

# **FEATURES OF A COMPANY & CORPORATE PERSONALITY**

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## **The law governing companies in Sri Lanka**

The law governing companies in Sri Lanka is the Companies Act No.07 of 2007. This Act was brought into operation on 3<sup>rd</sup> May, 2007. The Companies Act, No.07 of 2007 has followed the New Zealand Companies Act of 1993 and the Canadian Business Corporation Act 1985.

The Companies Act No.07 of 2007 repealed (Cancelled) the following three previous Acts which were applicable to companies in Sri Lanka.

- The Companies Act No. 17 of 1982,
- Companies (Special Provisions) Law No.19 of 1974
- Foreign Companies (Special Provision) Law No. 09 of 1975

## **Some of the new features introduced by the Companies' Act No.07 of 2007**

- Incorporation of a company made convenient

Under this Act a company can be incorporated by filling four documents. Under the earlier Act there were about seven documents had to be submitted. Further under the Companies' Act 2007, companies are now incorporated online.

- Single shareholder companies

Under the previous law, a public company was required to have a minimum of seven shareholders and private company was required to have a minimum of two shareholders. In terms of Section 4(2) of the new Companies Act, a company may have a single shareholder, such a single shareholder can be

- the Secretary to the Treasury who is holding shares on behalf of the Government of Sri Lanka
- an individual or
- a body corporate.

- Unanimous Agreement-applicable only to Private Companies  
In private companies with the consent of all its shareholders, any decision can be taken regarding the company even though it is inconsistent with the Articles
- Reduction of capital and amalgamation of companies without court approval  
Under the new Act to reduce the capital and to amalgamate the companies court approval is not required.

## REGISTRATION OF A COMPANY

### Artificial legal persons – Corporate Bodies-Body Corporate-Corporation

A company is an artificial legal person. Artificial legal persons mean 'Persons' created by the Law.

Creating an artificial legal person is known as Incorporation. There are two methods by which artificial legal persons can be created in Sri Lanka.

1. By an Act of Parliament – if a Law is made by Parliament declaring a particular organization, entity or body as a legal person, it will be treated as a legal person.

**Example:** Sri Lanka Rupavahini Corporation, Sri Lanka Broadcasting Corporation, YMBA, Petroleum Corporation etc. have been recognized by the Parliament as legal persons.

2. By registration under the Companies Act No.7 of 2007.

If any business entity, organization or any association is registered under the Companies Act No.7 of 2007, such entity, organization or association is treated as a 'Company'. After 3<sup>rd</sup> May, 2007, the companies are registered under the Companies Act No.7 of 2007.

Under the Companies Act, a company could be incorporated as a 'Limited Company' or as an 'Unlimited Company' or as a 'Company Limited by Guarantee'.

## **INCORPORATION OF A COMPANY (REGISTRATION OF A COMPANY) UNDER THE COMPANIES ACT NO.7 OF 2007**

As per Sec 4(1) **any person** or **persons** may apply to the Registrar of Companies to incorporate a company.

- **Name approval**

The first step in incorporating a company is selecting a name and getting that name approved by the Registrar. If the Registrar approves the name, the name approval number will be given by the Registrar.

After getting the name approved, four documents should be submitted to the Registrar to register a company

- **Documents to be submitted**

- (a) **Application Form (Form 1)** – it should be signed by each of the initial shareholders, together with a declaration stating that ‘to the best of his or their knowledge, the name of the company is not identical or similar to that of an existing company;
- (b) **The Articles of Association** of the company signed by each of the initial shareholders;
- (c) **Form 18** - Consent from each of the initial directors, to act as a director of the company; and
- (d) **Form 19** - Consent from the initial secretary, to act as secretary of the company.

In addition to the submission of the above documents Registration fee also has to be paid.

Under Sec.5(1), on receipt of the above documents and fees, the Registrar shall enter the particulars of the company on the Register, assign a unique number to that company as its company number and issue a **CERTIFICATE OF INCORPORATION** to the applicant company.

## Certificate of Incorporation

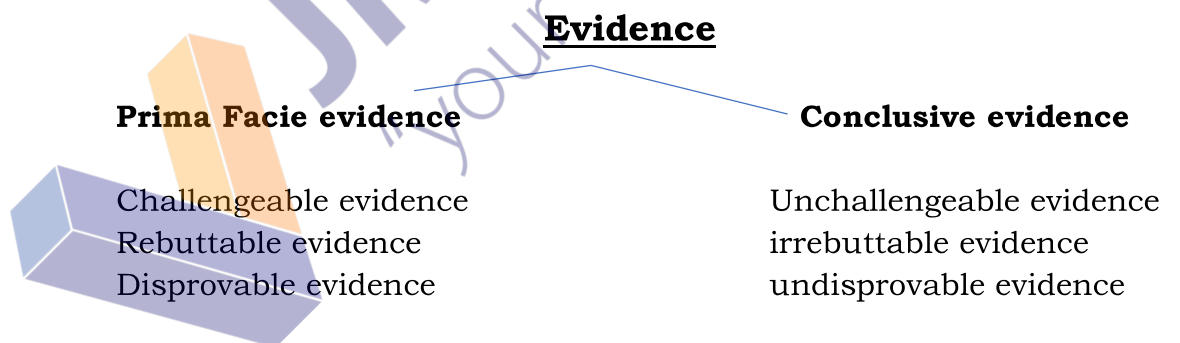
As per sec.5(2) the certificate of incorporation shall specify

- (a) the name and number of the company;
- (b) the date on which the company was incorporated;
- (c) whether the company is a limited company, an unlimited company or a company limited by guarantee;
- (d) whether the company is a private company; and
- (e) whether the company is an off-shore company;

The certificate of incorporation issued by the Registrar of companies is treated as the birth certificate of the company. According to Sec.5 (3) a certificate of incorporation issued by the Registrar, shall be **conclusive evidence** of the fact that

- (a) All the requirements under this Act relating to the incorporation of a company have been complied with; and
- (b) The company has been incorporated on the date specified in such certificate of incorporation.

Therefore if the certificate is issued by the Registrar, it will be an irrefutable (undisprovable) evidence that the company is properly registered. Therefore, even though there are mistakes in the registration procedure, those mistakes will not invalidate or affect the creation or registration of the company.



Example- share certificate

Certificate of Incorporation

As per Sec.5(3)(b), a company comes into existence **on the date specified** in the **certificate of incorporation**, and not from any other date.

### **Jubilee Cotton Mills Vs Lewis**

In this case a certificate of incorporation was dated 6<sup>th</sup> January 1923, but in fact it was signed and issued on 8<sup>th</sup> January 1923. On the 6<sup>th</sup> January 1923 the directors allotted shares to a person called Lewis. Later when the company demanded money, he refused to pay stating that the company was not in existence on the 6<sup>th</sup> January 1923. But the court held that the company came into existence on the date mentioned in the certificate and therefore Lewis should pay for the shares.

### **COMPANY NAME**

According to the Companies Act every company must have a name. Sec.6 provides that, the name of every—

- (a) **Limited company** other than a listed company, shall end in the word “**Limited**” or by the abbreviation “**Ltd**”;
- (b) **Private** company, shall end in the words “**(Private) Limited**” or by the abbreviation “**(Pvt) Ltd**”; and
- (c) Limited company which is a **listed company**, shall end in the words “**Public Limited Company**” or by the abbreviation “**PLC**”.

In selecting the name there is a duty to check regarding certain prohibited or restricted words. The restricted or prohibited words can be divided into two.

They are

#### 1. Absolutely Prohibited Words

These words cannot be used in a name of the company in any circumstances. As per Sec.7(1) A company shall not be registered by a name which—

- (a) is identical with the name of any other company or of any registered overseas company;
- (b) is in the opinion of the Registrar, misleading.

## 2. Conditionally Prohibited Words

There are certain words which are prohibited conditionally. That is only after receiving the permission of the relevant authorities these words can be used.

As per Sec.7(1)(b) a company shall not be registered by a name which contains the words “Chamber of Commerce”, unless the company is a company which is to be registered under a license granted under section 34 without the addition of the word “Limited” to its name;

As per sec. 7(2), except with the consent of the Minister given having regard to the national interest, no company shall be registered by a name which contains the words:

President, Presidential, incorporated, Co-operative, Municipal, State, Society, Sri Lanka, National or words which in the opinion of the Registrar suggest any connection with the President, Government or any Local Authority.

### **Change of Name (Sec. 8)**

A company may change its name by special resolution with the prior written approval of the Registrar.

As per section 9 (2) if a company changes its name, it should give public notice within twenty working days of such change specifying—

- (a) the former name of the company;
- (b) the company number;
- (c) the address of the registered office of the company; and
- (d) the new name of the company.

The change of name will not affect company’s existing rights, obligations or pending cases.

## **GENERAL CHARACTERISTICS OF A COMPANY - CONSEQUENCES OF INCORPORATION-FEATURES OF A COMPANY**

When the company is incorporated it will get certain consequences or effects they are;

1. Separate legal personality
2. Limited Liability - Shareholders can limit their liability for the company's debts
3. The right to offer shares to the public- Only Public Companies have this right
4. The right to transfer shares - Shareholders can sell their shares to any person without any restriction
5. Increased borrowing powers - Companies can borrow money by giving fixed charges and floating charges
6. Perpetual succession – that is the death of a shareholder or changes in the shareholding will not affect the company's existence.

### **Separate legal personality Under company law**

Subsequent to incorporation, a company becomes a separate legal personality compared to its members. In other words, the company is distinct and different from its members in the eyes of the law. It has its own seal and its own name, and its assets and liabilities are separate and distinct from those of its members. It is capable of owning property, incurring debt, borrowing money, employing people, having a bank account and entering into contracts.

### **Capacity to sue and be sued**

A company can sue or be sued in its own name distinct from its members. Thus, members are not named as parties in a case when a company institutes action or is sued by a third party.

### **Limited liability**

Limited in effect means that the liability of the members of the company (namely the contribution a member will have to make if the company is being wound up) is limited to the contribution made to the assets of the company, up to the face value of shares held by the member. A member is liable to pay only the uncalled money due on shares held by him/her.

### **Perpetual succession**

A company does not cease to exist unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time to time but that does not affect the life of the company. Insolvency or death of a member does not affect the existence of the company.

### **Separate property**

A company is a distinct legal entity. The company's property is its own and such ownership is independent of the members of the company. A member cannot claim to be the owner of the company's property during the existence of the company. When a company is wound up, its assets would be sold to settle its creditors.

### **Transferability of shares**

Shares in a company are freely transferable, subject to certain conditions, such that no shareholder is permanently or necessarily wedded to a company. When a member transfers his/her shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares.

### **SEPARATE LEGAL PERSONALITY (VEIL OF INCORPORATION)**

When a company is incorporated, the main consequence or the effect will be that, the company is treated as a person separate from those who created it (promoters), those who own it (shareholders) and those who manage it (directors). Therefore, the company is treated as a person capable of doing all its activities in its own name and it can own properties file or defend cases and it can make contracts in its own name.

As per Sec.2 a company incorporated shall be a body corporate by the name by which it is registered and subject to the Articles, it shall have the capacity to carry on or undertake any business or activity both within and outside Sri Lanka.



**The properties or assets of the company belong only to the company and not to** the shareholders or directors. Similarly, the company's liabilities also belong to the company and not to the shareholders or directors. Further, for the company's activities, it is **the company that is personally liable** and not the shareholders or directors.

Identifying the company as a separate legal person is also known as **Veil of Incorporation**. Suppose X and Y form a company by the name XY (Pvt) Ltd, then there will be three persons. Because X is a person Y is a person and the Company is another person. Suppose the company, that is XY (Pvt) Ltd, borrows Rupees One Million from Z and if the company does not repay the money, Z has to file a case against XY (Pvt) Ltd and not against X or Y. Because for the company's activities, it is the company that is liable and not the directors or the shareholders. The law considers that there is an artificial veil protecting the members and directors for the company's activities.

Separate legal personality principle=veil of incorporation

Therefore, as a general rule, if the company does any wrong, if it breaches any contract or if it does not repay the loans, the outsiders have to file cases against the company and not against the members or directors, because members or directors are not liable for the company's activities. This principle was first established in.

### **Salomon Vs Salomon & Co Ltd (1896)**

In this case a leather merchant called Salomon formed a company with his family members by the name Salomon and Company Ltd. Salomon bought majority of shares and he acted as the only director in the company. The company issued debentures for the value of £10,000 on the security of the company's assets. Salomon bought all those debentures. While the company was doing business, it borrowed about £7,000 from trade creditors without giving any security. The company carried on business for nearly one year but it suffered a heavy loss and it was decided to wind up (close down) the company. At the time of winding up it was found that the company's assets were insufficient to settle the liabilities.

The issue was to whom the remaining assets to be given. Solomon argued that he should be given preference, because he has got security for his debentures. But trade creditors argued that Solomon and Solomon and Company Limited are in effect one and the same person, therefore Solomon is not entitled to get any preference in the repayment of loan. The court held that Mr. Solomon and his company Solomon and Co Ltd are two separate persons. Salomon has given loan to Salomon and Company Limited on the security of the company's assets. But outside creditors did not get any security. Therefore, Salomon must be given preference in the repayment of the company's loan and the remaining assets should be given to Salomon.

### **Macura Vs Northern Assurance**

A timber merchant formed a company and transferred the timbers to the company and then he got the timbers insured in his own name. One day a fire destroyed all the timbers. The court held that even though the company was actually owned by the timber merchant and even though the insurance policy is in the timber merchant's name he cannot get insurance benefit, because the timbers belong to the company and not to the timber merchant. Because the company and timber merchant are two separate persons. The company also cannot claim insurance, because the company has not got the insurance in the company's name.

The above cases recognize the principle of separate legal personality of a company. Therefore, we can see that a company can act and exist independently in its own name. As stated above, for the company's activities it is the company that is responsible and not the shareholders or directors. This is known as the veil of incorporation.

As long as the veil of incorporation exists the members or directors are not liable for the company's activities. But in certain circumstances the law lifts the veil of incorporation, if the veil of incorporation is lifted, for the company's activities, members or directors become personally liable.

## **LIFTING OF VEIL (Exceptions to the Veil of Incorporation)**

Lifting of veil means making the members or the directors liable for the company's activities. As a general rule, for the company's activities, it is the company that is liable. But if the veil is lifted, for a company's activities members or directors will be held personally liable.

Some of the circumstances where the **courts have lifted the veil of incorporation**

- If the controlling shareholder uses the company as his agent, or if the corporate body is abused for an unlawful or improper purpose.
- To prevent a fraud.
- To determine a company's place of residence for the application of specific statutes such as tax laws.
- To prevent deliberate evasion of contractual obligations.
- To promote the interests of national security, or to ensure conformity with public policy.

### **Relevant Cases**

#### **Gilford Motor Company Vs Horne**

Horne was recruited by an employer to work as a salesman. In his contract of service there was a clause preventing him from soliciting (attracting) the employer's customers after leaving employment. Later when he left the employment, he wanted to start his own business and he established a limited company in which all the shares were held by his wife and a friend. He purported simply to work for the company. Through the company he solicited the customers of his former employer. The court lifted the veil of incorporation to show that the company was a mere sham designed to allow Horne to evade his contractual obligations. Accordingly, an injunction was granted to restrain Horne and his company from breaking the agreement.

### **Daimler Company Vs Continental Tyre Company**

During World War I German & the UK were opposed to each other. Before the war started a citizen of UK (X) had borrowed some money from Continental tyre Company. This company had been registered in the UK but all the shares had been held by the Germans except one which was held by a citizen of UK called (Y). The issue was whether X was liable to pay money to the company. The court held that in times of war it is illegal to trade with enemy, therefore if the court finds that the controllers of a company are from the enemy country, the court has the power to lift the veil to identify the true controllers of the company. Therefore, the court held that the UK citizen need not repay the debt, because the company is effectively controlled by the enemies.

### **REGISTERED OFFICE**

Sec.113(1) provides that every company shall have a registered office in Sri Lanka to which all communications and notices may be addressed.

Sec.113(3) provides that 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 regarding that fact and the particulars of the location of those offices.

### **Change of Registered Office**

Sec.114(1) provides that subject to the company's articles, **the board** of a company may change the registered office of the company at any time. Notice shall be given to the Registrar in the prescribed form (Form 13) of the change.

### **Advantages and Disadvantages of Incorporation**

#### Advantages

- Separate legal personality (Independent corporate existence)
- Perpetual succession
- Ease of raising capital-Public companies can advertise the shares
- Transferability of ownership
- Limited liability of shareholders

#### Disadvantages

- Expense
- Double taxation
- Complex procedure
- Lack of control