



COMPANY LAW

(PART I)

Shanila H. Gunawardena

LL.B. (Hons.) (Colombo)

Attorney-at-Law, CTA (CASL)

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APPLICABLE STATUTE

- Companies Act, No.7 of 2007 (as amended).

LEGAL STATUS OF A COMPANY – SECTION 2

- A company is a body corporate identified by the name by which it has been registered.
- 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 Articles of Association of the company. For this purpose, a company has all necessary rights, powers and privileges, subject to the laws of the country (Sri Lanka or any other country, as the case may be).

SEPARATE LEGAL ENTITY

- A company is separate and distinct from its members (those who own it) – shareholders.
- It is also different from those who direct and manage it – directors and other employees.
- Existence of the company is unaffected by changes in its shareholders/directors – perpetual succession.
- Company's assets, liabilities and contracts belong to the company; not to the shareholders/directors.
- A company can sue its own employees and directors if they have caused any loss to the company by their actions.

SEPARATE LEGAL ENTITY

- A company “dies” only when it is liquidated, wound up or becomes insolvent or bankrupt.
- This separate existence of the company is a significant principle in company law.
- This principle was judicially established in 1897 by House of Lords, England’s highest court, in the famous case of *Salomon v Saloman & Co Ltd* (1897) AC 22.4
- This important decision is called the *Saloman* principle.

Salomon v Salomon & 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 debentures 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.

Salomon v Salomon & Co Ltd (1897) AC 22

- 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.

APPLICATION OF THE *SALOMON* PRINCIPLE IN MODERN TIMES

- *Lee v 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 one 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.

APPLICATION OF THE *SALOMON* PRINCIPLE IN MODERN TIMES

- *Trade Exchange (Ceylon) Ltd v 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.

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).
- Similarly, in certain circumstances, a court of law will lift the corporate "veil" and look behind the incorporation to see the true facts.

Examples:

1. Where a majority shareholder or "one-man" company attempts to commit a fraud or engage in improper conduct.
2. In times of national emergency.

TYPES OF COMPANIES – SECTION 3(1)

- Limited companies
 - public companies
 - private companies
 - off-shore companies
- Unlimited companies
- Companies limited by guarantee

LIMITED COMPANIES

- A company that issues 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.
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PUBLIC LIMITED COMPANIES

- A limited company that has listed its shares on the stock exchange.
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- Must comply with the provisions of the Securities and Exchange Commission Act, No.36 of 1987 (as amended) and Listing Rules, Takeovers and Mergers Code etc.:
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 -;

PRIVATE LIMITED COMPANIES

- Prohibited from offering shares or other securities to the public.



- Articles 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.
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UNLIMITED COMPANIES

- A company that issues shares, the holders of which have an unlimited liability to contribute to the assets of the company under its articles.

COMPANIES LIMITED BY GUARANTEE

- A company that does 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.
- Unsuitable for business purposes. Frequently used for establishing not-for-profit or charitable organisations.
- 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.
- Minimum of 2 shareholders necessary.

OVERSEAS COMPANIES

- Companies incorporated outside Sri Lanka could register as overseas companies in Sri Lanka to carry on business in Sri Lanka.
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- The overseas company registered in Sri Lanka is required to notify certain changes in the company to the Registrar General of Companies within 30 days of the change. Examples of such change which require to be notified are:
 - the charter, statutes, or memorandum and articles of the company or any other instrument constituting or defining the constitution of the company;
 - the directors of the company or the particulars contained in the list of the directors;
 - the names and the addresses of the persons authorised to accept service on behalf of the company;
 - the address of the registered or principle office of the company;
 - the address of the principle place of business of the company within Sri Lanka.

INCORPORATION OF A COMPANY

- Section 4 – By making an application to the Registrar General of Companies in the prescribed form (i.e. Form 1) signed by each of the initial shareholders, together with the
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- Section 5 – The Registrar will enter the particulars of the company in the Register, assign a unique number and issue a certificate of incorporation.
- Section 9 –
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COMPANY NAMES

- Section 6 – Company name should end as follows:
 - a listed company –
 - every other limited company –
 - private company –
- Section 7(1) – Prohibited names:
 - Identical with a name of another company
 - Containing 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
 - Misleading in the opinion of the Registrar
- Section 7(2) – Consent of the Minister, having regard to the national interest, 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

CONSTITUTION OF THE COMPANY

- Articles of association 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.
- Not mandatory to have an objects clause. However, may provide for the same. If provided, 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.
- May provide for rights and obligations of shareholders, management and administration of the company.



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 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.

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.
- 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 —

- directing the company to return property acquired under the pre-incorporation contract, to that party;
- validating the contract in whole or in part; or
- granting any other relief in favour of that party relating to that property acquired.