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Company Law

AAT Level II

BLA – Business Law

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Chapter 5 - Company Law and Partnerships

Company Law

The history of company law in Sri Lanka can be outlined as follows:

a) Companies by Royal Charter - Companies were initially established through Royal Charters.
b) Joint Stock Companies Ordinance No. 4 of 1861 - The first formal legislation regarding companies was the Joint Stock Companies Ordinance No. 4 of 1861.

c) Influence of English Law Principles - English Law principles started to influence Sri Lankan company law through section 3 of the Civil Law Ordinance in 1852.

d) Companies Ordinance No. 51 of 1938 - Subsequent development led to the Companies Ordinance No. 51 of 1938, a significant piece of legislation.

e) Companies Act No.17 of 1982 - The Companies Act No. 17 of 1982 replaced the Companies Ordinance, establishing a modern legal framework for companies.

f) **Companies Act No. 7 of 2007** - The Companies Act No. 7 of 2007 was introduced, founded on New Zealand and Canadian company law principles. It replaced the Companies Act No. 17 of 1982, which was initially based on English Law.

This evolution reflects the historical development and legislative changes in Sri Lanka's company law, incorporating international influences to adapt and modernize the legal framework governing companies

Q1) What are the basic types of businesses in Sri Lanka?

Engaging in business activities involves choosing a business structure, and different structures come with various pros and cons. For some, the structure is a natural way of conducting activities, while for others, it's a deliberate decision. In Sri Lanka, three main business structures exist:

a) Sole Trader: An individual running a business alone. Unincorporated, meaning it doesn't go through a formal process of creation.

b) Partnerships: Involves two or more individuals managing a business together. Like sole traders, partnerships are unincorporated entities.

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c) Limited Liability Companies: Created through a process known as 'incorporation.'

- Also called 'body corporate,' these companies have distinct legal status.
- Limited liability companies are distinct entities due to the incorporation process, while sole traders and partnerships are unincorporated.
- Despite sharing the common goal of conducting business, these structures differ significantly in their legal rights and obligations.
- Understanding these differences helps businesses make informed decisions about their preferred structure.

Q2) What are the consequences of incorporation?

When a business is registered as a company under the law, it enjoys several advantages compared to operating as an unincorporated entity. These benefits arise from the concept of corporate personality and the distinct legal status granted to registered companies:

a) **Corporate Personality**: The company is recognized as a separate legal person under the Companies Act. It is distinct and independent from its founders, owners, or investors.

b) **Entity Shielding**: The company's separate legal personality allows for a clear separation of business assets from the personal assets of shareholders.

c) **Perpetual Succession**: An incorporated company has the potential for continuous existence until dissolution. Changes in shareholders or directors do not affect the perpetual legal personality of the company.

d) **Contractual Capacity**: Being a legal entity, the company can enter into contracts both internally and externally.

e) **The Ability to Sue and Be Sued**:The company can initiate legal actions in its name. Legal actions can also be brought against the company in its name.

f) **Facilitation of Capital Accumulation**: A company can issue various financial instruments such as shares, debentures, and bonds to accumulate capital. This facilitates a diverse range of financing options compared to partnerships or sole proprietorships.

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g) **Transferability of Shares**: Transferring ownership in a company is straightforward due to the transferable nature of shares. Shareholders can sell their shares, effectively transferring their interest in the company.

h) **Limited Liability of Shareholders**: Shareholders are not personally liable for the company's debts and liabilities. Their liability is limited to the amount invested in shares; their personal assets are protected.

The consequences of incorporation offer businesses a unique set of advantages, providing legal, financial, and operational flexibility that is not readily available to unincorporated entities.

Q3) What is meant by having a corporate entity or corporate personality?

The legal or corporate personality of a company is a crucial concept that emerges upon its incorporation, providing the company with distinct and independent status apart from its founders.

a) Incorporation and Existence: The legal or corporate personality is established when the company is incorporated. This results in a separate and independent existence from the individuals who established the company.

b) Independent Functioning: Corporate personality empowers the company to operate as a legal person or body corporate in its own right. It can function independently, carrying out activities and transactions in its own name.

c) Recognition Before the Law: In the eyes of the law, the company's corporate personality is acknowledged as an entity with independent standing before the court. This recognition is distinct from its members and directors.

d) Legal Capacity and Functions: As a juristic person and body corporate, the company can sue and be sued. It has the ability to enter into contracts, buy and sell property, and engage in transactions with third parties. All these functions create legal rights and obligations for the company in its own name.

e) Separate Existence: The corporate personality allows the company to maintain a separate existence from its shareholders and directors. It operates as a distinct entity, and changes in its membership or directorship do not affect this separate existence. For example;

a) Salomon v Salomon & Co

- S was a sole trader making shoes. He created a company - A Salomon & Co Ltd - and sold his business to this new company for 99% shares of the company and £10,000 worth secured debentures (a secured loan).

- Six members of his family held one share each (the law at that time required a minimum 7 shareholders to form a company). The business soon failed and the company entered liquidation and a liquidator was appointed.
- S recovered the £10,000 owed to him on debentures and that left the debts of other creditors unpaid. The liquidator opposed this and argued that S should be personally liable for the company's debts and bear the losses as the company was his agent.
- **Held** – A company is a separate legal entity with rights and obligations, independent and distinct from its shareholder. Therefore, S was not personally liable for the company's debts.

b) Lee v Lee’s Air Farming Limited

- Mr L had formed Lee’s Air Farming Limited and became the majority shareholder. He was the sole director too. The company was formed to conduct an aerial spreading of fertilizer. He appointed himself the chief pilot for the company and entered into a contract of employment with that company. He was killed whilst working for the company, but the insurance company refused to pay the insurance.
- **Held** - One person may function in dual capacities. Setting up a company to shield the shareholders from liability is a legitimate use of the corporate form. As the company is a legal person, it can enter into contracts with any person.

c) Macaura v. Northern Assurance Co. Ltd

- Mr M sold timber to a company where he was the sole shareholder. He insured the timber in his name against losses caused by fire. There was a fire and the insurer refused to pay arguing that though the timber was owned by the company there was no insurance for timber in the name of the company.
- **Held** - Though shareholders are the proprietors of the company, they do not own the company's property. The assets of the company are separate from the assets of its members. M is not entitled to insurance money.

The corporate personality is defined and governed by statutory provisions under the Companies Act No.07 of 2007.

- According to **Section 2(1)**, a company registered under the Act is recognized as a body corporate.
- **Section 2(2)** specifies that a company has the capacity, both within and outside Sri Lanka, to carry out business, activities, acts, or transactions, subject to the laws of Sri Lanka or any other country.

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Q4) What is meant by lifting of the corporate veil?

While the principle of corporate personality grants a company distinct legal standing, there are rare instances where courts may disregard this separation. This concept is known as "piercing the corporate veil," and it allows the identification of individuals with the company under specific circumstances. Two notable cases illustrate the application of this principle:

a) **Woolfson v Strathclyde Regional Council:**

- Background: The principal shareholder sought compensation for land taken by the state under the company name.
- Outcome: The House of Lords (HL) declined the claim, emphasizing the real existence of a company's separate personality.
- Principle: Piercing the corporate veil is appropriate only when special circumstances exist, such as when the company is a mere facade concealing wrongdoing.

b) **Jones v Lipman:**

- Background: Party A, pending a land transaction, transferred the land to a company created to evade a specific performance decree in a lawsuit by Party B.
- Outcome: The court held that the company was essentially a creation of Party A, serving as a mask to avoid legal obligations.
- Principle: The court pierced the corporate veil due to the company being a mere instrument of the individual's intent.

Key Considerations to lift the corporate veil are;

- Special Circumstances: Courts will only disregard the corporate personality in exceptional cases, emphasizing the real existence of the separate legal entity.
- Mere Facade or Instrument: Piercing the corporate veil is often justified when a company is used as a mere facade or instrument to conceal wrongdoing or evade legal obligations.
- Judicial Prudence: Courts exercise caution and scrutinize the circumstances thoroughly before disregarding the corporate veil.

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Although the principle of corporate personality is fundamental, courts may, in rare cases, pierce the corporate veil when presented with evidence that the company is being misused as a tool to perpetrate fraud, conceal wrongdoing, or evade legal responsibilities.

Q5) What are the essential characteristics of a Company?

1) Body Corporate (S. 2(1)): The incorporation of a company grants it the status of a distinct legal entity.

2) Capacity to Carry Out Activities (S. 2(2)): A company, subject to its articles, has the capacity to engage in lawful activities, acts, and transactions within and outside Sri Lanka.

Q6) What are the types of Companies?

1) Limited Companies (S. 3(1)(a)): Issue shares; shareholder liability specified in articles.
    - Private Limited Companies - cannot issue shares to the public, but can issue shares to friends and family.

    - Public Limited Companies - can issue shares to the public

2) Unlimited Companies (S. 3(1)(b)): Issue shares; shareholders have unlimited liability.

3) Guarantee Companies (S. 3(1)(c)): Do not issue shares; members contribute as per articles.

Q7) What is the incorporation Process under Section 4?

1) No Prescribed Minimum Shareholders: Except for guarantee companies, no minimum number of shareholders is prescribed.

2) Application Requirements (S. 4(1)):
    - Declaration of a non-identical name.
    - Articles signed by initial shareholders.
    - Consent from directors and a secretary.

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3) Single Shareholder (S. 4(2)): A company can have a single shareholder, including the secretary to the treasury, an individual, or a legal entity.

Q8) What is the Certificate of Incorporation under Section 5?

- Registrar assigns a number and issues a certificate specifying name, number, date of incorporation, and legal status.
- Indicates whether the company is private or offshore.
- Public notice must be given within 60 working days of incorporation.

Q9) What are the requirements for Company Names under Section 6?

- The name should reflect the nature of the company.
- Indication of legal status:
  > Limited company: Ends with "Limited" or "Ltd."
  > Private company: Contains "(Private) Limited" or "(Pvt) Ltd."
  > Public limited company: Contains "Public Limited Company" or "PLC."

Q10) What are the restrictions on Names under Section 7(1)?

- Identical Names: Cannot be identical to an existing company or registered overseas company.
- Chamber of Commerce: Words "Chamber of Commerce" prohibited unless registered under a license.
- Misleading Names: Names considered misleading by the Registrar are not allowed.

Q11) What names are prohibited as to Names under Section 7(2)?

Special Consent Required (Ministerial Consent) for;
- Names containing words suggesting a connection with the government, e.g., President, Presidential.
- Words suggesting a connection with local authorities or statutory bodies, e.g., Municipal, Incorporated.
- Prohibited words such as Co-operative, Society, National, State, Sri Lanka, or others indicating a connection with the government.

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Q12) What is the effect of Articles of Association?

- **Section 16** – Effect of Articles of Association
- This acts as a contract between the company and the shareholders and states the rights and obligations of the company and shareholders.

Q13) What is the effect of stating the objectives of the Company in Articles of Association under section 17?

- The company will be limited to entering into contracts that are in line with the articles of association. However, even if they do any act that breaches the articles of association it will still be valid as a contract.
- However, directors who cause the company to enter into contracts that are against the articles of association breach their duty as directors.

Q14) What are the duties of the directors in a Company under the Companies Act No. 07 of 2007?

- Section 187 - Duty of directors to act in good faith and in the interests of the company.
- Section 188 - Directors to comply with Act and company's articles.
- Section 189 – Directors shall not act in a manner that is grossly negligent and shall exercise the degree of skill and care expected of a person of his position.
- Section 190 – Can use information and advice of the employees of the company/professional adviser/ other directors.
- Section 192 – Disclosure of interest
- Section 197 – Duty to use of company information only as authorized.
- Section 200 - Disclosure of share dealing by directors.

Q15) What are the qualifications/disqualifications to be a director in a Company under the Companies Act No. 07 of 2007?

- Section 202 – Disqualifications to be a director.

  1) A person who is under 18 years of age.

  2) A person who is an undischarged insolvent.

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3) A person who is judged to be of unsound mind.

4) A person who is not a natural person.

5) Any person who does not comply with any qualifications for directors contained in articles of association of the company.

6) A person who is prohibited from being a director under Companies Act No. 17 of 1982.

7) A person who is prohibited from being a director under section 213 or 214 of Companies Act No. 07 of 2007.

8) According to section 213 of the Act, any person during the five years after the conviction or adjudication of the following actions shall be prohibited from managing the company.

Where a person:

➢ Has been convicted of any offence under this act which us punishable by imprisonment.

➢ Has been convicted of an offence involving dishonest or fraudulent acts.

➢ Is judged insolvent under the insolvency ordinance.

➢ Is judged to be of unsound mind.

Q16) How to terminate / wind up a company?

Companies have different procedures to dissolve, depending on their specific circumstances:

1. Registrar's Power of Dissolution: The Registrar may exercise the power of dissolution for a defunct company.
2. Amalgamation: Companies may dissolve due to amalgamation with other entities.
3. Enforcement of s 487 (Renumbering): Dissolution may occur due to the enforcement of s 487 (Renumbering) of the Companies Act.
4. Winding-Up: Winding-up is a procedure for companies facing severe financial difficulties.
    - Winding Up under Section 267(1);
    - Winding up is a legal procedure for companies facing severe financial distress jeopardizing their survival. There are three types;

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a) Winding Up by Court (Compulsory Winding Up - S.270):

Occurs when someone petitions the court for an order to wind up the company.The court makes such an order on various grounds, including:

- Company resolves to wind up by special resolution.
- Company doesn't commence business within a year of incorporation.
- Business suspension for a year.
- No directors in the company.
- Inability to pay debts.
- Court determines it is just and equitable to wind up.

b) Voluntary Winding Up (S.319):

- Initiated by the company itself through a resolution.
- Two types: Members' voluntary winding up (solvent) and Creditors' voluntary winding up (insolvent).

c) Winding Up Subject to the Supervision of the Court (S.351):

- A hybrid between compulsory and voluntary winding up.
- Court supervision ensures protection of interests.

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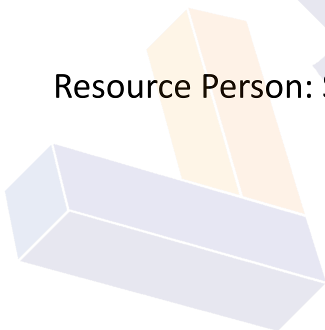

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