

Law principles in business company formation



Introduction

In a modern capitalist market economy, companies are a familiar part of everyday life. Companies own supermarkets, supply gas, foods, drinks, electricity and products we are depending on. As we all know in Malaysia there are different types of business entities. Local or foreign investors are coming to Malaysia to start a business. Besides, company has been defined as three formal business entities for profit which may be a corporation, a partnership, association or sole proprietorship. However, usually are people thinking the term of “ company” means the business is incorporated, but that is not true. In fact, a corporation usually must use some. In order to incorporate a company, there are two stages that we have to go through, which are, pre-incorporation and post incorporation. In the pre incorporation stage, the promoter is responsible to bring the company into the legal existence and ensure its successful running, and in order to accomplish the obligation he or she may enter into some contract on behalf of prospective company. Promoters are the persons involved in formation of a company. They will undertake the initiative to prepare necessary documents and do other significant works in order to register the company.

The principles of law relating to the formation of a company

There are various forms of business organizations operating in any given economy. The business structure in use can be defined by the legal framework under which it operates. Therefore, the rules applied to these entities are different. Some of the types of business forms include Partnerships, Sole Proprietorships, and Corporations. Other forms may include entities set up not to make a profit but sometimes for the benefit of

the community. Incorporation is when a business decision is made to form a new legal entity which is recognized by law to either undertake a not for profit business or for profit business.

The process of forming of a company can be divided into four distinct stages such as promotion, registration or incorporation, capital subscription and commencement of business. Usually, promotion is the first stage in the formation of a company. It refers to the entire process by which a company is brought into existence. It starts with the conceptualization of the birth a company and determination of the purpose for which it is to be formed.

A private company as its name implies cannot offer its shares to the general public. The next form of incorporation is a Private Company limited by guarantee. This form of incorporation will have no share capital. Under the Companies Act, a company cannot be limited by guarantee if it has a share capital.

This form of incorporation is also limited by shares. It may be referred to as the opposite of a private company limited by shares. This is because it has a share capital and limits the liability of its members to the amount unpaid on their shares. The shares held in such companies can be traded in the capital market in line with listing rules.

SEPARATE LEGAL PERSONALITY

The principle of separate corporate personality has been firmly established in the common law since the decision in the case of *Salomon v Salomon & Co Ltd*, whereby a corporation has a separate legal personality, rights and obligations totally distinct from those of its shareholders. Corporate

personality is a common law principle that grants a company a legal identity, separate from the members who comprise it. On the other hand, it follows that the property of a company belongs to that company, debts of the company must be satisfied from the assets of that company, and the company has perpetual succession until wound up.

When a company receives a certificate of incorporation it automatically be a 'separate legal personality'. In law when the company becomes a legal person it means its own right. This essentially means that if one commences business as a limited liability company, then the corporation or company is a legal entity with distinct legal personality separate to that of the owners, members, or shareholders. This is known as the concept of legal personality.

The 'veil of incorporation' can be described as being the separation between a company and its members. Due to the separate legal status of a company from its members this is usually very strictly maintained. However, there are certain circumstances when the courts will deny the people who run the company the advantage of hiding behind the corporate veil. In these instances the veil of incorporation is said to be 'lifted', the barrier between a company and its members is removed so there is no legal separation between them. There instances are however, difficult to predict as the reasons depend on the judges interpretation of "fairness" or "policy" or of how a particular statute should be interpreted.

In the leading case of *Salomon v Salomon & Co Ltd*, Salomon incorporated his boot and shoe repair business, transferring it to a company. Based on the cases of Mr. Salomon is when he was ran a boot manufacturing business as a

sole trader. He and his family were shareholders and then he sold the business to the company. However, the company paid part of the purchase price to Salomon and agreed to pay the remainder over time. To secure its obligation to pay, the company gave Salomon security over its assets in the form of company charge. Effect of the charge, the company's assets had to be used to pay out Salomon in full before they could be applied to pay out the company's other unsecured creditors. Unfortunately, the company's business failed, the value of assets was insufficient to pay both Salomon and the company's other creditors. However, the creditor argued that Salomon should not receive the benefits of charge, because the degree of control exercised over the company meant it should be treated as being his agent or trustee for Salomon in the conduct of the business. Lastly, the charge given by the company to Salomon was valid and he was entitled to be paid his debt even though other creditors would not be paid because of insufficient assets. This is because Salomon was not personally liable and the company was treated as operating the business in its own right which is separate from its controller.

Conclusion

The law as it is under the English company law will rather impute the principle of separate legal personality to a limited liability company as was the case in the case of *Salomon v Salomon* than apply the doctrine of lifting the veil. However the law will be ready to go after a person who takes advantage of the principle of the case in *Salomon v Salomon* to act in a fraudulent or unspeakable manner. It is the intent of the law is to create justice and fairness as it evidenced in both statutory provision and judicial

decisions. However the principle of separate legal personality comes with it some vagueness especially when one looks at the exceptions which come with the principle. It is therefore necessary that something is done to reduce if possible eliminate such vagueness.