FORMATION OF COMPANIES IN ISRAEL

PRESENT LAW AND CONTEMPLATED REFORMS*

INTRODUCTION

Company law in Israel is based mainly on English law. It is codified in an enactment passed in Mandatory Palestine — the Companies Ordinance, 1929.[1] This Ordinance is modelled upon the English Companies Act, 1929,[2] with only few diversions, and includes an interpretation provision in s.2(2) which reads:

> "This Ordinance shall be interpreted by reference to the law of England relating to companies".

This provision adds to the general reference to English law as a supplementary legal system contained in Art. 46 of the Palestine Order in Council, 1922, which provides that the jurisdiction of civil courts, so far as local enactments do not extend or apply

> ". . . . . shall be exercised in conformity with the substance of the common law and the doctrines of equity in force in England . . . . . ".

In spite of the close resemblance of the Company Law of Israel to that of England, one should note the main grounds of difference between them. English company law has been substantially amended by the subsequent Companies Act, 1948, and no parallel amendments were introduced into the Companies Ordinance. That year, 1948, is also the time of the establishment of the State of Israel, which in s.11 of its Law and Administration Ordinance, 1948, made the continuation of the law which had prevailed in Palestine —

> ". . . . . subject to such modifications as may result from the establishment of the State and its authorities".

* This article has been submitted for publication by colleagues of the author after his untimely death. In view of the resemblance between Malayan and Israeli Company Law (both of which are based on the Companies Act, 1929) it has been decided to publish the article without alteration. The reforms in company law suggested in Israel — which differ in several aspects from the reform in the Companies Act, 1948 — should prove of interest. The article arrived too late for inclusion in the Company Law Symposium published in vol. 4 part 1 of the Malaya Law Review.

1. The authentic text of the original enactment (in which a considerable number of amendments have been introduced later) is in *Drayton's Laws of Palestine,* Cap. 22.

2. The arrangement of chapters and sections in the Ordinance is more similar to that of the English Companies Act, 1908.

This reservation rightly made the courts in Israel shy to introduce innovations of English decisions delivered subsequent to 1948, even when based on provisions unaffected by statutory amendments.[3] One should also note that sometimes even identical provisions in the Act and the Ordinance may give rise to different legal consequences, due to the difference of some basic concepts of private law of the respective countries, both of which do not recognise commercial law as a distinct and self-sufficient legal branch, but treat it as part and parcel of the general law of the land, tightly interconnected with other branches of the law.

Having thus indicated the similarity between the company law of Israel and England, we shall, in this paper, pay special attention to the points of diversion of Israel company law from English company law, as the latter is more widely known and more easily accessible.

Bearing in mind that the text of the present Companies Ordinance is almost identical with that of the English Act of 1929, it is self-evident that far-reaching measures are required to make Israel's company law cope with modern commercial practice. Thus in 1949 a Company Law Committee was appointed (headed by Judge Zeltner) and in 1952 it presented its Report, which recommended continuing the links with English company law by retaining the present Ordinance, but to make English decisions persuasive rather than binding on Israeli Courts. Most of the reforms suggested by the Committee are based on the amendments of English company law in 1947-8 and the recommendation of the 'Cohen Committee' which initiated them.

In 1957 the Minister of Justice published a Draft Company Law (prepared by Dr. U. Yadin). This Draft, while adopting some of the recommendations of the Committee Report, intends to replace the Ordinance by a new law whose provisions are inspired mainly by English law, but which draws freely on many other legal systems, and intends to discontinue the interpretation by reference to English company law.

Though the Committee Report and the Draft Law have not yet been implemented by the legislator and are just being re-considered by a new committee, they will be surveyed here as representing the current trends towards law reform which the legislator will probably follow in due course.

PLURALITY OF MEMBERS

A Company registered under the provisions of the Companies Ordinance[4] must consist of several members, as the 'one man company' in its strict legal meaning (as distinct from the economic meaning of this term) is not recognised by the Ordinance. S.4, which deals with the "mode of forming incorporated company", requires a minimum of seven

3. About the general aspect of this problem see Tedeschi, "The problem of Lacunae in the Law and Article 46 of the Palestine Order in Council, 1922" in *Studies in Israel Law,* p.166 *et seq.*

4. In Israel the alternative modes of incorporation as a company under a Charter or a Private Act have not been introduced. Incorporation of other legal entities, such as cooperative societies, are out of the scope of this paper.

persons, or — in the case of a private company[5] — a minimum of two, to be the founders of a company by subscribing their names to a memorandum of association and otherwise complying with the requirements of the Ordinance in respect of registration. The Ordinance also ensures that the required number shall not be reduced below the minimum set for registration; s.112 provides that:

> "If at any time the number of members of a company is reduced, in the case of a private company, below two, or in the case of any other company, below seven, and it carries on business for more than six months while the number is so reduced, every person who is a member of the company during the time that it so carries on business after those six months and is cognisant of the fact that it is carrying on business with fewer than two members, or seven members, as the case may be, shall be severally liable for the payment of the whole of the debts of the company contracted during that time, and may be sued for the same without joinder in the action of any other member".

Another provision of the Ordinance, s.148(d), makes it a ground of compulsory winding-up by the court if the number of members is reduced, in the case of a private company, below two, or in the case of any other company, below seven. In spite of those strict provisions, the so-called 'one man company' is quite common in the economic life of the country, as the requirement of a minimum number of members can be satisfied by nominees having no real interest in the assets and activities of the company which is being managed exclusively for the benefit of a single person.

In other than private companies, any number of members can be admitted, within the share capital of the company, and any other provisions of its memorandum and articles of association. A private company,[6] on the other hand, is required[7] to provide in its articles for the limitation of the number of its members to fifty,[8] as well as to restrict the right to transfer its shares and prohibit any invitation to the public to subscribe for any of its shares or debentures. These provisions of the articles ought to be observed as long as the company desires to retain the privileges and exemptions conferred on private companies; if they are altered or not observed, the company loses the privileged status of a private company and becomes subject to the same duties as any other company.

Both the Committee Report and the Draft Law recommend the granting of legal recognition to the economic phenomenon of 'one man company' and suggests provisions as to general meetings applicable to companies having a single member only.

The Committee Report and the Draft Law do not recommend the

5. The distinction introduced into English law in 1948, between exempt and non-exempt private companies, has not been adopted in Israel.
6. Introduced by an amending Ordinance, in 1936.
7. See, s.25A(b).
8. "Not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have continued after the determination of that employment to be members of the company".

present English distinction between private companies and exempt private companies, but seek to ensure that the privileges of private companies shall not be abused, by adding new requirements for attaining and maintaining the status of a private company, *i.e.* limiting the maximum number of members to twenty and excluding subsidiaries of other companies, or companies engaged in banking or insurance business.

LEGALITY OF OBJECTS

It is evident, and specifically provided by s.4 of the Ordinance, that the right of association is confined to lawful purposes. Illegality in the course of incorporation or the objects of the proposed company is a ground for refusal of incorporation, even where the proposed objects are in conformity with the laws of another country whose links with the proposed company are closer than those of the State of Israel.[9]

The problem of the status of a company whose objects are illegal has not been decided in Israel, but an *obiter dictum* of the House of Lords[10] can be taken as authority that such a corporation exists, though subject to sanctions visited upon any undertaking tainted by illegality. S.18(3) authorises the Registrar to accept a sworn declaration by an advocate that he has been engaged in the formation of the company and that the company has complied with the requirements of the Ordinance (including, therefore, the requirement as to legality of objects) as sufficient evidence of the compliance. In practice, however, the Registrar scrutinises the documents submitted to him for registration to check their legality. On the registration of the memorandum of association, the Registrar issues a certificate of incorporation which, under s.18(2) of the Ordinance, is conclusive evidence that all the requirements of the Ordinance in respect of registration and of matters precedent and incidental thereto have been complied. This provision has been invoked[11] to uphold the existence of a company which had been registered with the object of acquisition and development of land without having obtained previously a licence of the High Commissioner to hold lands generally[12] which was then a condition precedent for incorporation with such objects. On the other hand, the conclusiveness of the certificate of incorporation cannot legalise any of the objects or other provisions of the memorandum or articles of association, and their legality can always be contested.[13]

The Committee Report and the Draft Law do not deal with the status of companies registered for illegal objects, and therefore they apparently do not claim to change the present law, except that the Draft intends discontinuing the application of English company law.

9. *R. v. Registrar of Joint Stock Companies* [1931] 2 K.B. 197.

10. *Bowman v. Secular Society* [1917] A.C. 406.

11. In *H.C. 127/42,* [1942] S.C.J. (Palestine) 843.

12. This provision, in s.15 of the Ordinance, was abolished by s.1 of an amending law, in 1953, and since then there is no restriction at all upon the acquisition and development of land by companies in Israel.

13. *Bowman v. Secular Society* [1917] A.C. 406.

FREEDOM OF ASSOCIATION

As a matter of practice, any group of persons complying with the formal requirements of the Companies Ordinance may be incorporated for any lawful purpose. This practice is being observed even where the dominant (or sole) motive for incorporation is some fiscal advantage obtained thereby. This liberal practice, however, does not seem to be adequately safeguarded by the Ordinance. In the British Companies Act, 1929,[13a] upon which the Ordinance is modelled, ss.12 and 13 are so drafted as to impose upon the Registrar the duty to register every company which has complied with the formal requirements of the Act.[14] The parallel provision, s.14 of the Ordinance, was enacted differently:[15]

> "The registrar shall submit the memorandum to the High Commissioner[16] who may in his absolute discretion either authorise or refuse the incorporation of the company".

S.4 of the Ordinance, which proclaims the right of incorporation, was specifically made "subject to the provisions of section 14". The scope of the Registrar's discretion in refusing to register a company has been recently examined by the Supreme Court sitting as a High Court of Justice.[17] The Registrar refused the registration of a company for the purpose of publishing a newspaper and other printed matter, because the subscribers to the memorandum had previously been convicted of publishing a newspaper without licence and the contents of that newspaper gave the Registrar grounds to believe that the activities of the proposed company, through its publications, might endanger the security of the State and be contrary to public policy. Upon these grounds the Registrar used his absolute discretion under the said s.14 and refused to register the company.

The Supreme Court, before whom the Registrar's decision was challenged, held in the majority judgements,[18] that the absolute discretion can be exercised only within the scope of the Companies Ordinance, and that general considerations of security and public policy are, therefore, extraneous and invalidate the refusal. The minority judge[19] considered the 'absolute discretion' as being unfettered by the Registrar's general scope of authority under the Ordinance. In his view, any *bona fide* grounds for refusal are legitimate. The effect of the decision[20] is

13a. And also in the present Act, of 1948.

14. S.12: ". . . . . the registrar *shall* retain and register" (the memorandum and articles of association).

15. Presumably more in line with the legislative policy in colonial and mandated territories.

16. Whose powers under the Companies Ordinance have been assigned by the Government of the State of Israel to the Minister of Justice who, in turn, delegated his authority under this section to the Registrar of companies.

17. *H.C. 241/60,* 15 P.D. (Israel) 1151.

18. Agranat and Witkon JJ.

19. Cohen J.

20. Especially as confirmed after further hearing, by a bench of five Supreme Court Justices, in *D.N. 16/60,* 16 P.D. (Israel) 1209.

actually a recognition of the right of incorporation, as the Registrar's discretion, being confined to ensure compliance with the provisions of the Companies Ordinance, does not derogate from the right of incorporation and does not convert it into a privilege.

Both the Committee Report and the Draft Law recommend the repeal of the provision investing the Registrar with absolute discretion as to registration of companies. The Committee Report recommends that the Registrar shall be bound to register a company whenever the documents filed for its registration comply with the formal requirements and do not disclose any unlawful object. The Draft Law, too, replaces the Registrar's absolute discretion by a duty to register, but it mentions an additional ground of refusal, *i.e.* where it appears to the Registrar that the proposed company is intended to be used for a fraudulent or improper purpose. Under the Draft Law a refusal should be based on reasons revealed in a written decision which should be subject to appeal before the Court.

The purposes for which companies may be registered are almost unlimited[21] and are not confined to commercial enterprises; special concession is made[22] for companies formed for promoting commerce, art, science, religion, charity or "any other useful object", who intend to apply their profits, if any, or other income in promoting their objects and prohibit the payment of dividends to their members. Such companies, while enjoying limited liability of their members, may not use the word 'limited' as part of their names and are exempt from certain other duties.[23]

Companies registered in Israel are subject to the English rule of *ultra vires* under which a registered company[24] can act only within the frame of objects set out in the objects clause of its memorandum. Strict adherence to this rule may justify the conclusion that companies exist only for the particular purposes defined in their objects clauses. The harshness of the rule is, however, mitigated in Israel by s.6 of the Companies Ordinance, which practically adds implied objects to companies by providing that, in addition to the objects set out in its memorandum, every company shall be deemed, subject to any contrary intention expressed in its memorandum, to have power to do the things set out in the (lengthy) second Schedule to the Ordinance. The result is that companies in Israel are less affected by the English *ultra vires* doctrine and come nearer to the status of full capacity, similar to that of an adult person.

The inclusion of certain objects may still fall short from authorising the company to act upon them, where the laws regulating such activities

21. Except, of course, activities which by their nature are confined to physical persons, and certain professions, like advocacy, which cannot be practised by companies.

22. By s.23.

23. S.23 (3).

24. As distinct from a chartered company — which does not exist in Israel.

disqualify companies absolutely *(e.g.* from advocacy), or conditionally (a company may not act as executor or administrator unless, besides being empowered to do so by its constitution, it is especially approved by the Minister of Justice). Under the Banking Ordinance, 1941, a company may not be registered with the object of carrying on banking business, unless its registered capital is not less than fifty thousand pounds; and a certificate authorising the company to commence business[25] may not be issued to a banking company unless at least that amount of share capital has been subscribed and not less than half of it paid in cash. Originally s.15 of the Companies Ordinance made incorporation for landholding purposes subject to a special licence by the High Commissioner, but since the abolition of that section in 1953, there is no restriction on acquisition and development of land by companies.

Both the Committee Report and the Draft Law intend to avoid the unjust consequences of the *ultra vires* doctrine, but by different means. The Committee Report recommends to maintain that doctrine as a safeguard protecting shareholders against unauthorised and careless management; to mitigate unjustified effects of the rule it suggests to expand the implied powers of registered companies and simplify the procedure of altering the objects clause. The Draft Law, on the other hand, recommends the abolition of the *ultra vires* doctrine, by conferring upon any registered company full legal capacity, thus enabling any outsider to hold the company bound by any act of its authorized agents.

DUTY OF INCORPORATION

The duty of incorporation as a company under the provisions of the Companies Ordinance is imposed by s.3 thereof which reads:

> "No company, association or partnership consisting of more than ten persons shall in Israel carry on any business that has for its object the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Ordinance, ... or is registered under the Cooperative Societies Ordinance."

The section is based upon s.357 of the English Companies Act, 1929,[25a] with some variations. It has been interpreted in England as prohibiting larger groups[26] to engage in any activity with a view of obtaining any benefit, though not a pecuniary gain without incorporation. The interpretation section of the Ordinance, s.2(1), defines 'gain' as including "mutual indemnity for loss and mutual accommodation by loan". This definition, however, is not exhaustive, and therefore other situations too are included, as under the English cases, which are not limited by a statutory definition. While the English section prohibits the *formation* of such a partnership without incorporation, the Ordinance only prohibits the carrying on of business. This difference was the ground of a Supreme Court decision[27] which held that, unlike the English law on this point, a business association of more than ten persons does not constitute a

25. Under s.92 of the Companies Ordinance, see *infra.*

25a. 19 & 20 Geo. 5 c. 23.

26. There, exceeding twenty in any business other than banking and exceeding ten in the latter.

27. *C.A. 83/27,* 1 (Palestine) L.R. 206.

contravention of the section,[28] as long as they do not actually carry on business. It should be noted, that the prohibition contained in the section is not accompanied by any criminal sanction; but nevertheless, any transaction by such an unlawful association is tainted with illegality and subject to the maxim *ex turpi cause non oritur actio.*[29]

In order to eradicate associations illegal for failure to register, s.240 provides that —

> "... .any company association or partnership which is required to be registered .... and is not so registered may be wound up by the court on petition by the Attorney General".

'Winding up' under this section is, of course, different from a winding up of a registered company; it is aimed at putting an end to an unlawful activity, as in such a case there is no corporate entity to be dissolved.

Neither the Committee Report nor the Draft Law suggest to change the law requiring the incorporation of any business carried on by ten or more persons. The Draft Law adds a criminal sanction for violation of the prohibition; on the other hand it seems to limit the duty of incorporation to a business carried on with a view to 'profit', while the present law uses the wider term, 'acquisition of gain', discussed above.

TRANSACTIONS ON BEHALF OF THE COMPANY PRIOR TO ITS REGISTRATION

The corporate personality of a company exists only from the date of incorporation mentioned in the certificate of incorporation. The English rule which prevails also in Israel is that a preliminary contract is not binding on the company when registered, even if subsequently adopted by it,[30] and persons signing such a preliminary contract on behalf of the company are personally liable,[31] though not entitled to enforce it.[32] In this stage the persons acting for the proposed company are its promoters. The Ordinance, like the Act, contains no definition of the term 'promoter', save in s.90 which deals with "liability for statements in prospectus", and for its purposes defines that,

> "....promoter means a promoter (sic) who was a party to the preparation of the prospectus, or of the portion hereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company".

28. This is now subject also to the provisions of the Partnership Ordinance, 1930, which provides that "a partnership formed in Israel shall not consist of more than ten persons".

29. Where the action is in view of winding up the business and the remedy sought is essential in order to do justice to innocent parties, the illegality is sometimes disregarded; see, *e.g.*, *Greenberg v. Cooperstein* [1926] Ch. 657.

30. The only effective course is to make a new contract in identical terms.

31. *C.C. 280/49,* 4 Ps. (D.C.) (Israel) 261.

32. *Newborne v. Sensolid* [1954] 1 Q.B. 45.

The promoter's duties have been defined in English decisions[33] which hold that a promoter stands in a fiduciary position towards the company and has, therefore, to make full disclosure to an independent board of directors[34] or to all members and prospective members of the company.[35]

The Draft Law suggests to empower a company to ratify any preliminary transactions made on its behalf prior to registration, thus enabling to uphold contracts which under present law are considered void.

DOCUMENTS TO BE FILED FOR REGISTRATION

The most important document of a company is its memorandum of association which is sometimes compared to its constitution as it determines the status and capacity of the company and is unalterable except in the cases and in the mode and to the extent for which express provision is made in the Ordinance. The memorandum, according to s.5 of the Ordinance, should contain the following items:

(i) *The name of the company*

Each company may choose almost any name it likes, including the name of its founder or any other person. The choice is however subject to the following requirements of the Ordinance: the word 'limited' must form the last word of the name of every company limited by shares or by guarantee.[36] This is the only positive requirement as to what the name should contain; other provisions[37] prohibit the use of certain names on grounds of public policy and for avoiding unfair competition. Special licence is required[38] for a name which suggests the patronage of the Government or any of its departments or of a local authority. The use of the titles 'cooperative' or 'building society' is forbidden[39] and 'chamber of commerce' is confined to companies registered without the addition of the word 'limited' to their names. The restrictions on the free choice of name in order to avoid unfair competition are the following: a company may not be registered by a name identical with that by which a company or partnership is already registered in Israel, or so nearly resembling that name as to be likely to deceive, except where

33. The leading authority on the subject is *Erlanger* v. *New Sombrero Phosphate Co.* (1878) 3 App. Cas. 1218.

34. Especially in public companies.

35. More typical to private companies, where the promoter is to have a substantial interest in the company.

36. Incorporation with unlimited liability is extremely rare, but under s.23 of the Ordinance charitable companies, which intend to apply their assets and income exclusively for their objects and to prohibit the payment of any dividend to their members, may be registered as companies with limited liability without the addition of the word 'limited' to their names.

37. Ss.22, 24.

38. Under s.22(2).

39. Building societies have not been regulated by any enactment; the restriction was copied *verbatim* from the English section, like the prohibition against the use of the names of members of the Royal Family.

the other company or partnership is in the course of being dissolved and signifies its consent in such manner as the Registrar requires. The Registrar is also given authority, under s.24, to refuse registration of a company with a name which it desires to adopt for an improper or fraudulent purpose. Besides these administrative safeguards which come to ensure that a company shall not be registered with an improper or deceptive name, s.24 (4) entitles every person, partnership, society or company to apply to the court to restrain a company which has adopted a name identical with, or so nearly resembling its own as to be likely to deceive, from using such name, and the court may grant such relief.[40]

The Committee Report recommends that the Registrar's refusal to register a company on grounds of similarity of name with another registered name should be final, but refusal on other grounds should not postpone registration pending an appeal to Court. Another suggested innovation is the 'reserved name', which enables promoters to have a desired name reserved during the months preceding the actual registration of the company. The Draft Law intends to widen the Registrar's discretion as to proposed names by replacing the detailed provisions about undesirable names by a general provision authorising the Registrar to refuse to register a name which is likely to be misleading or offensive. Where the proposed name is identical with or similar to a registered name, the Draft follows the existing law in prohibiting registration.

(ii) *The objects of the company*

The memorandum must include the objects for which the company is incorporated. These objects must be legal, in compliance with the Companies Ordinance and any other enactment.[41] The legal effect of stating the objects is not confined to a contractual undertaking on behalf of the subscribers and any future members to act within the objects. The English doctrine of *ultra vires* applies, and under it only acts within the scope of objects specified in the memorandum can be ascribed to the company which, for this purpose, can be regarded as existing only for the performance of its objects.[42]

The consent of all the members or even the provisions of the articles of association, or any other document, cannot make any act *intra vires* the company, if it is outside the scope of the objects clause in the memorandum, as expanded by the second schedule to the Ordinance.[43] Any

40. The courts are guided by the principles laid down by English decisions on this matter; commercial, *i.e.* pecuniary interests are protected, and mere inconvenience is not a sufficient cause of action; *C.C. 470/47,* 1 Ps. (Israel) 299. A foreign company can invoke this protection only when having established goodwill in Israel, *C.A. 82/50,* P.D (Israel) 309.

41. See *supra,* p. 367.

42. *Supra,* p. 369.

43. In *C.A.D.C. 44/38,* N.L.R. (Palestine) 52, the Haifa District Court held that the second schedule refers to powers incidental or conducive to the attainment of the Company's main object; but, with due respect, this does not seem compatible with the last paragraph of the schedule, which empowers the company "to do all such other things as are or may be deemed incidental or conductive to the attainment of the above objects or any of them". Whether the schedule confers on the company additional objects or only powers has not been decided yet.

alteration of the objects requires a special resolution (not less than three fourths of the votes at a general meeting of which not less than twenty one days' notice has been duly given) and takes effect only when confirmed by the court and authorised by the Minister of Justice.

As already observed the Committee Report recommends to retain the doctrine of *ultra vires,* but to mitigate its harshness by simplifying the procedure required for the alteration of objects. The Draft Law, on the other hand, aims at the abolition of the *ultra vires* doctrine, so that the mere fact that a transaction entered on behalf of a company is outside its registered objects should be an internal matter of the company, unaffecting the validity of the transaction. Under the Draft Law objects should be alterable in an informal way, like any other alteration which does not involve reduction of capital.

(iii) *Limitation of liability*

A company may and practically always does limit the liability of its members. The limitation is most often by shares, and the liability of any member is limited to the amount, if any, unpaid on the shares held by him.[44] A company may also be formed as limited by guarantee, in which case every member undertakes to contribute a certain sum to the assets of the company in the event of its being wound up. A combination under which the liability of members is limited both by shares and guarantee is possible, and there is also the scarcely used provision for an unlimited company. All that is necessary to do for limiting the liability is to state it in the memorandum of association. Directors or employees of the company as such incur no personal liability for debts of the company as long as they do not exceed their authority and commit no civil wrong.[45] The Ordinance provides a safeguard against abuse of limited liability by providing[46] that if, in the course of winding up, it appears that any business of the company has been carried on with intent to defraud creditors or for any other fraudulent purpose, the court may impose personal unlimited liability on any director[47] who was knowingly a party to the carrying on of the business in such a manner. Such a person can also be disqualified from taking part in the management of any company during five years.

(iv) *The share capital*

Every company limited by shares[48] has to state in its memorandum the amount of its share capital and the division thereof into shares of a

44. S..43 of the Ordinance.

45. Under s.57(l) "… .the liability of the directors or managers, or of the managing director, may, if so provided by the memorandum, be unlimited." This provision is, of course, very unlikely to be used.

46. In s.234.

47. Under s.2(l) it "includes any person occupying the position of director by whatever name called".

48. Or limited by guarantee and having a share capital.

fixed amount. The registered capital of a company is the means and limit of allotting shares and admitting to membership. Apart from fiscal consideration,[49] the Ordinance attaches only moderate importance to the registered share capital. It may be altered[50] by special resolution of the company, without confirmation by the court.[51] The issued share capital (whether paid up or not) has an important bearing on the solvency of a limited company and therefore any reduction of the issued share capital is subject to confirmation by the court, under a procedure which ensures that the reduction will not be prejudicial to the creditors of the company.[52]

The first shares are allotted to the subscribers of the memorandum, each of whom must subscribe to one share at least.[53] On allotment, not less than five percent of the nominal amount of the shares subscribed should be paid. No share may be allotted for less than its nominal value,[54] and where the allotment is for other than cash consideration, full particulars have to be filed with the Registrar.[55]

The memorandum of association has to distinguish between unredeemable and redeemable share capital,[56] but it is not necessary to distinguish between any other classes of shares. If rights attaching to shares are specified in the memorandum, they are unalterable,[57] like any voluntary clause in the memorandum,[58] unless the mode of alteration is specially provided by the memorandum.[59]

The Draft Law recommends to introduce no-par-value shares, enabling any company to have it besides or instead of its nominal share capital. The limit of liability of holders of such shares should be determined by company's regulations as such shares have no nominal value. The Draft Law also provides that subject to the rules against unauthorized reduction of capital, a company should be entitled to redeem any of its shares and not only those issued as redeemable preference shares.

49. Registration fees are payable at a certain percentage of the registered capital and therefore companies usually do not puff their registered capital unnecessarily. The same applies to increase of capital.

50. Increased, consolidated, sub-divided, converted into stock and even reduced (by cancelling unissued shares).

51. S.43.

52. Ss. 45-53.

53. S.5.

54. But a commission, not exceeding ten percent of the nominal value, may be granted to any subscribers; s. 96. There is also a complicated procedure for issuing shares at discount; s.95.

55. S.93.

56. S.5(d).

57. Save by scheme of arrangement under s. 117, which requires the voting of a majority in number representing three fourths in value and a subsequent sanctioning by the court.

58. *Ashbury* v. *Watson* (1885) 30 Ch. 376.

59. *Re Welsbach etc.* [1904] 1 Ch. 87.

ARTICLES OF ASSOCIATION

Besides the memorandum, a company has another set of rules regulating its functions and transactions — contained in a document subordinate to the memorandum — the company's articles of association. Unlike the memorandum, it is not always obligatory to file articles of association on registration. For companies limited by shares[60] it is provided[61] that —

> "....if articles are not registered or, if articles are registered, in so far as the articles do not extend or modify the regulations of Table A of the third Schedule to this Ordinance, those regulations shall, so far as applicable, be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles".

Therefore, a limited company which has not registered articles of association has in fact adopted a set of regulations whose validity is indisputable, being a part of the Ordinance,[62] while the validity of other articles may always be questioned. No model regulations are provided for companies limited by guarantee and unlimited companies, which have to draft and register their own articles of association. Private companies, though limited by shares, have to register at least those articles which the Ordinance[63] requires them to include, namely, to restrict the right to transfer its shares,[64] to limit the number of its members to fifty,[65] and to prohibit invitation to the public to subscribe for its shares or debentures.

Unlike the rigid memorandum, the articles are alterable by special resolution of the company, without any further confirmation.[66]

The Committee Report recommends many amendments to Table A, most of them following Table A of the English Companies Act of 1948. The reforms suggested by the Draft Law are much more drastic. It seeks to abolish the distinction between memorandum and articles of association by providing that a company should be registered and governed by a single document instead of the existing two. Accordingly, the rigidity or otherwise of a certain provision should not be determined by its location in the memorandum or articles, but as a rule shall be alterable by special resolution.

60. The vast majority.

61. S.10.

62. It has been held in *C.A. 264/55,* 10 P.D. (Israel) 1494, that in case of a conflict between the provisions of the Ordinance and the said Table A, the same rules of interpretation should be applied as in conflicts between different sections of the same enactment.

63. In s.25A.

64. It also involves the abolition of those articles of Table A which regulate share warrants.

65. Excluding employees and ex-employees of the company.

66. But under s.12 any alteration is subject to the provisions of the Ordinance and to the conditions contained in the company's memorandum.

The first Schedule to the Draft Law is a set of model regulations which every company should be deemed to have adopted, to the extent that it has not rejected or modified them.

DIRECTOR OF THE PROPOSED COMPANY

On the application for registration of the memorandum and articles of association, if any, the applicants should submit a list of at least two persons who have consented to be directors of the company.[67] The proposed directors should sign and file with the Registrar a consent in writing to act as directors; they also have to acquire their qualification shares.[68] The Ordinance does not set any special standards for company directors, but ensures that they duly comply with the requirements of the articles providing for acquisition of qualification shares, under the sanction of their office being vacated for failure to comply with such articles.[69] Under the wording of the Ordinance a *private* company is not required to have even a single director. This situation, which is probably due to an oversight, will be amended both by the Committee Report and the Draft Law. The Draft Law does not require directors to acquire qualification shares unless special provision is made by a company to this effect, while under the existing Ordinance Table A requires all directors to acquire qualification shares, unless their respective companies have modified that provision of Table A.

PROSPECTUS AND STATEMENT IN LIEU OF PROSPECTUS

The measures which the Ordinance provides for protecting the public against fraudulent and reckless schemes which may appeal to the uninformed, are compelling adequate disclosure and publicity of facts material to the solvency and prospects of companies which the public is invited to finance, and providing effective remedies against breach of duties imposed upon those engaged in public flotations of securities.[70]

Any notice, circular, advertisement or other invitation offering to the public for subscription or purchase any shares or debentures of a company is a 'prospectus' for the purpose of the Ordinance,[71] and therefore subject to the strict provisions relating to the contents of the prospectus and the liability for its accuracy. The Ordinance further provides[72] that when a company allots, or agrees to allot, shares or debentures

67. S.70.

68. Unless the articles of the proposed company provide for no qualification shares.

69. Which are, however, optional from the company's point of view; s.71.

70. At present there is no other direct control of issues offered to the public Stock Exchange quotation is optional and of no binding legal effect. Restriction imposed by the Finance Regulations are outside the scope of Company Law.

71. S.2(1).

72. In s.87.

with a view to offer them for sale to the public,[73] any document by which the offer to the public is made shall for all purposes be deemed to be a prospectus issued by the company. A copy of every prospectus issued is to be filed with the registrar of companies, where it is subject to inspection by any person interested.[74] This is besides the requirement[75] that any form of application for shares in, or debentures of, a company should be released to the public only with a prospectus properly drafted.

Section 86, probably the longest section in any enactment of the country, specifies the information which the prospectus is to include:— the contents of the memorandum; particulars about the signatories, the shares subscribed by them[75a] and their interest in the property and profits of the company; the number of shares, if any, fixed by the articles as the qualification of a director, and any provision in the articles as to the remuneration of the directors; the 'minimum subscription' *i.e.* the minimum amount which, in the opinion of the directors, must be raised by the issue of shares, in order to provide (or repay) the sums required for the purchase of any property to be defrayed in whole or in part out of the proceeds of the issue, the preliminary expenses[76] and commission payable to facilitate the issue of shares and working capital; other sources of finance, if any, for those matters; the amount payable on application and allotment of each share.[77]

The prospectus should also state the names and addresses of the vendors of any property acquired or to be acquired and paid for out of the proceeds of the issue, and the amount so payable, specifying separately the amount, if any, payable for goodwill;[78] sums paid of payable within the preceding two years as a commission for subscribing or procuring subscription; the amount or estimated amount of preliminary expenses; payments made to any promoter, and the consideration for such payments; the dates of, and parties to, every material contract; names and addresses of the auditors, if any, of the company; full particulars of the

73. When the offer to the public was within six months after the allotment, or when, at the date when the offer was made, the whole consideration to be received by the company had not been so received — the company shall be deemed to have offered the shares or debentures to the public — unless the contrary is proved.

74. S.243.

75. Contained in s.86(6).

75a. These particulars may be dropped from a prospectus published in a newspaper.

76. Payment of which is unenforceable against the company; but usually special arrangements are made for such payment, which is authorised even when unenforceable.

77. In the case of a second or subsequent offer of shares by the company, full particulars about the conditions under which shares and debentures were issued in the two preceding years.

78. In *C.A. 21/31,* 2 (Palestine) L.R. 2 the court held, in relation with a similar section, that "the English doctrine of goodwill has not been introduced into Palestine by the Ordinance in question". This view was not adopted later, see *C.C. 345/27,* [1938] P.*D.T.A.* (Palestine) p.111. It seems clear enough that 'goodwill' is not an 'English legal doctrine' but an economic phenomenon which requires legal regulation.

nature and extent of the interest, if any, of every director in the promotion of or in the property proposed to be acquired by the company. In case of different classes of shares, the prospectus should state the different rights of voting and in respect of capital and dividends, attaching to the several classes of shares respectively. A report of the auditors of the company is to be included, indicating (in appropriate cases) the profits made and dividends distributed.

More typical for a new company is the requirement to include in the prospectus the contents of a report, made by accountants, on the profits made during three years preceding the issue of the prospectus by any business to be acquired out of the proceeds of the issue.

The section requiring this detailed disclosure prevents contracting-out by providing[79] that any condition requiring or binding any applicant for shares or debentures to waive compliance with any requirement as to the contents of the prospectus shall be void.

A company which does not issue a prospectus on its formation, is not allowed to allot any of its shares or debentures unless, at least three days before the first allotment, it has filed with the Registrar a statement in lieu of prospectus,[80] in which it has to make substantially the same disclosure as in the prospectus.

The Ordinance[81] imposes strict liability on every director or person held out as director, every promoter or other person who has authorised the issue of the prospectus, by making them liable[82] to pay compensation to all persons who subscribe for shares or debentures on the faith of the prospectus[83] for the loss or damage they may have sustained by reason of any untrue statement; liability does not arise where the publication was due to *bona fide* and reasonable reliance on experts or official publications, or on proving that the person otherwise liable promptly and publicly disassociated himself from the incorrect statement.[84]

Both the Committee Report and the Draft Law recommend many changes in the law relating to prospectus, with a view of making it disclose more material information to prospective investors, not all of whom are sufficiently acquainted with legal technicalities and corporate finance. The Draft Law substitutes the lengthy and cumbersome s.86 of the

79. In s.86 (4).

80. In a form set out in the fourth Schedule to the Ordinance; s. 88.

81. In s.90.

82. Severally, but subject to the right to recover contribution from any other person liable, unless the person against whom judgement has been issued was, and the other person was not, guilty of fraudulent misrepresentation.

83. Usually it is limited to subscribers and cannot be invoked by purchasers; *Peek* v. *Gurney* (1873) 6 H.L. 377; but enforeable by the latters too when the misrepresentation was calculated to facilitate transactions in the open market; *Andrews* v. *Mockford* [1898] 1 Q.B. 382.

84. S.90(1).

Ordinance by a schedule which in twenty concise provisions specifies the matters which ought to be disclosed by the prospectus. In line with the policy of the Draft to provide for a self-sufficient company law, it includes a number of rules which under present law are applied as English case law.

RESTRICTION AS TO ALLOTMENT

The Ordinance ensures, by its prospectus provisions, adequate publicity of the company's background and prospects, its basic assumption being that any prospective investor or creditor is to be left to act according to his best judgement, upon the information which the Ordinance ensures will be available to him. Some measures are taken, however, to ensure that the company actually complies with the standards set by its own prospectus.[85]

No allotment may be made of any share capital of a company offered to the public for subscription unless the amount stated in the prospectus as the 'minimum subscription' necessary for raising initial capital,[86] has been received in cash by the company, each subscriber having paid not less than five percent of the nominal amount of the shares he had applied lor. If these conditions are not complied with on the expiration of forty days after the first issue of the prospectus, all money received from applicants for shares shall be forthwith repaid to them. The directors are personally liable for the repayment of these sums, with interest. Whenever a limited company makes an allotment of its shares (at any time after it is authorised to do so), the company has, within one month hereafter, to file with the Registrar a return of the allotment, giving full particulars of the terms of the allotment and the identity of the allottees.[87] In the case of shares allotted as fully or partly paid up otherwise than in cash, allotment is to be under a contract in writing, a copy of which is to be sent to the Registrar and filed with him.

The Draft Law intends to increase the minimum cash payment on application for shares, from 5 to 25 percent of nominal value, but on the other hand extends the time for raising that sum to two months from the publication of the prospectus.

RESTRICTIONS ON COMMENCEMENT OF BUSINESS

A company which has issued a prospectus inviting the public to subscribe for its shares is not allowed to commence business or exercise borrowing powers unless,[88]

> ". .. . shares held subject to the payment of the whole amount thereof in cash have been allotted to an amount not less in the whole than the 'minimum subscription'; and every director of the company has paid for his shares a sum

85. S.91.

86. For purposes specified in s.86(l) (d). See *supra* at p,378.

87. S.93.

88. S.92.

equal to that payable for such shares by other allottees, and there has been delivered to the Registrar a sworn declaration by the secretary or one of the directors, that the aforesaid conditions have been complied with."

Where a company has not issued such a prospectus, it ought to file with the Registrar a statement in lieu of prospectus; but as this statement does not include the 'minimum subscription' clause,[89] such a company has only to comply with the requirement that every director should pay for his shares a sum equal to that payable by others for such shares, and that a sworn declaration to this effect, by the secretary or director of the company, be delivered to the Registrar.

On the delivery of the said sworn declaration,[90] the Registrar has to certify that the company is entitled to commence business,[91] and that certificate is conclusive evidence that the company is so entitled. Any contract made by a company before the date at which it is entitled to commence business is provisional only and not binding.[92]

The Draft Law suggests doing away with the provisions about the certificate entitling a company to commence business, as it has not proved to be a reliable criterion for solvency or prospects, and is only a bureaucratic obstacle to any company which has not been originally registered as a private company.

STATUTORY MEETING AND STATUTORY REPORT

Within a period of not less than one month nor more than three months from the date of the issue of the certificate that the company is entitled to commence business, it has to hold a general meeting of the members, called 'the statutory meeting'.[93] At least seven days before the day on which the meeting is to be held, the directors have to forward a report, called the 'statutory report', to every member of the company, and file a copy of that report with the Registrar. The statutory report has to be certified by not less than two directors,[94] and to state the total number of shares allotted, fully or partly, for any consideration other than cash; the total amount of cash received by the company in respect of all the shares allotted; an abstract of the receipts of the company

89. This is the main difference between the prospectus and the statement in lieu of prospectus whose contents are very similar otherwise.

90. And, of course, after filing a prospectus or a statement in lieu of prospectus, as the case may be.

91. According to s.92(3) he has no discretion in the matter ("The Registrar *shall* certify").

92. As a result, a company wound up before it was entitled to commence business is not liable under any of its contracts.

93. S.62.

94. S.62(3) provides that ". ..where there are less than two directors, by the sole director and manager...." — but under s.70(1) every company must have at least two directors, unless it is a private company; a private company is exempt altogether from holding a statutory meeting or sending a statutory report.

from shares and debentures, distinctively from any other sources; the payments made thereout and particulars concerning the balance remaining in hand; an account or estimate of the preliminary expenses of the company; the names, addresses and descriptions of the directors, auditors, managers, if any, and secretary of the company; and the particulars of any contract which, or the modification of which, is to be submitted to the meeting for its approval, together with the particulars of any modification or proposed modification. Terms of contracts mentioned in the prospectus or statement in lieu of prospectus cannot be varied, except subject to the approval of the statutory meeting,[95] but it is not up to *the* statutory meeting to reject a contract duly signed on behalf of the company, and the approval or disapproval of any contract by the statutory meeting is an internal matter of the company, and does not affect outsiders.[96]

The Draft Law does not require companies to hold statutory meetings or submit statutory reports, as those were found to be unnecessary in most cases. It is therefore considered preferable to leave every company to decide for itself which procedure is necessary to keep the shareholders informed about the activities of the company in its first stages.

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95. S.89.

96. *C.A. 240/47,* 1 Ps. (Israel) 256. It should be noted that while the parallel section in the British Companies Act, 1929 (s.113(3) (e)) speaks of "the particulars of any contract, the modification of which is to be submitted to the meeting for its approval", the Ordinance (s.62(3) (e)) speaks of "the particulars of any contract which, or the modification of which, is to be submitted to the meeting for its approval".

The Supreme Court, in the above mentioned precedent, decided that this divergence does not entitle the statutory meeting to impeach a legally binding contract.

* M. Jur. (Jerusalem), Ph.D. (Lond.); late Lecturer in Law in the Hebrew University, Jerusalem.