

COMPANY LAW – PART I
(INTRODUCTION, TYPES OF COMPANIES, INCORPORATION ETC.)
Companies Act, No. 7 of 2007 (as amended)

(1) LEGAL STATUS AND CAPACITY OF A COMPANY – SECTION 2

- A company is a **body corporate** identified by the name by which it has been registered.
- Subject to the Articles of Association (“articles”) of the company, a company has the capacity to carry on or undertake any business or activity, do any act or enter into any transaction within or outside Sri Lanka.
- Subject to the laws of Sri Lanka or of any other country, a company has all the rights, powers and privileges, necessary for the aforesaid purpose of carrying on or undertaking any business or activity, doing any act or entering into any transaction within or outside Sri Lanka.

(2) SEPARATE LEGAL ENTITY/ PERSONALITY

- A company is separate and distinct from its members (those who own it), i.e. the shareholders.
- A company is also different from those who direct and manage it, i.e. the directors and other employees.
- The existence of the company is unaffected by changes in its shareholders/ directors/ other employees. Accordingly, there is perpetual succession of the company regardless of the changes to any of its shareholders/ directors/ other employees. A company “dies” only when it is liquidated, wound up or becomes insolvent or bankrupt.
- The company’s assets, liabilities and contracts belong to the company; not to the shareholders/directors/ other employees.
- A company can sue its own employees and directors if they have caused any loss to the company by their actions.
- This separate existence of the company is a significant principle in company law. This principle was judicially established in 1897 by the House of Lords, England’s highest court, in the famous case of *Salomon vs. Saloman & Co. Ltd.* (1897) AC 22. This important decision is called the “**Saloman principle**”.
- *Salomon vs. Saloman & Co. Ltd.* (1897) AC 22:
Salomon was a boot and shoe manufacturer who traded as a sole proprietor for nearly 30 years. Consequently, he incorporated a company and gave his wife and children 1 share each in the company and kept the balance shares in his own name. As security for the shares in the company, Salomon obtained debentures from the company. Subsequently, the company went bankrupt. On the company’s winding up it was found that its remaining assets were insufficient to satisfy both its debenture holders and its trade creditors. The question arose as to whether the debentures secured on assets issued to Salomon will get preference as against the other unsecured debts of the company.

The unsecured trade creditors argued that Salomon and the company (i.e. Salomon & Co. Ltd.) were truly the same person since he and his wife and children owned the company; therefore, he could not owe money to himself; and accordingly, his rights as a debenture holder should not get priority and he should be paid after making payment to third party unsecured trade creditors.

Court held: Salomon’s company was a separate legal entity from Salomon, although he owned almost 99% of the shares, and therefore, the debentures issued to Salomon was a secured debt which should gain priority over the unsecured debts owed to the trade creditors. Thus Salomon’s claim should prevail over that of the third party trade creditors and proceeds of the assets should be first allocated to settle the debentures of Salomon.

Salomon's case established many legal principals as to companies and recognized the following:

- ***principal of separate legal personality***;
- family owned companies;
- the limited liability of members;
- a member can give a loan to a company;
- a secured creditor (over assets), even if he is a member or director of the company, will have preference over unsecured creditors.

- Application of the *Salomon* principle in modern times:

(i) *Lee vs. Lee's Air Farming Ltd.* [1961] AC 12:

Lee was the MD of a small company that operated air planes. He owned all the shares in the company except for 1 share. He also piloted the company's planes. While piloting a plane he died and his widow claimed workmen's compensation insurance. The insurance company argued that since the company was owned basically by Lee, he could not also be a "worker" in the same company and denied liability. Court held, however, that the company and Lee were separate and the widow's claim for insurance compensation was upheld.

(ii) *Trade Exchange (Ceylon) Ltd. vs. Asian Hotels Corporation* (1981) 1 SLR 67:

95% of the shares in the hotel company were held by a Government corporation. Supreme Court held that the company and its shareholders were distinct legal entities and that the company did not become an agent of the Government even though almost all the shares were held by a Government corporation.

- Corporate 'veil' & lifting the corporate 'veil'

The doctrine in Salomon's case casts a "veil" over the personality of a company through which no one can see. Sometimes the courts will look behind what is called the "veil" or "mask" of incorporation to ascertain whether a company is really different from its major shareholder(s). The term lifting the "veil" comes from the practice of Christian wedding ceremonies where the bride comes to the church with her face covered in a "veil" and after the religious ceremony is completed, the "veil" is lifted or uncovered disclosing the bride's face. Similarly, in certain circumstances, a court of law will lift the corporate "veil" and look behind the incorporation to see the true facts.

Examples:

- (i) where a majority shareholder or "one-man" company attempts to commit a fraud or engage in improper conduct;
- (ii) in times of national emergency.

(3) TYPES OF INCORPORATED COMPANIES – SECTION 3(1)

(i) **Limited companies:**

- Limited companies are the most commonly used method for operating a business under the corporation form.
- These are companies that issue shares, the holders of which have the liability to contribute to the assets of the company, if any, specified in the company's articles as attaching to those shares.
- The liability of the shareholders is limited to what they have invested.
- There can be public limited companies, private limited companies or off-shore companies.

- **Public limited companies:**

This is a limited company that has listed its shares on the stock exchange. A listed company has the opportunity to raise its capital from the public and therefore has access to a larger capital base.

Such a company must comply with:

- (a) the provisions of the Sri Lanka Accounting and Auditing Standards Act, No.15 of 1995 – To comply with the specified standards in the preparation and presentation of accounts;
- (b) the provisions of the Securities and Exchange Commission of Sri Lanka Act, No.36 of 1987 (as amended), Listing Rules, Takeovers and Mergers Code etc. including the following:

- a company should satisfy the following in order to be eligible to be listed:

Main Board:

- ✓ Stated Capital of not less than Rs.500, 000,000/- at the time of listing;
- ✓ Net profit after tax for 3 consecutive years immediately preceding the date of application;
- ✓ Positive Net Assets as per the consolidated audited financial statements for the last 2 financial years immediately preceding the date of application;
- ✓ meet the applicable Minimum Public Holding Requirement;

Diri Savi Board:

- ✓ Stated Capital of not less than Rs.100, 000,000/- at the time of listing;
- ✓ Positive Net Assets as per the consolidated audited financial statements for the financial year immediately preceding the date of application;
- ✓ meet the applicable Minimum Public Holding Requirement;
- ✓ An operating history of at least one (1) year immediately preceding the date of application;

- corporate disclosure requirements and mandatory offer requirements prior to/ upon reaching a certain specified percentage of shares apply;
- there are prohibitions relating to insider dealings.

- Private limited companies:

These companies are prohibited from offering shares or other securities to the public. The number of shareholders is limited to between 1 to 50. Those who obtain shares by virtue of their employment with the company (for example, under an employee share option scheme) are not taken into account in calculating the aforesaid number of shareholders.

The articles of the company must contain provisions relating to the above.

- Off-shore companies:

A company incorporated in or outside Sri Lanka may register itself in Sri Lanka as an off-shore company to carry on any business outside Sri Lanka. If a company incorporated outside Sri Lanka registers itself as an offshore company, it is deemed to have been incorporated in Sri Lanka. An offshore company cannot conduct any business in Sri Lanka.

They are broadly not subject to taxation in their home jurisdiction. Another common characteristic of offshore companies is the limited amount of information available to the public.

Due to not being subject to tax and the limited availability of information, allegations are frequently made about offshore companies being used for money laundering, tax evasion, fraud, and other forms of white collar crime.

(ii) **Unlimited companies:**

- These are companies that issue shares, the holders of which have an unlimited liability to contribute to the assets of the company under its articles. Accordingly, the shareholders have a joint, several and non-limited obligation to meet any insufficiency in the assets of the company to enable settlement of any outstanding financial liability in the event of the company's formal liquidation. These companies extend, in general, a greater assurance and confidence to creditors and trade financial transactions, because of the unlimited liability taken upon by the shareholders
- Certain instances where unlimited liability may be required/preferred:
 - (a) in a situation where persons would be willing to stand behind their business, but wish to use the corporate form to protect their identities and facilitate flexibility in transfer of ownership;
 - (b) when the law specifically prescribes it as a requirement e.g.: Professional firms.

(c) **Companies limited by guarantee:**

- These are companies that do not issue shares, the members of which undertake to contribute to the assets of the company in the event of its being put into liquidation, in an amount specified in the company's articles.
- This is unsuitable for business purposes. They are frequently used for establishing not-for-profit or charitable organisations.
- The articles must set out the objects of the company and include a statement to the effect that the liability of its members is limited by the amount of guarantee undertaken by each member in the event of the company being put into liquidation.
- A minimum of 2 members is necessary.

(4) OVERSEAS COMPANIES – PART XVIII

- Companies incorporated outside Sri Lanka could register as overseas companies in Sri Lanka to carry on business in Sri Lanka.
- The overseas company registered in Sri Lanka is required to notify certain changes in the company to the Registrar General of Companies (“RGOC”) within 30 days of the change. Examples of such change which require to be notified are:
 - (i) the charter, statutes, or memorandum and articles of the company or any other instrument constituting or defining the constitution of the company;
 - (ii) the directors of the company or the particulars contained in the list of the directors;
 - (iii) the names and the addresses of the persons authorised to accept service on behalf of the company;
 - (iv) the address of the registered or principle office of the company;
 - (v) the address of the principle place of business of the company within Sri Lanka.
- An overseas company could be registered as a branch office, project office, liaison office, representative office, regional office or any similar office.
- A branch office, project office or other similar office can carry out any permitted commercial, trading, or industrial activity. Such a company is required to invest a minimum of USD 200,000/- or equivalent amount in other designated foreign currencies, out of remittances received from abroad and channeled through an Inward Investment Account (“IIA”) opened with a licensed commercial bank as an authorized dealer in Sri Lanka to the credit of an account of the overseas company.
- Consequently, such overseas company is required to provide evidence for the proof of said remittance, to the RGOC, within 30 days of the registration.
- A liaison office, representative office or other similar office can only carry out non-commercial, non-trading or non-industrial activity. Such a company is required to remit in the funds required for the setting up and maintenance of such place of business through an IIA opened with a licensed

commercial bank as an authorized dealer in Sri Lanka to the credit of an account of the overseas company.

- An overseas company may remit out of Sri Lanka, their profit, royalty, franchise or other similar payments or surplus funds at the time of termination net of tax through the IIA of the parent company through which the investment was routed.

(5) INCORPORATION OF COMPANIES

- Section 4: A company may be incorporated by making an application to the RGOC in the prescribed form (i.e. Form 1) signed by each of the initial shareholders, together with the articles signed by each of the initial shareholders, consent from each director (Form 18) and initial secretary (Form 19).
- Section 5: The RGOC will enter the particulars of the company in the Register, assign a unique number and issue a certificate of incorporation. Consequently, within 60 working days of the incorporation of the company, the RGOC will notify the general public, by a notice published in a daily newspaper which has circulation in Sinhala, English and Tamil languages specifying (i) the name of the company; (ii) the company registration number; and (iii) the address of the registered office of the company.

(6) COMPANY NAMES

- Section 6 – Company name should end as follows:
 - a listed company – “Public Limited Company” or “PLC”;
 - every other limited company – “Limited” or “Ltd”;
 - private company – “(Private) Limited” or “(Pvt) Ltd”.
- Section 7(1) – Prohibited names:
 - A name that is identical to a name of another company;
 - A name that contains the words “Chamber of Commerce” unless it is a company limited by guarantee incorporated for the purpose of promoting art, science, religion, charity, sport or any other like useful object;
 - A name that is misleading in the opinion of the RGOC.
- Section 7(2) – The consent of the Minister, having regard to the national interest, is required, to use:
 - 'President' or 'Presidential' or similar words;
 - 'Municipal' or 'other Local Authority' or suggesting connection with any Society or body incorporated by an Act of Parliament;
 - 'Co-operative' or 'Society';
 - 'National', 'State' or 'Sri Lanka' or similar words.
- Change of name
 - Prior name approval from the RGOC required as a preliminary step.
 - Special resolution with the prior approval in writing of the RGOC is required. A company is deemed to have resolved to change the name upon a change of status of a company.
 - Upon resolving to change its name the company must give notice to the RGOC within 10 working days of the change, in the prescribed form (i.e. Form 3).
 - Upon receiving notice, the RGOC (a) enters the new name on the Register in place of the former name; and (b) issues a fresh certificate of incorporation, altered to indicate— (i) the change of name; and (ii) where the company has become or has ceased to be a private company, the fact of that change.
 - Change of name does not affect any rights or obligations of the company, or render ineffective any legal proceedings by or against the company.

- A company changing its name must give public notice of it within 20 working days of such change, specifying (i) the former name of the company; (ii) the company number; (iii) the address of the registered office of the company; and (iv) the new name of the company.
- The RGOC is empowered to give directions to change the name under Section 10.

(7) USE OF COMPANY NAME AND COMPANY NUMBER – SECTION 12

- A company must ensure that its name and its company number are clearly stated in:
 - (a) all business letters of the company;
 - (b) all notices and other official publications of the company;
 - (c) all bills of exchange, promissory notes, endorsements, cheques and orders for money or goods signed on behalf of the company;
 - (d) all invoices, receipts and letters of credit of the company;
 - (e) all other documents issued or signed by the company which creates or is evidence of a legal obligation of the company; and
 - (f) the company seal, if any.
- Every company shall ensure that its name and its company number are clearly displayed at its registered office.

(8) REGISTERED OFFICE

- Every company is required to have a registered office in Sri Lanka to which all communications and notices may be addressed.
- A company can have its registered office **in any part of Sri Lanka**.
- The registered office of a company at a particular time is the place that is described in the Register as its registered office at that time.
- If the registered office of a company is at the office of any chartered accountant, attorney-at-law, or any other person, the description of the registered office shall state:
 - (a) that the registered office of the company is at the office of the chartered accountant, attorney-at-law, or any other person; and
 - (b) particulars of the location of those offices.

(9) CONSTITUTION OF THE COMPANY

- The **articles** of a company contain the provisions for the internal regulation of the management of the affairs of the company and the conduct of its business, over which the shareholders will have full control.
- It is not mandatory to have an objects clause in the articles. However, a company may provide for the same. If an objects clause is provided in the articles, it will be deemed to be a restriction on the company carrying on any business or activity that is not within the scope of the objects.
- The articles may provide for rights and obligations of shareholders, management and administration of the company.
- **Shareholders** have the power to **amend** the articles by **special resolution**.

(10) COMPANY CONTRACTS – SECTION 19

- A contract or other enforceable obligation may be entered into by a company as follows:
 - an obligation which, if entered into by a natural person is required by law to be **in writing signed** by that person and be **notarially attested**, may be entered into on behalf of the company in writing signed under the name of the company by (i) 2 directors of the company; (ii) if there be only one director, by that director; (iii) if the Articles of Association of the company so provide, by any other person or class of persons; or (iv) one or more attorneys appointed by the company, AND be notarially executed;

- an obligation which, if entered into by a natural person is required by law to be **in writing** and **signed** by that person, may be entered into on behalf of the company in writing signed by a person acting under the company's express or implied authority;
- an obligation which if entered into by a natural person is **not required by law to be in writing**, may be entered into on behalf of the company in writing or orally, by a person acting under the company's express or implied authority.

(11) PRE-INCORPORATION CONTRACTS – SECTION 23

- A “pre-incorporation contract” means:
 - (a) a contract purported to have been entered into by a company before its incorporation; or
 - (b) a contract entered into by a person on behalf of a company before and in contemplation of its incorporation.
- A pre-incorporation contract may be **ratified** within such **period as may be specified** in the contract **or** if no such period is specified, **within a reasonable time** after the incorporation of such company, in the name of which or on behalf of which it has been entered into.
- A pre-incorporation contract that is ratified as aforesaid, shall be as **valid and enforceable** as if the company had been a party to the contract at the time it was entered into – retrospective effect.
- A pre-incorporation contract may be ratified by a company in the same manner as a contract may be entered into on behalf of a company under section 19.

- Warranties implied in pre-incorporation contracts – section 24
 - Unless a contrary intention is expressed in the contract, there shall be an implied warranty by the person who purports to enter into such contract in the name of or on behalf of the company:
 - (a) that the company will be **incorporated within such period as may be specified** in the contract, **or** if no period is specified, **within a reasonable time** after the making of the contract; and
 - (b) that the company will **ratify the contract within such period as may be specified** in the contract **or** if no period is specified, **within a reasonable time after the incorporation** of such company.
 - The amount of damages recoverable in an action for breach of an implied warranty as aforesaid, shall be the same as the amount of damages that may be recoverable in an action against the company for damages for breach by the company of the unperformed obligations under the contract, if the contract had been ratified by the company.
 - If a company, after incorporation, enters into a contract in the same terms as or in substitution for, a pre-incorporation contract, which is not ratified, the liability of the persons who entered into such pre-incorporation contract shall be discharged.

- Failure to ratify pre-incorporation contracts – section 25
 - Where a company has acquired property pursuant to a pre-incorporation contract that has not been ratified by the company after its incorporation, a court may on an application made in that behalf by the party from whom the property was acquired, make an order —
 - (a) directing the company to return property acquired under the pre-incorporation contract, to that party;
 - (b) validating the contract in whole or in part; or
 - (c) granting any other relief in favour of that party relating to that property acquired.