not enforce this covenant as between the individual shareholders in most cases.

Some writers have supported the views expressed by Lord Herschell above. One of them is Barc and Bowel (1988) that in their view a member cannot enforce the articles of association of a company directly against another member unless the company is a quasi-partnership.

The proper claimant in such a situation is the company itself. However, Davies (2008) considers that a 'direct action between the shareholders concerned is here possible; and for the law to insiston an action through the company would merely be to promote multiplicity of actions, and involve the company in unnecessary litigation.

In England, the CLRSG in their final report recommended quite clearly that the members should be given the right to sue and enforce the articles without necessarily going through the company but the S33 of the 2006 Act failed to clear the issue and merely almost repeated the former position in section 14 of the 1985 Act. However, the position in Nigeria is better, under the S41 of the CAMA, the law has been clearly stated and even extended the provisions to cover the rights of officers of the company. The members can therefore freely maintain can action as between themselves without recourse to the company.

Section 41(1) of CAMA states as follows, Subject to the provisions of this act,the memorandum and articles , whenregistered, shall have the effect of a contract under seal between the company and its members and officers and between the members and officers whereby they agree to observe and perform the provisions of the memorandum and articles , as altered from time to time in so far as they relate to the company, members, or officers as such.

It follows that in Nigeria rather than for the officer to sue as a member to enforce outsider right due to him as officer he is at liberty to commence action as an officer to enforce the articles.

OUTSIDER RIGHTS

We should further emphasize that ordinarily being a contract anyone who is not privy to the agreement cannot enforce the article of association. The parties to the contract are the members and the company; therefore anyone who is not a member cannot enforce the articles. It is possible for a member to be, not only a member but also an officer of the company, the question is that whether such a person can sue. The issue was resolved in the case of *Eley v Positive Government Life Assurance Company* (supra) that outsiders are not entitled to sue under the contract, and trough the member is also an officer, if he institutes the action in his capacity as on outsider or officer, in the case , he instituted the suit in his capacity as a solicitor to enforce his rights as a solicitor qua solicitor to the company, he is not entitled to do so. However, in cases where the clause in the article was made specifically for his benefit, like in the Eleys case, the court will still not allow him to maintain the action as the rule of privity of contract will not allow him to maintain the action.

In the case of *Browne v LaTrinadad*(1887)37 Ch. D 1 a shareholder who had a right to be a director confirmed in the articles was removed by a valid resolution of the general meeting. The court placed emphasis onEley's case in concluding that "it would be remarkable that, upon the shares being allotted to him, a contract between him and the company, as to a matter not connected with the holding of shares, should arise. He therefore could not enforce a right to be a director.

In the Hickman's case, the court considered the matter settled, and stated:

This much is clear, first, that no article can constitute a contract between the company and a third person, secondly, that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as far instance, as solicitor, promoter, director, can be enforced against the company; and thirdly, that articles regulating the rights and obligations of the members generally as such do create rights and obligations between them and the company respectively.

The only solution would have been as pointed out in the recent case of *Globalink Telecommunications Ltd v Wilmbury Ltd (2003) 1 BCLC 145,* where there was an indemnity provision on behalf of a director in the article, the court found that such provision would not be binding because the articles do not constitute a contract between the company and its officers; and that it will only be binding on the company if the provision is contained in a separate contract between the company and the officer.

It follows that directors qua directors are outsiders to the articles. When the article provides for the settlement of disputes between the company and members, this will not cover disputes between the directors and the company.

In the case of *Beattie v Beattie Ltd. (1938) Ch. 709,* the company's articles provided for any dispute between the members and the company to be referred to arbitration. There was a dispute between a director and the company, and it was held by the court that it was not governed by the articles. Although the director was a member, the dispute was in his capacity as director and therefore it cannot be referred to arbitration. The Court of Appeal relying on the Hickman's case held that since the dispute relates to his status as director he cannot rely on the articles.The Master of Rolls in his judgment saw the issue as being framed as a director-member action in which the enforcement of the directors outsider rights were central rather than tangential. He suggested that had the action being framed as a member-director action in which the central issue was a member suing to enforce the articles which had the tangential effect of enforcing an outsider right it might have been successful. This view was supported by the court in the case of *Salmon v Quin&Axtens supra*, in this case, the articles of association provided that the consent of both managing directors was needed for certain decisions. Mr. Salmon was a managing director and member of the company and he dissented from a decision to buy and letting of property. The general meeting then passed a resolution authorizing the purchase and letting of the property. Mr. Salmon sued as a member to enforce the article requiring his consent as managing director to the transactions. In this case, the House of Lords accepted a general personal right of members to sue to enforce the articles by allowing a member to obtain an injunction to stop the completion of the transactions entered into in breach of the articles. Here the court agreed that since the member has a right to enforce the articles of association, then even if in the long run he will thereby enforce rights due to him as an outsider it is still within the ambit of the section.

Based on the case of *Beattie and Salmon-Quin&Axtens*, Lord Wedderbum in his article on *Foss v Harbottle*argued that the courts have a recognized a general right to sue by members in order to enforce the articles notwithstanding that they may be indirectly enforcing outsider rights. (see –Wedderburn, 1957, Shareholders Rights And The Rule In *Foss V Harbottle, 1957, Camb. L.J. 193, 1958, Canb.L.J. 93*).

Other writers agreed with their own reasons, see, Goldberg, 1972, The enforcement of Outsider Rights under section 20(1) of the Companies Act 1948, 1972 MLR 362, The Controversy on the Ssection 20 Contract Revisited, (1985) MLR 158.

Gregory, 1981, The Section 20 Contract (1981) 44 MLR 526, Prentice, 1980, The Enforcement of Outsider Rights (1980) 1 Colo 179.

Who Can Sue

A major issue is, who can sue on the contract?, and when and how could this be done? In the first instance, where the breach is personal to the member, then the member can sue to enforce the articles. In the case of *woods v Odessa Water works (supra)*, in the case, the company planned to convert dividends payable to the members into bonds, a member objected since the articles do not allow dividends to be converted to bonds, it was held that since the articles constituted a contract between the shareholders and the company, a shareholder could by injunction restrain the company from acting in contravention, hence the individual member may sue to enforce his personal rights.

Where however, the claim is a collective one, the members that are aggrieved may maintain a representative action to enforce the provisions of the articles. In the case of *Pender v Lushington (1877) 6 Ch.D. 70,* where some members of a company were prevented from voting at the general meeting, by a director, the court held that the members may sue in a representative capacity to enforce their rights under the articles of association of the company.

See also Griffith v Paget (1877) 5 Ch.D 894.

We may safely conclude that the members are at liberty to enforce personal rights in the article, while common grievances may be enforced collectively through the representative action. However, it may be difficult to say in view of the rule in *Foss v Harbottle* which says that in an action where the companysuffer any injury only the company can sue to enforce its rights. And, only the directors have the power to institute action on behalf of the company and in its name. It follows that where the wrong is done to the company only the company may sue to enforce its rights under the articles.

See Mozley v Alsten (1847)

Macdougal v Grndiner (1875)

4. CONCLUSION

Articles of association is a contractual document binding the members and the company and the members *inter Se*. the relationship between the members is still doubtful, and the legislature in U.K. has not done much to change the situation.

5. SUMMARY

The article binds the members and the company. The courts in England have been reluctant to recognize the rights of outsiders to sue on the contract simply because of privity of contract. However, based on the courts decisions in Salmon, and Beattie cases we can assertively say that the member who is also on outsider may enforce the contract in his position as a member and if indirectly he is enforcing rights conferred on him as outsider, the company cannot object successfully.

6. TUTOR MARKED ASSIGNMENT

Discuss critically the effect of articles of association on the rights of members and outsiders.

7. REFERENCES/FURTHER READING