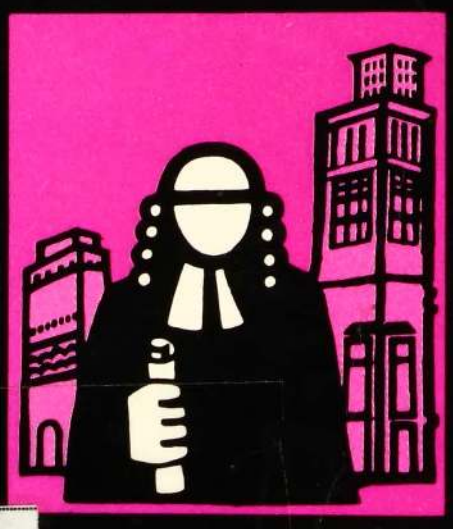
WICKREMASINGHE'S COMPANY LAW OF SRI LANKA

REVISED, 2ND EDITION



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REVISED, 2ND EDITION

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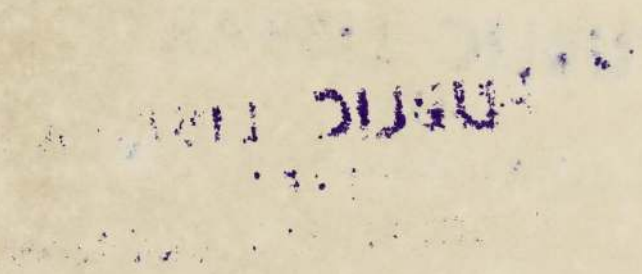

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TO MY PARENTS

AND

TO THE MEMORY OF MY LATE UNCLE TIVANKA

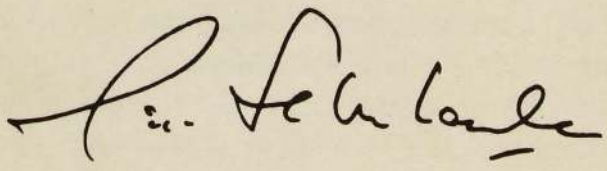
FOREWORD

This is the book on Company Law in Sri Lanka that you have been waiting for. The author of this work refers to it as a second edition. The first one, on the Ceylon Companies Ordinance of 1938, was written by Mrs. Ayoma Wickremasinghe, the mother of the author of the present volume. It was what it was then designed to be "For students of Legal and Professional Examinations" primarily. It was the first work of its kind in Sri Lanka and was useful to lawyers, too, as a quick referencer. The present work is a much more comprehensive and ambitious one. It delves into the history and development of Company Law in England and particularly in Sri Lanka; it deals exhaustively with the various sections of the Companies Act No. 17 of 1982, and is replete with judicial citations principally from the English courts. It also deals with Unit Trusts, Insider Trading and the Securities Market as well as the relevant provisions of other statutes affecting Companies – Finance Act, Exchange Control Act, Banking Act, Inland Revenue Act, Stamp Duty Act and the Penal Code. The material within the covers of this book is not to be found in any other single publication in Sri Lanka concerning the Company Law of this country.

With the rapid growth of companies and the vast increase in the registration of companies since the enactment of the Companies Act No. 17 of 1982, this is a well-timed publication. This book will doubtless be of considerable value to lawyers, practitioners as well as academics, accountants, secretaries of companies and, in fact, anyone who has anything to do with administering or advising companies in Sri Lanka.

The book is well arranged, following the scheme that was adopted in the earlier book; with complete tables of relevant cases and relevant statutes, with well-indexed references to sections and comments on sections of the Act and is very easy to use. Adequate reference is made also to the earliest English authorities on Company Law. It is evident that much study, research and sifting of material has gone into the preparation of this book.

If you are looking for quick reference or wanting to do a detailed study of the Company Law as it prevails in Sri Lanka, you should find room for this book on your shelves. It should also whet your interest in this branch of the Law.



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Chairman
Company Law Advisory Commission

1st May, 1992.

PREFACE

The first chapter of this book is on the history of company law. Though history of the law is of little practical importance, the outline of the evolution of company law could be of interest to students and those in the legal profession. Since Sri Lankan company law was derived from English company law, a brief history of English company law is given, followed by an account of the introduction of legislation governing corporate bodies in Sri Lanka. The first joint stock company came into existence by the Civil Law Ordinanace of 1853. At present, the statute in force is the Companies Act, No: 17 of 1982. Other legislation affecting corporate bodies are cited in the relevant chapters. New chapters included in the second edition are on insider trading, the securities market, off-shore companies, companies incorporated outside Sri Lanka and the Registrar.

The first edition of this book was written by my mother, primarily for students of legal and professional examinations and for those in trade, commerce and industry; great detail had been avoided as it would have rendered the subject cumbersome and hence of little practical use to such persons. To those in the legal profession it was a primary reference because of the lack of greater detail and example of case law. The present edition consists of a more detailed study of the statutes as well as an increased volume of case law, hence it would be of greater value to the legal profession.

This book deals purely with the legal requirements, and forms an easy reference on what the law is on a particular topic, e.g. on directors' qualification, special resolution and annual accounts. Those requiring application of company law in practice, e.g. persons wanting to know the procedure in forming a company or the process in an issue of shares must realise that this book does not cover these aspects in detail, as application and practice of company law is a separate subject, referred to as Company Secretarial Practice.

Since I was overseas during the year prior to publication, the onerous task of proof reading was undertaken by my parents, for which I thank them most sincerely. My father's thirty-five years of practical experience in applying legal requirements to various company situations proved invaluable whilst drafting this book. On numerous occasions, his queries resulted in some important aspect being researched, added or amended. Rangita De Silva LL.B. (Hons.) also helped by looking through the manuscript and making suggestions.

My uncle, the late Tivanka Wickremasinghe, P.C., a leading criminal lawyer of his day, gave me the initial impetus in the legal field with his brilliance, legal knowledge and inspiring personality.

The printers were excellent. An author could not expect a better service. They were prompt, efficient and always obliging. The manuscript given to them was extremely difficult to work with. I doubt whether any other printer would have undertaken to print from such an untidy manuscript. In spite of this, the proofs contained few errors. I thank them for a difficult task done extremely well.

14/2, Ward Place, Colombo 7.
May 1992

Kimarli Wickremasinghe

CONTENTS

TABLE OF STATUTES

CHAPTER A

HISTORY OF THE REGISTERED COMPANY

Sri Lankan Company Law is based on and chiefly derived from the English Company Law.

In **England,** the formation of Joint Stock Companies began several centuries ago. In 1600, three years before the death of Queen Elizabeth I, the East India Company was formed; the Hudson's Bay Company was formed in 1670 and the Bank of England in 1694. Such companies were formed by Royal Charter or by Special Act of Parliament. At that time incorporation by any other means was not available, and groups carrying on important businesses such as banking and insurance being considered partnerships. For the first time in 1844, incorporation into companies other than by Royal Charter or by Special Act was introduced. Provisions for the winding up of companies were also introduced for the first time in the same year. The limitation of liability was available only after 1855 by the passing of the Limited Liability Act, 1855.

In the following year, by the Joint Stock Companies Act, 1856, the law that existed in England was repealed and notably the deed of settlement was replaced by the memorandum of association. In 1857 an Amending Act was passed. The law was codified in 1862 followed by some sixteen amending Acts during the next forty-six years, referred to collectively as "The Companies Acts, 1862 to 1908": the Companies Act, 1862, introduced the limitation of liability by guarantee and prohibited the alteration of the Objects Clause; the Directors' Liability Act, 1890, introduced the liability of directors to compensate persons taking shares on the basis of a prospectus containing false statements; the Companies Act, 1900, introduced the compulsory audit of companies' accounts; the Companies Act, 1907, distinguished between the public and private companies; the Companies (Consolidation) Act, 1908, consolidated the 1862 Act with the subsequent Acts.

Subsequent Acts passed in England were The Companies Act, 1913, The Companies (Foreign Interests) Acts, 1917, The Companies

(Particulars as to Directors) Act, 1917, and The Companies Act, 1928; such Acts were consolidated by the Companies Act, 1929.[1] The Companies Act, 1929, required the presentation of the balance sheet and the profit and loss account before the members annually. The Act required the auditors of public and ordinary private companies to be professionally qualified. The Companies Act, 1948, required greater detail in the annual accounts and a stricter audit; the Act created the Exempt Private Company. The Companies Act, 1967, abolished the Exempt Private Company and required still greater detailed information in the annual accounts especially in regard to directors.

The Companies Act, 1976 amended the law relating to accounting procedures and auditors, and the disqualification of persons taking part in the management if they persistently defaulted in complying with the requirements of delivering documents to the Registrar. The Companies Act, 1980, provided for the first time a major distinction between public and private companies, including minimum financial requirements for the former; tighter restrictions on directors and on payment of dividends were enacted; insider dealing was made a criminal offence. This Act as well as the Companies Act of 1981 were influenced by an EEC Directive of 1978 on company accounts and for the public disclosure of them; new rules for company names, the purchase and redemption by a company of its own shares and for more stringent disclosure of shareholdings were included amongst other reforms.

A new development in English company law from this period onwards, is the influence of the EEC Directives.

The Companies Act (Pre-Consolidation Amendments) Order 1985 And the Companies Act (Pre-Consolidation Amendment) (No. 2) Order, 1984 were enacted to consolidate the various Acts from 1948 onwards. Finally, a single main Act, the Companies Act, 1985 with three small satellite Acts were enacted. The Business names Act, 1985 incorporating the 1981 Act's provision relating to the use of business names by all traders including companies: the Company Securities (Insider Dealing) Act, 1985 incorporating the provisions of the 1980 Act; the Companies Consolidation (Consequential Provisions) Act, 1985 dealing with transitional matters, savings provisions, repeals and

[1] The Ceylon Companies Ordinance 1938 is based on the English Companies Act, 1929.

consequential amendments to other Acts.

Departing from previous practice the model forms of memorandum and articles etc. were placed in separate regulations, the Companies (Table A to F) Regulations, 1985.

Mainly due to EEC Directives more provisions affecting companies were introduced in the Insolvency Act, 1986, Directors Disqualification Act, 1986 and the Financial Services Act, 1986.

In **Sri Lanka,** the Joint Stock Company was first introduced on the 1st of July, 1853, by the Civil Law Ordinance. This Ordinance provided:

"In all questions or issues which may hereafter arise or which may have to be decided in Ceylon with respect to the law of partnerships, corporations, banks and banking, principals and agents, carriers of land, life and fire insurance, the law to be administered shall be the same as would be administered in England in the like case, at the corresponding period, if such question or issue had arisen or had to be decided in England, unless in any case other provision is or shall be made by any enactment now in force in Ceylon or hereafter to be enacted"—s.3.

As there were no enactments governing joint stock companies, the English Company Law of that period applied to Ceylon, till the passing of the Joint Stock Companies Ordinance of 1861.[2] This Ordinance contained generally the provisions of the English Acts up to such period; hence, provision was made for the limitation of liability, the replacement of the deed of settlement by the memorandum and articles of association, and for winding up.[3]

The Ordinance of 1861, was amended by No. 9 of 1867, No. 3 of 1893, No. 13 of 1905, No. 17 of 1907, No. 18 of 1909, No. 34 of 1916, No. 7 of 1918, and No. 29 of 1919; the Ordinance did not apply to persons incorporated for purposes of insurance or banking. The penalty on associations of more than 20 persons carrying on business was

[2] No. 4 of 1861.

[3] Winding up was by compulsory winding up by court and by voluntary winding up (in effect a members' voluntary winding up), the creditors having the right in the latter case to apply to court for a compulsory winding up.

introduced by the Ordinance No. 9 of 1867. The alteration of a company's name was allowed by Ordinance No. 3 of 1893. The subdivision and consolidation of shares were permitted by Ordinance No. 17 of 1907. A balance sheet was required to be sent to the Registrar of Companies annually and within 12 months of incorporation, by the Ordinance No. 18 of 1909. The prohibition against the use of misleading names, the inclusion of particulars of directors on the annual list, and provisions for overseas Companies to carry on business in Ceylon were introduced by Ordinance No. 7 of 1918.

Ordinance No. 4 of 1888 was passed to enable joint stock companies to compound for the stamp duties payable on certain shares issued by them unstamped. Provision for the reduction of capital was given by Ordinance No. 6 of 1888 which is cited as the Joint Stock Companies Ordinance 1888. The Joint Stock Companies Ordinance, 1861 and 1888 were further affected by Ordinance No. 3 of 1893 and Ordinance No. 2 of 1897. The former, empowered a Company to alter its objects subject to confirmation of the Court, required the maintaining of a Register of members and for more detailed disclosure in the prospectus, and treated wages and salaries as having a priority as to settlement in a winding up; the latter incorporated banking companies under the Joint Stock Companies Ordinances.

The Companies Ordinance No. 51 of 1938 was amended by Ordinance No. 6 of 1939, No. 19 of 1942 and No. 54 of 1946 and Acts No. 58 of 1949, No. 35 of 1951 and No. 15 of 1964. The provisions that only registered auditors may be appointed was incorporated by the Ordinance No. 6 of 1939. The inclusion of particulars of directors on business documents, letters etc. and the keeping of a branch register was introduced by the Ordinance No. 19 of 1942 which also made significant provisions applicable to banking companies. The right to examine on oath officers, agents etc. and the books and documents of the company on an Inspection[4] was given by the Ordinance No. 54 of 1946.

The Companies (Amendment) Act No. 15 of 1964 introduced 19 alterations. Among the more significant changes were the power of

[4] See M 1.

objection given to certain members and debenture holders in an alteration of the objects clause in the memorandum, the right to change the situation of the registered office by special resolution, and the power granted to court to restrain persons convicted of certain offences from managing companies. The most significant, however, was the provision concerning the prevention of oppression and mismanagement. For the prevention of oppression and mismanagement, the court was given wide powers, such as the regulation of the company's affairs, contracts and transfers.[5] The Act also specified in greater detail the powers and duties of the Registrar of Companies.

The duties and powers now generally devolving on the Registrar of Companies were originally carried out under the direction of the Governor, who was later replaced by The Director of Commerce. By the Companies (Amendment) Act No. 15 of 1964 almost all the powers of the Director of Commerce were transferred to the Registrar of Companies.

The Companies Ordinance No. 51 of 1938 as amended by subsequent Ordinances and Acts was in force for over 42 years. In other countries, such as the United Kingdom, every few years new legislation was enacted to keep in line with changing commercial trends and the changing activities of companies. The reform of Sri Lankan Company Law was long overdue.

In August 1977, the Minister of Trade & Shipping appointed a committee to draft the Law for a new Companies Act to keep in line with world trends and the changing situation in Sri Lanka.

This Committee took into consideration the Draft Bill on Company Law prepared by the L. M. D. de Silva Commission which was published as a Sessional Paper XIII of 1951 and a later Draft Bill prepared by the Committee appointed by the Minister of Trade and Commerce in 1967, and also the views of a symposium on Commercial Laws of Sri Lanka held by the Bar Association of Sri Lanka in 1980. Trade Chambers, Institutes connected with the

[5] The provision for the prevention of oppression and mismanagement is not wholly derived from nor based on the English Company Law. The English Companies Act, 1948, did not give the Court such wide control over the affairs of a Company.

formation and management of companies, lawyers, businessmen, shareholders, trade unionists and such like were consulted for their suggestions. A revised draft Law was published as Sessional Paper IV of 1979. Examination was also made of the statutes of other relevant countries, particularly of the United Kingdom, India, Singapore and some States of Australia. The Companies Bill, gazetted in 1981 endeavoured to establish a legal framework that would meet the needs created by the upsurge in commercial activity. The Bill received the assent of the Speaker in May 1982.

On the 2nd of July 1982, by Gazette Extraordinary No. 199/14, the Companies Act No. 17 of 1982 became law.

This Act contains 453 sections and nine schedules. It aims to enhance the level of public disclosure by both public and private companies, to make available a greater opportunity for inspection and investigation of a company's affairs by the Registrar of Companies, and the shareholders and investors, to facilitate recourse to the courts in restraining oppression and mismanagement, to provide for the enforcement of conversion of private companies into public companies under particular circumstances, to introduce for the first time new aspects uncatered for in previous legislation, such as the control of Insider Trading, and the formation of People's and Offshore Companies in Sri Lanka.

The major changes brought about by The Companies Act No. 17 of 1982, from the Ordinance No. 51 of 1938 are, in outline, as follows:

Every company is required to indicate in its name whether it is a private, guarantee or a people's company. The Memorandum of every company is required to set out the primary objects of the company, which it intends the company should carry out during the first five years of incorporation (the ancillary powers to attain the primary objects and other objects of the company could be exercised and performed only with a special resolution); a director can be removed by ordinary resolution of which special notice must be given; a register of directors', their spouses' and their childrens' shareholdings must be maintained; directors of public companies or private companies which

are subsidiaries of public companies, must cease to hold office on their attaining 70 years of age,[6] the Secretary of every company must have the prescribed qualifications (as it is in the United Kingdom since 1980); both private and public companies are required to file their balance sheets with the profit and loss accounts and the auditors' reports and directors' reports; the Registrar of Companies' powers are widened, and he is also empowered to appoint competant Inspectors under specified circumstances (these circumstances being wider than those specified by the former Ordinance); a statutory right was granted to a member to appoint a proxy to represent him at a shareholders' meeting (earlier this was permitted only if the Articles of Association provided); completely new legislation enacted: provisions controlling Insider Trading, – the Act prohibits the abuse of information obtained in an official capacity whether as directors, dealers on the Stock Exchange or even public servants; offenders found guilty are liable to heavy penalties whilst the transaction itself remains unaffected; Peoples' Companies may be formed provided that the maximum shareholding of a single shareholder or through a member of his family does not exceed 1/10 of the paid-up capital of the Company; Offshore Companies may be registered but are not permitted to carry on business within Sri Lanka; the Act authorises The Registrar of Companies on his own or on the request of any member of the public (if appropriate), to call upon a private company to be converted into a public company in the interests of the national economy (the Companies have recourse to give their objection in the first instance to the Registrar of Companies and thereafter to courts if they are not satisfied with the ruling made by the Registrar of Companies).

Two Acts, the Security Council Act No. 36 of 1987 and the Security Council (Amendment) Act No. 26 of 1991 were enacted for the regulation of the securities market and for the protection of shareholders and investors. The former Act repealed part V of the Companies Act on Insider Dealing.

These Acts legislate for the formation of the Securities and Exchange Commission which is a mechanism to advise the Government on the development of the securities market and to implement Government policy with respect to the securities market.

[6] This age limit will not apply if the company has passed a resolution of which special notice has been given: s. 182 – see L 22.

History of the Registered Company

The Security Council (Amendment) Act No. 26 of 1991 introduces legislation to regulate the formation and control of Unit Trusts – a concept new to Sri Lanka but prevalent in many other countries.

The Banking Act No. 30 of 1988 repealed Part XIV of the Companies Act No. 17 of 1982 dealing with provisions relating to Banks.

CHAPTER B

NATURE OF COMPANIES – INCORPORATION – COMMENCEMENT OF BUSINESS

1. WHAT IS A COMPANY?

Company Law recognises an artificial or fictitious being – the corporate body.[1] This being, though only a concept, exists in that it acts, contracts, and behaves as if it were a live person. A company can do business, have its own money and property, engage workers, borrow and owe money, enter into contracts, and sue and be sued like an individual. Law regards a registered company as a person just as it regards human beings like Mr. Dharmasena or Mr. Perera.[1a]

A company is separate and distinct from those who own it – the shareholders, and those who manage and direct it – the directors. One of the basic principles of company law is this separateness. The company's assets, liabilities and contracts belong to the company and not to the shareholders who own it, nor to the directors who are its officers and agents. Further, the company's existence is unaffected by changes in membership. Members may come and go but the company continues unaffected: a company has perpetual succession.

This concept of a company as a person separate from those who compose and direct it, is the fundamental principle of company law, and distinguishes companies from sole traders and partnerships.

Salomon v. Salomon Co., Ltd., (1897) A.C. 22

"S" was a boot manufacturer. He formed a company, the members being himself, his wife and children, and sold his boot manufactory to the Company in consideration for shares and debentures (secured on the assets). His wife and children were given one share each and himself the balance shares and all of the debentures. Subsequently the Company became insolvent. On winding up it was found that the assets were insufficient to satisfy both debenture holders

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[1] For a definition of a corporation and the different types of corporations, see Weeramantry, 'The Law of Contracts', Ch. 16.

[1a] The law as it stands, permits a corporation or a company the option of instituting an action by way of summary procedure under chapter 53 of the Civil Procedure Code for recovery on liquid claims: Science House (Ceylon) Ltd. v. IPCA Laboratories (Pvt.) Ltd. (1987) 1 SLLR - 185.

and trade creditors. The latter claimed that the debenture rights should be waived as the company and "S" were the same person and he could not owe money to himself. It was held, that the Company was a separate legal entity distinct from the members who compose it, and the debentures were valid and must be settled before the trade creditors.

In Trade Exchange (Ceylon) Ltd. v. Asian Hotels Corporation (1981) 1 SLLR 67, where ninety-five percent of the shares were held by a Government Corporation, it was held by the Supreme Court that the company and the shareholders were distinct entities and that the company cannot become an agent of the Government even though almost all the shares were held by a Government Corporation.

Sometimes, however, the law goes behind the 'veil of incorporation' and regards the persons who are actually involved. For instance:

(a) In the 1914-18 War when all the members of an English Company were aliens, the Courts held that the company could not sue in English Courts as it had assumed an alien character – Daimler Co. v. Continental Tyre Co. (1916), 2 App. Cas. 307.

(b) When the number of members fall below the statutory minimum, members may become personally liable for the company's debts, under certain circumstances (see B 10).

(c) Legislation sometimes lifts the veil – e.g., in requiring Holding & Subsidiary companies to prepare group Accounts - s.146; in prohibiting a company from giving financial assistance, subject to a certain exception, to anyone to purchase shares of that company or its holding company - s.55.

(d) If the controlling shareholder uses the company as his agent, or if the corporate body is abused for an unlawful or improper purpose – Re Bugle Press Ltd. (1961) ch. 270 (C.A.).

(e) In the field of taxation, e.g. it is the residence of a company, which matters in the ascertainment of the company's liability, as determined by the location of the central management and control of the company.

2. WHAT IS A 'REGISTERED COMPANY'?

A registered company is a corporate entity registered under the Companies Act.

The Companies Ordinance, No. 51 of 1938 which was the original Ordinance, was amended by,

Ordinance No.	6 of 1939
	19 of 1942
	54 of 1946
and Act No.	58 of 1949
	35 of 1951

such amendments being consolidated in Chapter 145 of the Ceylon Legislative Enactments. Chapter 145 was amended by Companies (Amendment) Act No. 15 of 1964.

The Companies Ordinance (Chapter 145) was repealed when the Companies Act No. 17 of 1982 came into operation on 2nd July 1982.

Reference in this book to "Companies Act" or "Act" is to be taken as reference to the Companies Act No. 17 of 1982.

3. CLASSIFICATION OF REGISTERED COMPANIES[2]

A registered company may be:

(1) a **company limited by shares**, in which case the liability of a member to contribute to the company's assets is limited to the amount, if any, remaining unpaid on his shares, or

(2) a **company limited by guarantee**, in which case the liability of a member is limited to the amount which he has undertaken to contribute in the event of the company being wound up; or

(3) an **unlimited company**, in which case the liability of a member is unlimited: s.2(2).

Companies limited by shares must have a share capital. Companies limited by guarantee and unlimited companies may or may not have a share capital.

[2] In 1989 and 1990 (the latest figures available at time of publication) registration of companies was as follows: public companies with limited liability - 91, private companies with limited liability - 2084, companies limited by guarantee - 2, unlimited companies - 98.

Most companies are registered as limited liability companies.

A **registered company** may be a public company, a private company or a people's company.

A **private company** is a registered company which, by its Articles of Association, contains the restrictions of s.30 which are as follows:

(a) Restricts the right to transfer its shares.

(b) Limits the number of its members to fifty,[3] not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have continued after the termination of that employment, to be members of the company.

(c) Prohibits any invitation to the public to subscribe for any shares or debentures of the company. – See Q 1 – 4.

A **People's company** is a registered company which conforms to the requirements of Part VII (ss.231 to 240) of the Act, which are as follows:

(a) The nominal value of a share shall not exceed rupees ten (Rs. 10/-).

(b) The maximum shareholding of any member shall be limited to ten percent of the issued capital. The shareholding for this purpose includes shares held by the spouse, any minor children or through nominees. This limit does not apply to shares held by the State.

(c) There shall be a minimum of three directors, each holding at least one share in the company.

(d) The directors shall be elected by the shareholders.

(e) The directors shall retire every year but shall be eligible for re-election at the annual general meeting.

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[3] If two or more persons hold one or more shares in a company jointly, they are treated as a single member : s.30.

(f) A director cannot be a director of another people's company.

(g) The shares cannot be held by any other company except another people's company.

(h) There shall be a minimum of fifty members; if the number of members of a people's company fall below fifty and remains so for a period exceeding six months, such company shall cease to be a people's company and shall be deemed to be a public company; similarly, if the number of members falls below seven for a period of more than six months the company shall be deemed to be a private company.

Subject to these provisions, the provisions of the Act applicable to public companies shall apply to people's companies.

4. OBLIGATION TO REGISTER

An association of more than 20 persons formed to carry on business for the acquisition of gain, whether by association or by members individually, must be registered under the Act unless it is otherwise incorporated: s.426.

Associations contravening these provisions are void, and hence,

(1) has no legal existence;

(2) persons involved are,

(a) guilty of an offence and liable to a fine not exceeding Rs. 500/- or imprisonment of not more than three months or to both;

(b) severally liable (without joinder in the suit of any other member) for the whole debts of any unregistered company, association or partnership.

5. HOW REGISTRATION IS EFFECTED

Registration is effected by,

(a) depositing ('registering' or 'filing') certain documents with the Registrar of Companies, and

(b) paying specified fees and duties whereupon a 'Certificate of Incorporation' is issued by the Registrar, and the Company comes into existence on the date of the certificate. ss.14, 15.

(a) The documents required to be filed are:

(1) **Memorandum of Association.**

(2) **Articles of Association.**

(3) A **Declaration of Compliance** with the requirements of the Companies Act by an Attorney-at-Law engaged in the formation of the company or a person named in the Articles of Association as a Director or Secretary of the Company (Form 5).

(4) Statement of intended situation of **registered office** of company (Form 36 A).

(5) List of persons who have consented to be **Directors/ Secretary/ Secretaries or Joint Secretaries** (Form 47).

(6) The **consent of Directors/Secretary/Secretaries** or **Joint Secretaries to act as such** (Form 46).

(b) Fees are payable on the registration of forms and for the registration of capital.

Further, the following must be filed:

(i) Notice of the situation of the registered office must be filed within 14 days of incorporation or from the day on which the company commences to carry on business, whichever is the earlier: s.103.

(ii) A return of directors, giving particulars as contained in the Register of Directors[4] must be filed within 14 days of the appointment of first directors: s.194.

[4] See L 9.

(c) The duties and fees payable are specified in the Ninth Schedule attached to the Ordinance.

6. COMPANIES INCORPORATED OUTSIDE SRI LANKA –

The registration of a place of business within Sri Lanka – see C 3, 4.

7. CERTIFICATE OF INCORPORATION

Upon the registration of the above documents and the payment of the necessary fees and capital duty, the Registrar issues a certificate that the company is incorporated and, in the case of a limited company, that it is limited.

The certificate is **conclusive evidence** that all the requirements of the Act as to registration and as to matters precedent and incidental thereto, have been complied with, and that the company is duly registered under the Act. From the date named in the certificate the company becomes a body corporate having perpetual succession, a common seal, and the right to exercise the powers given in the memorandum: ss.15, 17.

8. EFFECT OF INCORPORATION

From the date of incorporation mentioned in the certificate of incorporation, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, form a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal: s.15.

A public company cannot commence business until a **trading certificate** is obtained – see B 9 below.

A company on becoming registered is a legal person, separate and distinct from its members, and all stated in B1 applies.

9. COMMENCEMENT OF BUSINESS

By s.107:

(a) a company formed as a **private company**, and any company without a share capital, may commence business immediately on receiving its certificate of incorporation,

(b) a company formed as a **public company** with a share capital may not commence business or exercise any borrowing powers until the Registrar has issued a certificate entitling it to commence business (**the trading certificate**).

In order to obtain a trading certificate, the following requirements must be complied with:

(i) Where a **prospectus** is issued, a **statutory declaration** by a director or a secretary must be filed declaring that –

(1) Shares payable wholly in cash have been allotted to an amount not less than the **minimum subscription.**[5]

(2) Every director has paid, on the shares for which he has contracted to pay in cash, the **same proportion as the public** have been required to pay on application and allotment.

(ii) Where the company has not issued a prospectus, a **statement in lieu of prospectus (form A 11)** and a **statutory declaration** (form 38), that the directors have paid, on the shares they have contracted to pay for in cash, the same proportion as is payable on application and allotment on the other shares allotted for cash, must be filed.

Any contracts made by a company (i.e. after incorporation) before it is entitled to commence business are **provisional** only. They are not binding on the company until the certificate to commence business is issued.

Every person responsible for the contravention of the provisions of s.107 is liable to a fine not exceeding Rs. 500/- for every day during which the contravention continues.

10. MEMBERS – STATUTORY MINIMUM

The Act demands a minimum of,

7 members for a public company,
2 members for a private company,
50 members for a people's company s.2 (1).

[5] See F 2.

The reduction of membership below the statutory minimum has two consequences:

(a) If the company carries on business for more than six months with the numbers so reduced, every person who is a member **after** such six months, and is **cognisant** of the fact, is severally liable for the whole debts of the company contracted after such six months; s.33. The effect of s.33 is that limited liability continues only for six months in these circumstances. If after that time the company incurs fresh liabilities, and any member is aware of the position, he is fully liable for these liabilities, and a creditor may sue him personally.

(b) The company may be wound up by Court: s.255, (see R 5).

11. WHEN PRIVATE COMPANIES MAY OR MAY NOT BECOME PUBLIC [6]

The Registrar of Companies on his own or at the request of any person giving adequate reasons in writing to him, may issue a notice to a private company to show cause why it should not become a public company. The Registrar must be satisfied that it is in the national interest or in the interest of the economy of the nation for him to issue such notice: ss.224, 227.

Once the notice is issued the company cannot –

(a) register a transfer of shares

(b) issue any shares

(c) pass a resolution for winding up the company or any subsidiary

(d) apply to court to wind up the company or any subsidiary.

If a transfer of shares is resulting upon the operation of law it may however be registered, provided it is not intended to defeat the provisions of this section of the Act.

The company must respond to such notice within thirty days or such extended time limit permitted by the Registrar. The company either consents to be a public company or may offer reasons as to why it should not be a public company: s.225.

[6] Part VI – ss. 224 to 230.

If the company consents to be a public company, the Registrar will ask the company to state:

(a) the period of time within which it will do so, (if the period exceeds six months, permission must be obtained from the Registrar);

(b) the number of shares it proposes to offer the public;

(c) in outline the steps the company proposes to take in this connection.

The Registrar may, subject to variations as suggested by such company, confirm such proposals.

If the company notifies to the Registrar:

(a) its unwillingness to become a public company; or

(b) its refusal to issue the number of shares to the public as required by him;

the matter will be referred to the District Court in the form of a petition by the Registrar.

The court has power, *inter alia*, to direct that –

(a) the memorandum and articles of association be altered,

(b) the share capital be altered or varied,

(c) the proportion of shares that should be offered to the public be altered or varied.

If any company contravenes any of these provisions or any direction by the Registrar or court, that company and every officer or agent who knowingly and wilfully authorises or permits such contravention is guilty of an offence and is liable to a fine not exceeding ten thousand rupees or to imprisonment for not more than 2 years or to both.

12. REGISTERED LIMITED COMPANIES AND PARTNERSHIPS CONTRASTED

	Registered Limited Companies	Partnerships
Creation	By registration of documents with the Registrar and the payment of fees etc.	By agreement, express or implied.
Legal Status	Legal body distinct from those who own and manage the company and is hence unaffected by changes in membership.	There is no separate legal entity. Firm consists of partners whose death or withdrawal, or the joining of a new partner alters the partnership which in effect ends and another partnership comes into being.
Maximum Number of Members	There can be any number of members, except in the case of a private company which may not have more than fifty.	May not have more than twenty partners and not more than ten in the case of a banking company.[7]
Liability of Members and Partners	Members are not personally liable for the company's debts, except in certain instances.[8]	Partners are personally liable for the whole debts of the partnership.
Management	Members cannot interfere with the powers of management delegated to the directors by the articles except by altering the articles.	All the partners have the right to share in the management of the partnership.

[7] See B4.
[8] See B1.

Agency of Members	Individual members are not agents of the company and cannot bind the company by their individual acts.	Every partner (i.e., general partners) is an agent of the firm and can bind the firm by his individual actions.
Transfer of Shares	Transfer or transmission of shares does not affect corporate existence.	A change in partners results in the old partnership ending and a new partnership coming into existence.
General Powers	The company can act only within the scope allowed by the Memorandum and Articles; the former can be altered only within certain limits and the latter by special resolution.	The partners can freely alter their objects and freely regulate their internal affairs.
Statutory Control	Companies must abide by the provisions of the Companies Act.	There is very little statutory control; partnerships being practically free from such regulation.

CHAPTER C

OFFSHORE COMPANIES – COMPANIES INCORPORATED OUTSIDE SRI LANKA

1. OFFSHORE COMPANIES

An offshore company is one which is registered in Sri Lanka but carrying on its business overseas and not in Sri Lanka. Part VIII of the Act provides for any company to make an application to the Registrar of Companies to be registered in Sri Lanka as an offshore company. A company incorporated abroad may also make application to the Registrar for it to be deemed to have been incorporated under the provisions of this Act. The application for registration must have annexed to it:

(a) Certified copy of the charter, statutes, memorandum and articles of association or similar document.[1]

(b) List of directors or those managing the company with their full names, addresses, occupations and offices they hold in the company.

(c) Name and address of the representative in Sri Lanka who should be resident in and a citizen of Sri Lanka.

(d) A statement showing the full address of,

(i) the principal office of the company in the country of incorporation;

(ii) the principal place of business in Sri Lanka.

The Registrar must be notified of alterations within the prescribed time and in the prescribed form: s.241.

(e) The prescribed fee (presently Rs. 10,000/-) : s.242.

(f) A bank certificate to show that the prescribed sum (presently US Dollars 25,000) to defray expenses of the Sri Lanka office has been deposited in a Bank. s.243.

(g) A certified copy of the certificate of incorporation: s.241 (e).

The Registrar of Companies may refuse to issue the certificate of registration if,

[1] Where such instrument is not in the official language of Sri Lanka, in such language as may be specified by the Registrar: s.241(2)(a).

(a) the winding up of the company has commenced;

(b) a receiver has been appointed;

(c) there is a scheme or order affecting the rights of creditors;

(d) there is a legal impediment in the country of incorporation preventing such company from engaging in the business of an offshore company;

(e) the issue of such certificate renders invalid any legal proceedings against the Company.

The Registrar of Companies having regard to the national interest or in the interest of the national economy may issue a certificate of registration to an offshore company.

The Registrar of Companies may impose such conditions as he may deem necessary in the national interest.

A company already incorporated in Sri Lanka may be registered as an offshore company.

2. EFFECTS OF REGISTRATION OF AN OFFSHORE COMPANY

The issue of the certificate will exempt the company from compliance with the other provisions of the Act: s. 242(1)(b).

An offshore company is prohibited from carrying on business within Sri Lanka. The registration gives power to carry on business outside the shores of Sri Lanka. s.244.

If such company ceases to continue business it must notify the Registrar of Companies of the cessation of business, in the prescribed form: s.245.

The Registrar of Companies has power to cancel such registration for "good causes". In which case the company shall cease to enjoy the privileges and benefits granted under Part VIII of the Act: s.242(3).

An offshore company may continue business as an offshore company if it produces to the Registrar of Companies before the 31st of January of **each** calendar year:

(a) proof of payment of the prescribed fee;

(b) a bank certificate as evidence of funds deposited to defray expenses of the Sri Lanka Office: s.243.

3. COMPANIES INCORPORATED OUTSIDE SRI LANKA – REGISTRATION OF A PLACE OF BUSINESS WITHIN SRI LANKA[1a]

A company incorporated outside Sri Lanka (foreign company) may establish a place of business within Sri Lanka. The law regarding this is contained in Part XIII of the Companies Act and is subject to the provisions of the Companies (Special Provisions) Law, No. 19 of 1974.[2]

By s.395, any foreign company which establishes a place of business in Sri Lanka must within one month of doing so deliver the following documents to the Registrar of Companies for registration:

(a) a certified copy of the charter, statutes, memorandum and articles of association or similar document defining the constitution of the company;*

(b) a list of the full names and addresses of the directors and their nationalities and business occupation;[3]

(c) the name and address of at least one person resident in Sri Lanka authorised to accept notices on behalf of the company;

(d) a statement containing the address of the registered office of the company and the principal place of business in Sri Lanka;

(e) a certified copy of the certificate of incorporation, certified of recent date.

The Registrar has the power to extend the period of one month within which registration is required, if sufficient cause is shown by the defaulting company.

[1a] For Prospectus of overseas companies see F 11.

[2] Vide C 4.

[3] Such particulars which 'are required by the Act to be contained in the register of the directors see L 9; 'director' includes any person in accordance with whose directions the directors of the company are accustomed to act.

Every foreign company which has established a place of business **before** 2 July 1982 shall within one month of that date deliver to the Registrar the documents and particulars specified above.These provisions do not apply to companies that have filed particulars required under s.111 of the Companies Ordinance 1861 as well as to companies that have registered the required particulars within one month from 31st March 1939: s.395(2).

Such companies have the power to own lands as if they were companies incorporated under this Act: s.396.

A company to which Part XIII applies has the following obligations:

(a) to deliver to the Registrar for registration a return containing the prescribed particulars, if any alterations are made in the particulars filed with the Registrar according to s.395 (a) to (d), given above: s.397;

(b) to deliver to the Registrar for registration in every calendar year a certified copy of the profit and loss account and balance sheet, group accounts (if any) made in compliance with the provisions of this Act (subject to prescribed exceptions) which had it been a company incorporated under this Act would have had to table at a general meeting:* s.398(1);

(c) to state in any prospectus inviting subscriptions for securities in Sri Lanka, the country in which the company is incorporated: s.399(a);

(d) to conspicuously exhibit in every place of business it has in Sri Lanka,

(i) the name of the company and

(ii) country of incorporation: 399 (b);

(e) to state the particulars stated in (d) of this paragraph and if the liability of members of the company is limited, the fact that it is so, in all bill heads, letter heads, notices, advertisements and all official publications of the company: s.399(c) (d);

(f) to inform the Registrar when it ceases to have a place of business in Sri Lanka, in which case the obligations required to be performed under this Part shall cease: s.401.

* If any document required to be delivered to the Registrar is not in the official language of Sri Lanka, the Registrar has the power to ask for a translation in a language specified by him: s.398 (2).

4. Companies (Special Provisions) Law No. 19 of 1974 prohibited companies from owning[4] property or carrying on any undertakings in **Sri Lanka unless, they were,**

(1) incorporated under the Ordinance;

(2) exempted companies; exemption was given by the Minister by notice published in the Gazette.

In Perumal v. Dharmalingam (1981), S.L.L.R. vol. 1 page xii, Wanasundera J. states, "The main thrust of the legislation is to bring all foreign companies within the control of the State as part of our national policy. If the law is so interpreted as to suggest that incorporation of such companies under our law is not compelling, then such a view will have the effect of frustrating the entire purpose of this legislation and rendering it nugatory".

However, as stated earlier, by s.396 of the Act, a foreign company which has delivered to the Registrar the documents and particulars specified in s.395, has the right to own property and carry on any undertaking as if it were a company incorporated under the Act.

5. SERVICE OF DOCUMENTS

A document is deemed to be served on the company by delivering or posting,

(a) to a person whose name has been delivered to the Registrar, or
(b) to the address which has been delivered to the Registrar, or
(c) to any established place of business in Sri Lanka, if a name of a representative or an address has not been given to the Registrar or if for any reason it cannot be served, such as the death of the person named or his refusal to accept the document : s.400.

[4] Owning property means whether as an owner, co-owner, lessee, mortgagee or otherwise.

CHAPTER D

PROMOTERS – CONTRACTS – SEAL

PROMOTERS

1. DEFINITION

The term "promoter" is a term not of law but of business, usefully summing up in a single word **a number of business operations familiar to the commercial world by which a company is generally brought into existence.**[1] A promoter has been described as "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose" — per Cockburn C.J. in *Twycross v. Grant* (1877) 2 C.P.D. 469. The term "promoter" is not defined in the Act, except in s.45 where it applies only to the provisions of that section.

Since **a company** is an **artificial body** there must **necessarily be persons who intend to form it** and who take the necessary steps to carry out that intention. Such persons are called promoters. Those who direct the preparation of the memorandum and articles of association and prospectus, who procure the directors and capital, and arrange for underwriting contracts and contracts for the purchase of property are promoters. Promotion may continue even after the company is formed, e.g., when capital is procured and prospectuses issued.

All persons involved in the formation of a company are **not** necessarily **promoters. Agents** and **servants of the promoters** such as **solicitors, bankers** and **accountants** are **not themselves promoters.** s.45(6).

Whether a person is a **promoter or not** is a **question of fact** and must be adduced from the circumstances. Thus a person may be a promoter who is only acting as agent for others, or as a director of a promoting syndicate, if he has personally taken an active part in the promotion.[2]

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[1] Whaley Bridge & Calico Printing Co. v. Green (1879) 5 Q.B.D. 109.
[2] Lydney & Wigpool Co. v. Bird (1886) 33 Ch.D. 85.

2. POSITION

Promoters are **not agents of** the **company** they are forming as they **cannot be agents to a non-existent principal,**[3] **nor** are they treated as **trustees.**[4] However, from the moment they act with the company in view, promoters stand in a **fiduciary position towards** the **company and its prospective shareholders,** as if they are agents or trustees of the company they are forming. Hence, they **must not make,** either **directly or indirectly** any **profit** out of their trust, **unless** the company, **after full disclosure** of the facts, consents.

(Co-promoters are not as such necessarily partners, nor is one promoter necessarily the agent of the others, or the act or admission of one, evidence against the others.)[5]

3. SALE OF PROPERTY

On a sale of property the promoters must **make full disclosure of any profits** made.

Promoters are **permitted to sell their own property,** even though such property may have been acquired with the definite purpose of re-selling to the company at a profit, provided disclosure is made that the promoters are the vendors and of the profits made by them.[3]

'I do not say that an owner of property may not promote and form a joint stock company, and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgement on the transaction'.[6]

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[3] Kelner v. Baxter (1866) L.R. 2 C.P. 174.

[4] Omnium Electric Palaces Ltd. v. Baines (1914). 1 ch. 332.

[5] Reynell v. Lewis (1846) M.&W. 517.

[6] *Per* Lord Cairns, L.C. in Erlanger's Case.

4. DUTY OF DISCLOSURE

Disclosure by a promoter must be a **'proper' disclosure.** The mere communication to the subscribers to the memorandum of association who are clerks in the vendor's office, or disclosure to directors who are mere nominees of the vendors or promoters is inadequate.[7] Disclosure must be made to,

(a) an **independent board of directors**[8] or

(b) to the **existing and prospective shareholders.**[9]

Sometimes disclosure to an independent board is not possible, as the promoters are usually the first directors of the company. In Salomon v. Salomon & Co., Ltd. (1897) A.C. 22, where a promoter who was the managing director and the largest shareholder, transacted with the company after disclosure to the board, the transaction was held to be valid as there was no independent board available and the shareholders were himself and his family. Generally, however, if an independent board is not available, full disclosure must be made to the existing and prospective shareholders either in a prospectus or in some other manner. In Re Leeds and Hanley Theatres of Varieties Ltd. (1902) 2 ch. 809, where company O bought two music halls through a nominee and sold them to the company X which it promoted, without disclosing that it was the true owner, it was held that company O was liable and must return the profits made to company X.

5. REMEDIES FOR BREACH OF DUTY

Civil or criminal liability would be imposed upon a promoter for misstatement and untrue statements contained in the prospectus: ss.45, 46.

If promoters **fail to make full disclosure** of **profit** made, the **company may –**

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[7] Gluckstein v. Barnes (1900) A.C. 240, Re Olympia (1898) 2 Ch. 149.
[8] Erlanger v. The New Sombrero Phosphate Co. (1878) 3 App. Cas. 1218; Re Leeds & Hanley Theatres of Varieties (1902) 2 Ch. 809 (C.A.).
[9] Lagunas Nitrate Co. v. Lagunas Syndicate (1899) 2 Ch. 392.

(1) Sue the promoters for **damages** for breach of their fiduciary duty: Re Leeds & Hanley Theatre of Varieties Ltd. (1902) 2 ch. 809 (C.A.).

(2) **Recover the profit** the promoters have made: Gluckstein v. Barnes (1900) A.C. 240, where the promoters disclosed only part of the profits made on resale of property to the company formed, and they were requested to return the undisclosed profits.

(3) **Rescind the contract** and **recover purchase money** paid where promoters have sold their own property: Erlanger v. The New Sombrero Phosphate Co. (1878) 3 App. Cas. 1218. **Rescission will be lost if,**

(a) the **parties cannot be restored to their original positions,**

or

(b) **third parties have acquired rights.**

The **death of a promoter does not release his estate from liability** for money claimed by the company in respect of a breach of fiduciary duties of moneys secretly received and retained by him.[10]

6. PAYMENTS OF PROMOTION COSTS AND SERVICES

In the absence of an express agreement[11] a promoter is not entitled to claim from the company payment for his costs and services. A promoter may secure an agreement to pay his costs and services by inserting such an undertaking in the contract by which the company acquires property from a seller. Articles sometimes give power to pay promotion costs, such as Table A art. 81 which states '. . . the directors may pay all expenses incurred in promoting and registering the company . . .' such articles, however, give no right to promoters to sue for promotion expenses since it confers a discretion on

[10] Murietta v. Concha (1889) 40 Ch.D at page 553.

[11] Such agreement must usually be under seal as the company cannot make a binding agreement before incorporation and as the promoters' consideration will usually be past.

the directors, but the promoters being usually directors will receive their expenses.

A promoter who made a secret profit was allowed to deduct his legitimate expenses before returning the balance to the company.[12]

Any payment made or benefit given to the promoters within the two preceding years must be stated in every prospectus issued: Part I of the 3rd schedule.

7. EXAMINATION OF PROMOTERS

When the **company is in liquidation,** if the winding up is by court, a **promoter may be examined** privately under s.299 and where a public examination is ordered under s.300, promoters are among the persons who may be publicly examined. Promoters **may also be rendered liable for misfeasance or breach of trust** under the procedure provided by s.359.

8. SUSPENSION OF PROMOTERS

A **promoter** who has been **convicted of any offence in connection with the promotion** of a company may have **a court order** made against him **that he shall not without leave of the court, be a director or take part in the management** of a company, **for a period of up to five years:** s.186.

CONTRACTS

9. PRE-INCORPORATION OR PRELIMINARY CONTRACTS

A **company cannot contract before it comes into existence.** Hence **all contracts purported to be made on its behalf before incorporation are void:** *Newborne v. Sensolid Ltd.* (1954) 1 Q.B. 45.

The general **effect of pre-incorporation** contracts are:

[12] Lydney & Wigpool Iron Ore Co. v. Bird (1886) 33 Ch.D 85 (C.A.)

(1) The other party cannot sue nor bind the company, and the company cannot sue nor bind the other party.

(2) The person purporting to act on behalf of the company, e.g., a promoter is personally responsible and liable on the contract.

K agreed to sell a hotel to B, (who was purporting to be acting on behalf of a company about to be formed). Held, B was personally liable on the contract and no subsequent ratification by the company could relieve him from the liability unless K agreed to release him: Kelner v. Baxter (1866) L.R. 2 C.P. 174.

The **person who acts for the intended company may avoid liability by, including in the agreement a clause,** either,

(a) that his liability should cease if the company adopts the contract, or

(b) that either party may rescind the contract if the company does not adopt the agreement.

The company, on incorporation may adopt preliminary contracts by –

(a) **novation,** i.e., by making a new agreement whereby the company takes over the promoter's liability. Novation may in some instances be implied by the circumstances;

(b) **including in its memorandum or articles** of association **the power to enter into the contract;** the memorandum and articles **cannot, however, bind the company with outsiders but may be brought in as evidence if the existence of the contract is proved otherwise.**

Pre-incorporation contracts must be distinguished from contracts made by public companies before becoming entitled to commence business, which are provisional contracts.

Promoters – Contracts – Seal

10. PROVISIONAL CONTRACTS

Vide B 9.

11. FORM OF CONTRACTS ENTERED INTO BY A COMPANY

S.34 states, where –

Private Persons	Companies
Contract in writing	Contract in writing under common seal
Contract in writing signed by persons charged	Contract in writing signed by authorised person
Contracts by parol	By parol by authorised* person

* authorization may be express or implied

SEAL

12. SEALING DOCUMENTS LOCALLY – COMMON SEAL

Every company must have a common seal on which it's name must be legibly engraved: ss.15, 104.

The company's articles give the manner in which the seal should be affixed and provides for its safe custody. Table A, art. 113 states,

> "The directors shall provide for the safe custody of the seal, which shall only be used by the authority of the directors or of a committee of the directors authorized by the directors in that behalf, and every instrument to which the seal shall be affixed shall be signed by a director and shall be countersigned by the secretary or by a second director or by some other person appointed by the directors for the purpose."

A company is **not bound** if the seal is affixed without its authority by a secretary: Ruban v. Great Fingall Consolidated (1906) A.C. 439, or by one of the directors and the secretary without the

requisite resolution of the board of directors: South London Greyhound Racecourse Ltd. v. Wake (1931) 1 Ch. 496. Apart from this if the document has been sealed in accordance with the articles, the company may be bound under Turquand's Rule.[13]

13. SEALING DOCUMENTS ABROAD

There are two methods,

(a) the company may appoint an attorney (in writing under its common seal) to use the **attorney's own seal** on behalf of the company: s. 36; or

(b) if the objects include business abroad, and the articles authorise, the company may have an **official seal** and appoint an attorney to use it; the official seal must be a facsimile of the common seal with the addition of the name of the territory in which it is to be used, the attorney adding the date and place of execution: s.37.

The use of either of these methods binds the company as if its common seal had been affixed. ss.36, 37.

[13] See E 23.

CHAPTER E

MEMORANDUM OF ASSOCIATION – ARTICLES OF ASSOCIATION

1. MEMORANDUM OF ASSOCIATION

The memorandum of association is the registered company's charter and defines its constitution and powers. It informs shareholders, creditors and all persons dealing with the company, what the company's objects are, its permitted range of activities, and what capital it has.

The memorandum affects and controls the company's external activities while the articles of association affects and controls its internal activities.

The memorandum and articles must be registered with the Registrar of Companies: s.14.

2. CONTENTS OF MEMORANDUM

By s. 3 the memorandum must state:

(1) The name of the company, with "Limited" as the last word of the name in the case of a public limited company, and with "(Private) Limited" in the case of a private limited company, and with "(Guarantee) Limited" in the case of a company limited by guarantee, and with "(People's) Limited" in the case of a people's company.

(2) The district in which the registered office of the company is to be situate.

(3) The objects of the company.

(4) That the liability of the members is limited, if the company is limited by shares or by guarantee.

(5) In the case of a limited company having a share capital, the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount.

In the case of a company limited by guarantee, the memorandum must also state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, such amount as may be required, not exceeding a specified amount: s.3(3).

The memorandum must,

(a) be signed by each subscriber in the presence of a notary public who shall witness the signature of each signatory and affix his seal: s.5,[1]

(b) be stamped to the value of Rs. 75/- and,

(c) each subscriber must write opposite to his name the number of shares he takes; no subscriber may take less than one share: s.3(4)(b)(c).

Seven or more persons in the case of a public company or two or more persons in the case of a private company, must subscribe their names to the memorandum: s.2(1).

The forms of the memorandum of association of the different types of companies are to be found in the following tables in the First Schedule of the Act: Company Limited by Shares - Table B, Company Limited by Guarantee and not having a share capital - Table C, Company Limited by Guarantee and having a share capital - Table D, Unlimited company having a share capital - Table E. The Act requires the forms to be adopted in their entirety or "as near thereto as circumstances permit": s.13.

[1] Under the Ordinance the witness was not required to be a Notary Public.

Memorandum of Association – Articles of Association

A specimen form of memorandum of a company limited by shares, given in Table 'B' of the First Schedule attached to the Ordinance is as follows:

Form of Memorandum of Association of a Company Limited by Shares

1st The name of the company is "The Eastern Steam Packet Company, Limited."

2nd The registered office of the company will be situated in the district of Colombo.

3rd The objects for which the company is established are:–

Primary Objects,

(i) The conveyance of passengers and goods in ships or boats between such places as the company may from time to time determine.

(ii) The purchasing and hiring of steam, sailing, motor and other ships or boats for the purposes of the company.

(iii) The construction and establishment of docks, warehouses, workshops and other conveniences.

Ancillary Objects:

(i) The carrying on of business as hotel, cafe and lodging house keepers.

(ii) The carrying on of business as commission agents, customs agents and warehousemen.

Other Objects:

(i) The carrying on of business as manufacturers of, and dealers in, rope, nautical instruments, gear, fittings and equipment of every description.

(ii) The building, construction and repair of ships and boats and sailing vessels of all types.

(iii) The carrying on of the business of deep-sea fishing, and as importers and exporters of seafoods.

4th The Liability of the members is limited.

5th The share capital of the company is two hundred thousand rupees divided into one thousand shares of two hundred rupees each.

We, the several persons whose names and addresses are subscribed, are desirous of being formed into a company, in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names.

Names, addresses and Descriptions of Subscribers		Number of shares taken by each subscriber
1. James Silva of	merchant	200
2. Kumara Ratnayake of.....	attorney-at-law	25
3. John Selvanathan of	businessman	30
4. Abdul Majeed of	merchant	40
5. Mahen Kumarasen of.....	accountant	15
6. Andrew Brown of	merchant	5
7. David Appuhamy of	merchant	10
	Total Shares taken	325

Dated the ..... day of .....19..... Witness to the above signatures, and I do hereby testify to the number of shares subscribed for by the signatories above named.

Notary Public.

3. ALTERATION OF THE MEMORANDUM

A company may alter the conditions contained in its memorandum only in the cases, in the mode and to the extent for which express provision is made in the Act: s.7.

The following alterations are permitted –

(1) to change the objects: s.7 (see E 6),

(2) to change the name, with the approval of the Registrar of Companies: s.20 (see E 10),

(3) to create reserve liability under s.61, by determining that a proportion of share capital which has already not been called up, shall not be capable of being called up until the company is wound up (see H 2),

and, if authorised by the articles, to:

(4) increase, consolidate, subdivide, cancel or otherwise alter the share capital: s.62 (see H 10),

(5) reduce the share capital, subject to confirmation by the court: s.67 (see H 11),

(6) make the directors' liability unlimited: ss.196,197 (see L 16).

An **ordinary resolution** suffices to effect the change in (4). A **special resolution** is required in all other cases.

An alteration that increases the liability of members is not binding unless they agree in writing: s.24.

Other clauses included in the memorandum may be altered by any method set out in those clauses - Re Welsbach Incandescent Gas Light Co. (1904) 1 Ch. 87. For the alteration of rights of different classes of shares set out in the memorandum see H 9.

4. POWER OF DISTRICT COURT TO ALTER MEMORANDUM & ARTICLES — SS.210, 211

A District Court could, on the application for the prevention of oppression and mismanagement, make an order for the alteration of the memorandum or articles. Any alteration made by the District Court will have the same effect as if they had been made by the Company in accordance with the provisions of this Act.

In such an eventuality, notwithstanding the other provisions of the Act, a company has no power, except to the extent, if any, permitted by the order, to make, without leave of the court, any alteration whatsoever which is inconsistent with the order, in the memorandum or articles. A certified copy of every order must be filed with the Registrar within 15 days of making of the order. In case of default a fine not exceeding two hundred and fifty rupees per day during which the default continues could be imposed on the company and every officer who is in default: s.217.

5. THE OBJECTS CLAUSE AND THE MAIN OBJECT

The memorandum must have a clause giving the objects: s.4. The objects clause serves a dual purpose:

(a) It protects the subscribers who learn from it the purpose to which their money can be applied, (a member can require the company to send him a copy on payment of Rs. 25/-: s.26 – see E 24)

(b) It protects persons dealing with the company, who can know from it (the memorandum kept by the Registrar is available to them for inspection) the range of the company's powers: per Lord Parkes J. in Cotman v. Brougham (1918) A.C. 514, at p. 520.

The objects clause in a memorandum of a company must make distinction among the primary objects, ancillary powers and other objects: s.4.

Primary objects are those objects which the subscribers or promoters intend that the company should carry out during the period of five years from the date of commencement of business.

(A private company commences business immediately on receiving the Certificate of Incorporation. A public company commences business only when the Registrar issues a certificate entitling it to commence business. see B 9.)

Ancillary objects are the powers that need be exercised to attain or carry on the primary objects.

If the memorandum contains a separate statement of other objects or of powers, a special resolution has to be passed before the carrying out of such objects or powers.[2]

6. ALTERATION OF OBJECTS

A company is permitted, by s. 7 to alter its objects to —

(a) carry on its business more economically or more efficiently;

(b) attain its main purpose by new or improved means;

(c) enlarge or change the local area of its operations;

[2] These requirements apply only to companies formed on or after 2nd July, 1982, as the Companies Ordinance did not stipulate them : s.4.

(d) carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company;

(e) restrict or abandon any of the objects specified in the memorandum;

(f) sell or dispose of the whole or any part of the undertaking of the Company;

(g) amalgamate with any other company or body or persons.

The alteration must be effected by **special resolution,** and is subject to **confirmation by court** if dissentients apply to court within 21 days of passing of the resolution, for the cancellation of the alteration. Dissentients must hold at least 15% of the issued share capital, or any class thereof or at least 15% of debenture holders entitled to object to the alteration. (Notice must, hence, be given to such debenture holders of any alteration.) A dissentient cannot be anyone who has consented or voted in favour of the alteration.

If no application is made to court within the 21 days the company must within a further 15 days file with the Registrar of Companies, a copy of the memorandum as altered, and if application is made, give notice forthwith of that fact to the Registrar and the resolution becomes of no effect except so far as it is confirmed by the court. When the court makes its order, a copy of the order together with a copy of the memorandum, if altered, must be filed with the Registrar.

7. DOCTRINE OF *ULTRA VIRES*

Though an action or transaction of a company may be legal in itself, if it is not authorised by or is contrary to the memorandum or any statute, it is *ultra vires* or beyond the powers of the company and is therefore void. For instance, if a company is authorised by the memorandum to make only chocolates it cannot sell shoes.

Though a company has power **only** to carry out the objects set out in the memorandum, it has an **implied** power also to do everything that is "reasonably necessary" to carry out such objects. The doctrine of *ultra vires* "ought to be reasonably, and not unreasonably understood and applied, and.... whatever may fairly be regarded as incidental to, or consequential upon, those things which the legislature has authorised, ought not (unless expressly prohibited) to be held, by judicial construction, to be *ultra vires*".[3] For instance, a company formed to "make, sell and deal in chocolates" may for the purpose of carrying out the stated objects, employ labour, agents, buy raw materials, vehicles etc., borrow on security and so on.

A single shareholder may restrain a company from doing an *ultra vires* act, by obtaining an injunction.

8. EFFECT OF *ULTRA VIRES* TRANSACTIONS

"A company is not bound by and cannot enforce an *ultra vires* contract, which is void and incapable of ratification".[4]

A company was formed to make, sell or lend on hire railway carriages and wagons; the directors contracted to purchase a concession for making a railway. Held, the contract was *ultra vires* and hence void, and not even the assent of all the shareholders could ratify it: Ashbury Railway Carriage Co., Ltd. v. Riche (1875) L.R. 7 H.L. 653.

It has been said "an *ultra vires* agreement cannot become *intra vires* by reason of estoppel, lapse of time, ratification, acquiescence, or delay".[5]

If people have supplied goods or performed services under *ultra vires* contracts, they cannot obtain payment and money lent cannot generally be recovered.

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[3] Per Lord Selbourne L.C. in Attorney-General v. G. E. Railway Co. (1880) 5. App. Cas. 473.
[4] Charlesworth's Company Law, chapter on Memorandum of Association.
[5] York Corp. v. Henry Leetham & Sons Ltd. (1924) 1 Ch. 557.

9. NAME

The following requirements affect the choice of a name for a company:

(a) By s.3 the last words of the name of a company shall be,

— for public companies	: "Limited"
— for private companies	: "(Private) Limited"
— Companies limited by guarantee	: "(Guarantee) Limited"
— People's Companies	: "(People's) Limited"

Charitable and other such companies can, by license, dispose with the term "Limited" in their names: s.21.

(b) A company may not be registered by a name if the name is too much like that of a person or firm carrying on a similar business, as to be calculated to deceive. The latter may obtain an injunction restraining the registration or preventing the company from using the name: s.19(1).

(c) Certain words such as "President", "Municipal", "Incorporated", "Co-operative", "Society", "National", "State", or "Sri Lanka" cannot be used in the name of a company unless consent has been obtained from the Minister. The Registrar can object if the name suggests or is calculated to suggest the patronage of the President or connection with the Government or any department thereof or any Municipality, local authority, society or body incorporated by Act of Parliament: s.19(2).

In Ceylon Insurance Co., Ltd. v. United Ceylon Insurance Co., Ltd. (1947) 48 N.L.R. 457, the plaintiff was unable to obtain an injunction as it was held that the words "Ceylon" and "Insurance"

cannot be made a monopoly of a single company, and the word "United" sufficiently distinguished the two Companies.

10. CHANGE OF NAME

By s.20,

(a) a company may at any time change its name by **special resolution** and the **written approval of the Registrar of Companies;**

(b) if the name is identical or too much like that of an existing company it may be changed with the sanction of the Registrar.

If the Registrar so directs within 6 months from the date of the name being registered, the company must change the name within a period of 6 weeks from the date of the direction or within such longer period the Registrar in his discretion allow. If the company defaults in complying with the direction it would be liable to a fine not exceeding Rs. 250/- for every day during which the default continues.

The Registrar issues a certificate of incorporation in the new name. The change does not effect the company's rights and obligations nor any legal proceedings by or against the company.

11. PUBLICATION OF NAME

By s.104 the company's full name must appear legibly and conspicuously,

(i) outside every office or place of business;

(ii) on its seal; and,

(iii) on notices, advertisements, and other official publications of the company, on bills of exchange, cheques, promissory notes, endorsements, orders, invoices, receipts, letters of credit and letterheads etc.

If the company defaults with regard to (i) above, the company and every officer who is in default are liable to a fine not exceeding Rs. 250/-; non-compliance with (ii) & (iii) above, **the company** is liable to a fine not exeeding Rs. 500/-. Where an **officer of the company** or any person on its behalf is in default of the requirements (ii) & (iii), he is guilty of an offence and is liable to a fine not exceeding Rs. 500/-. The officer is also liable to the holder of the promissory note, cheque, bill of exchange or order for money or goods for the amount thereof, unless it is duly paid by the company.

As "Limited" is part of the name, it must be included. The abbreviation "Ltd" in commercial documents has been held to be sufficient compliance.

12. ASSOCIATIONS NOT FOR PROFIT

An association not for profit is one formed to promote art, science, charity or other useful object which applies its income in promoting its objects, and prohibits the distribution of profits to members. Such an association may obtain the Registrar of Companies' permission to be registered as a limited liability company without the addition of the word 'Limited' to its name: s.21(1) — see E 9.

The association, on registration, enjoys all privileges of limited companies and is subject to all their obligations, except of using the word "Limited", of publishing its name and of sending lists of members to the Registrar of Companies (i.e. with the Annual Return).

The Registrar of Companies may revoke the licence on giving the company notice and an opportunity to object: s.21(5).

13. REGISTERED OFFICE

A company must, as from the day on which it commences business or as from the 14th day after the date of its incorporation,

whichever is earlier, have a registered office to which all communications and notices may be addressed: s.103(1).

Notice of the situation of the registered office, and of any change therein must be given to the Registrar of Companies within 14 days of incorporation or the change, as the case may be. The inclusion in the annual return or a statement as to the situation of the registered office will not fulfil this provision: s.103(2).

Where the above notice has not been given, the intended situation of such company's registered office on incorporation specified in the statement delivered prior to incorporation, is deemed to be the registered office: s.103(3).

In case of default, the company and every officer responsible are liable to a default fine: s.103(4).

The memorandum of association must state the district in which the registered office is situated: s.3(1)(b).

A company cannot alter the conditions contained in its memorandum except in the cases, in the mode and to the extent expressly provided for in the Act: s.6. No specific provision is given for the alteration of the memorandum relating to the "district" in which the registered office is to be situated. The "district" that is given in the memorandum in which the registered office is situated cannot therefore be changed. S.103(2) however stipulates that "any change in the registered office must be notified to the Registrar". The registered office could, therefore, be changed within the **district** specified in the memorandum. In the United Kingdom the memorandum needs to specify the situation of the Registered office as being in England or Scotland; the situation could, therefore, be changed anywhere either in England or in Scotland. S.5 of The Companies (Amendment) Act No. 15 of 1964, amended s.91 of the Ordinance by providing that the situation of the Registered office may be changed by special resolution and sanction of the Registrar or the Permanent Secretary. This provision, however, has NOT been incorporated into the Act.

The registered office is of significance from two points of view:-

(a) A document may be served on a company by leaving it or sending it by post to the registered office:[6] s.442.

(b) The following **statutory books** must be kept at the registered office ready for inspection as provided by the Act:

(1) Register of Members: s.108
(2) Register of Directors & Secretaries: s.194
(3) Register of Charges: s.100
(4) The Minute Books of General Meetings: s.142
(5) Register of Directors' shareholding: s.198
(6) Register of Debentures: s.85
(7) Duplicate Branch Register: s.117

Every register, book or document which is, by law, available for inspection by members must be kept at the registered office: s.105.

The Registrar may, by written notice, require a company to produce before a date specified, any books, registers or other documents kept or required to be kept by the company: s.431.

In the case of companies incorporated outside Sri Lanka see chapter C.

14. LIABILITY CLAUSE

The liability clause in the memorandum merely states that the liability of members is limited and whether the liability of members is limited by shares or by guarantee: s. 3. Unless duly incorporated with limited liability, where any person or persons trade or carry on business under any name 'Limited' or any imitation of that word is used, that person or persons are guilty of an offence and are liable to a fine nor exceeding Rs. 500/- for every day on which the name has been used: s.434.

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[6] See S 7.

15. CAPITAL CLAUSE

The nominal or authorised capital must be stated with its division into shares of a fixed amount, in the case of a limited company with a share capital: s.3. The amount and division will be determined by business considerations. The nominal or authorised capital is the capital the company is authorised to raise by the issue of shares. The actual or issued capital depends on the number of shares issued.

The shares may be divided into classes, e.g. preference, ordinary and deferred shares, but it is usual to do this in the articles rather than in the memorandum.

The share capital may be increased or its division into shares altered by ordinary resolution under s.62, unless the articles provide otherwise. Share capital may be reduced by a special resolution with the confirmation of the court under s.67, provided the articles authorise it.

16. OTHER CLAUSES

The memorandum may contain other provisions in addition to the statutory provisions. Thus, rights attaching to the various classes of shares, dividend and voting rights and the right to participate in the assets in a winding-up may be given.

17. THE ASSOCIATION CLAUSE

The association clause is the clause by which the subscribers to the memorandum (at least seven for a public company and two for a private company), declare that they desire to be formed into a company in pursuance of the memorandum and agree to take the number of shares set opposite their respective names.

18. THE SUBSCRIPTION

The subscription contains the names, addresses and descriptions of the subscribers and the number of shares for which each subscribes.

In the case of a company having a share capital, the subscribers must take at least one share; each subscriber must write opposite his name the number of shares he takes (s.3) and must sign in the presence of a Notary Public who must witness each signature and affix his seal: s.5.

19. ARTICLES OF ASSOCIATION

Articles of Association are the regulations governing the internal management of the company. They accept the memorandum as the charter of the company, defining its constitution, and proceed to define the rights of members among themselves, the duties of directors and the mode and form in which the business is to be carried on. It deals with the issue of shares, transfer of shares, alteration of capital, borrowing powers, matters concerning general meetings, voting rights, directors' powers, dividends, accounts, audit and winding-up.

Articles must be registered with the memorandum and signed by the subscribers to the memorandum: s.8.

The form of the Articles of the different companies are given in First Schedule:

A company limited by shares Such a company may adopt all or some of the rules in Table A: s.10. If a company adopts Table 'A' it need not register Articles of Association. Part I of Table A applies to public companies and Part II to private companies.	Table A
A company limited by guarantee not having a share capital	Table C
A company limited by guarantee having a share capital	Table D
An unlimited company having a share capital	Table E

Regulations governing the Articles of unlimited companies and companies limited by guarantee are given in Q 7 and 8.

20. PRINTING, STAMPING AND SIGNING OF ARTICLES

Articles shall:

(1) be printed;*
(2) be divided into paragraphs numbered consecutively;
(3) bear a stamp of the prescribed value; (presently Rs. 25/-)
(4) be signed by each subscriber to the memorandum in the presence of a Notary Public who must witness each signature and affix his seal: s.11.

* The Articles no longer **have to be** printed. All documents have to be 9" by 13" in size. This came into force by subsidiary legislation.

21. ALTERATION OF ARTICLES

Subject to the provisions of the Act and to the conditions of the memorandum, the company may by special resolution, alter or add to its articles. Any alteration or addition to the articles, subject to the provisions of the Act is as valid as if originally contained therein and is subject in like manner to alteration by special resolution: s.12. A company cannot deprive itself of the power to alter its articles: Andrews v. Gas Meter Co. (1897) 1 ch. 361. The alteration must –

(1) Be effected by **special resolution.** The notice must adequately disclose the nature of the alteration.
The directors of a company received remuneration from a subsidiary for a number of years. A special resolution was proposed and passed at a general meeting sanctioning the payment. The notice did not specify that the remuneration amounted to £ 44,876. Held, resolution invalid as the notice was insufficient: Baillie v. Oriental Telephone Co. Ltd. (1915) 1 Ch. 503.

(2) Not exceed the powers given by the memorandum of association.

(3) Not be inconsistent with any statute.

(4) Not be inconsistent with any Order of Court under ss. 210, 211 without leave of the court. (See chapter N on oppression and mismanagement.)

(5) In the case of a private company, not remove the restrictions applicable to private companies. It must be noted that the Registrar has the power to order a private company to become public: ss.224, 227.

(6) Be made *bona fide* for the benefit of the company as a whole[7] i.e., each member must act upon what in his honest opinion, is for the benefit of the corporate body.[8]

Further –

(7) Though a company cannot deprive itself of the right to alter the company's articles, if it is in breach of a contract it will be liable in damages to the other party.[9]

(8) An alteration that **increases the liability** of a member to contribute to the company is not binding on a **present member** unless he **agrees in writing:** s.24.

(9) An alteration of class rights under a provision in the articles or the memorandum, whereby they may be varied with the consent of a resolution or majority of the class, is subject to the right of dissentients to apply to court, under s.73. (See H 9 – Modification of class rights)

Form 43 has to be filed for the Articles to be altered.

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[7] Whether an alteration is for the benefit of the company is for the members and not the court to decide, and courts will not generally intervene unless it appears unreasonable to envisage that the alteration is for the benefit of the company, e.g., if the alteration gives the majority benefit over the minority. But if the alteration is on the whole for the benefit of the company, it is immaterial even if it inflicts hardship on the minority: Sidebottom v. Kershaw, Leese & Co. Ltd. (1920) Ch. 154 (C.A.)

[8] Greenhalgh v. Arderne Cinemas Ltd. (1951) 1 Ch. 286.

[9] Southern Foundaries (1926) Ltd. v. Shirlow (1940) AC 701.

22. RECTIFICATION OF ARTICLES

The court has no inherent jurisdiction to rectify the articles, even if it is proved that they were not in accordance with the intention of the original signatories.[10]

23. EFFECT OF THE MEMORANDUM AND ARTICLES OF ASSOCIATION

The Memorandum and articles when registered, bind the company and the members as if they had been signed and sealed by each member, and contained covenants on the part of each member to observe their provisions: s.22 (1). The result is –

(1) The members acting in their capacity as members are bound by their terms. For instance, if the articles say that any disputes between the company and its members are to be referred to arbitration, the members cannot sue the company regarding any matter concerning them as members.[11]

(2) Although s.22 (1) does not state that the company and members are bound as if they had been **signed and sealed by the company** and contained covenants on the part of the company, the section is interpreted as if it did and the company is bound to each member by the terms of the memorandum and articles. If the articles give a member a right to vote,[12] the member is entitled to such vote and can restrain the company by injunction from acting contrary to the articles.[13] The company, however, is bound to a member only in **his capacity as a member** and not in any other capacity, e.g. as a solicitor.[14]

(3) They effect a **contract between members,** the rights of which can be enforced directly by one member against another without the aid of the company.[15]

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[10] Scott v. Frank F. Scott (London) Ltd. (1940) Ch. 794 (C. A.)
[11] Hickman v. Kent or Romney Marsh Sheep Breeders Association (1915) 1 Ch. 881
[12] Pender v. Lushington (1877) 6 Ch. D. 70.
[13] Wood v. Odessa Waterworks Co. (1889) 42 Ch. D. 636
[14] Eley v. The Positive Life Assurance Co. (1876) 1 Ex. D. 20, 88
[15] Rayfield v. Hands (1958) 2 W. L. R. 851.

(4) Articles do not constitute a contract between the company and third parties, because persons not a party to a contract cannot acquire rights or liabilities.

(5) They act as a **notice to persons dealing with the company,** since they are public documents and people are presumed to know their contents. If a person enters into a contract which is beyond the powers of the company as set out in the memorandum or beyond those which have been delegated to the directors by the articles, he acquires no rights against the company. But if he has satisfied himself that a proposed dealing is not inconsistent with the memorandum and articles, he is not bound to make further enquiries as to its regularity: Royal British Bank v. Turquand (1856) 5 E. & B. 248.

TURQUAND'S CASE

The articles of a company required the sanction of an ordinary resolution before borrowing powers could be exercised. A bond signed by two directors was issued without the sanction of an ordinary resolution. Held, the lenders were entitled to assume that the borrowing was authorised and the bond was binding.

Turquand's Rule, therefore, applies only where the transaction is within the powers of the company, and within the ostensible authority of the directors or other agents concerned.

The rule does not apply where,

(a) the transaction requires an extraordinary or special resolution, (since such resolutions are required to be filed with the Registrar of Companies and is available for inspection to anyone);

(b) the transaction is of so unusual or suspicious a nature that the party concerned should have enquired as to its regularity;

(c) the transaction is known to be irregular by the other party;

(d) the person acting on behalf of the company is assuming powers which under normal circumstances he could not be envisaged to have, e.g., a cashier having authority to sign cheques on the company's behalf;

(e) the memorandum and articles are not referred to and hence reliance on them is not actually made;

(f) reliance is made upon a forged document.[16]

24. INSPECTION AND COPIES OF MEMORANDUM AND ARTICLES

Any person, whether a member of the company or not, may inspect the memorandum and articles of any company at the office of the Registrar of Companies on payment of a prescribed fee. Certified copies or extracts may be obtained on payment of a fee: s.427.

If a member requests in writing, a company must send within 7 days of receipt of such request a copy of the memorandum and articles to such member on payment of a fee of not more than Rs. 25/-: s.26. Copies sent must embody all alterations: s.27.

[16] Ruben v. Great Fingall Consolidated (1906) A.C. 439.

CHAPTER F

PROSPECTUS – UNDERWRITING

1. WHAT IS A PROSPECTUS ?

When shares or debentures of a company are offered to the public for subscription, the invitation must be accompanied by a document setting out the terms of issue and the advantages that would arise from an investment in the company. Such a document is called a prospectus. A prospectus is defined by the 'interpretation' section, s.449 as "any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company."

What constitutes an offer to the public has been the cause of much litigation. In Re South of England Natural Gas Co., Ltd (1911) 1 Ch. 573, when copies of an invitation to take shares, headed 'for private circulation only' were circularized by a gas company to members of other gas companies, it was held, that the document was a prospectus. In Nash v. Lynde (1929) A.C. 164, when a document similarly headed was sent by a director to a solicitor, who sent it to a friend who passed it to a relative, it was held, that there had been no publication by or on behalf of the company of a prospectus.[1]

A prospectus may be issued by,

(a) the company or a promoter – thereby constituting a **public issue;**

(b) an issuing house – thereby constituting an **offer for sale;** or

(c) a broker – thereby constituting **a placing.**[2]

The term "prospectus" includes any:

(i) statements contained in it;

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[1] Only a public company can issue a prospectus, a private company being unable to offer its shares or debentures to the public.

[2] When an issuing house subscribes for shares and then sells the shares to its clients at a higher price, it is also referred to as a placing.

(ii) reports and memorandum appearing on the face of it;

(iii) reports and memorandum incorporated by reference;

(iv) reports and memorandum issued with the prospectus: s.48(b).

2. CONTENTS OF A PROSPECTUS

There is a **practical need** to disclose to the public all the information they would require to know about the company to induce them to invest.

The **common law** imposes a duty upon a company to disclose every fact the non-disclosure of which might render that which is stated untrue. The common law obligation was summed up by Kindersley V.C. in New Brunswick etc. Co. v. Muggeridge (1860).

"Those who issue a prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations they contained are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature or extent or quality of the privileges and advantages which the prospectus holds out as inducements to take shares".

There is a **statutory duty** to include numerous particulars: s.40. A prospectus must state the matters specified in Part I of the Third Schedule and have attached the reports specified in Part II of the Schedule and subject to the provision of Part III; s.40(1).[3] The matters specified in Part I are as follows:

1. (1) Primary objects of the company. These are the objects the company intends to carry out during the 5 years from the date of commencement of the company's business.

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[3] Part III of the Third Schedule provides, amongst other stipulations, that in the case of a prospectus issued more than 2 years after the commencement of business certain regulations required to be fulfilled by Part I & II can be dispensed with. defines "vendors", "financial year" and who shall be competent to report as Accountants as required in Part II.

(2) Ancillary powers which are to be exercised or which may need to be exercised for the purpose of carrying out the companies primary objects.

2. The number of founders or management or deferred shares and the nature and extent of the interest of the holders in the property and profits of the company.
3. The number of shares, if any, fixed by the articles as the qualification of a director, and any provision in the articles as to the directors' remuneration.
4. The names, descriptions and addresses of the directors or proposed directors.
5. Where shares are offered to the public for subscription, particulars of :
   (a) the **minimum subscription**, i.e. the minimum amount which, in the opinion of the directors, must be raised by the issue of such shares to provide for –
      (i) the purchase price of any property which is to be defrayed wholly or partly out of the proceeds of the issue;
      (ii) the preliminary expenses, and commission payable to persons who have agreed to subscribe or procure subscriptions for shares;
      (iii) the repayment of any money borrowed by the company in respect of any of the foregoing;
      (iv) working capital; and
   (b) the amounts to be provided in respect of the matters aforesaid otherwise than out of the proceeds of the issue and the sources out of which those amounts are to be provided.
6. Time of opening and closing of the subscription lists.
7. The amount payable on application and allotment on each share. In the case of a second or subsequent offer of shares, the amount offered on subscription on each previous allotment within the two preceding years and the amounts allotted and paid up on the shares.
8. The number, description and amount of any shares or debentures which any person has or is entitled to be given an option to subscribe for, together with the following particulars of the option :–
   (a) period during which it is exercisable;
   (b) price to be paid for shares or debentures subscribed for under it;
   (c) the considerations given or to be given, if any;
   (d) names and addresses of the persons to whom the right/option was given. If it was given to existing shareholders or debenture-holders, the relevant shares or debentures.
9. The number and amount of shares and debentures which, within the two preceding years, have been issued or agreed to be issued as fully or partly paid up otherwise than in cash, the extent to which they are so paid up, and the consideration for their issue.
10. (1) As regards property:
   (a) Name and address of the vendor;
   (b) Amount payable in cash, shares or debentures to the vendor. If more than one vendor or the company is a sub-purchaser the amount payable to each vendor;

(c) Particulars of any transaction relating to property completed within the two preceding years to which any vendor or any person who is or was at the time of the transaction a promoter or a director or a proposed director who had any interest directly or indirectly.

(2) Property to which this paragraph applies is property purchased or acquired by the company or proposed to be purchased or acquired, which is to be paid for wholly or partly out of the proceeds of the issue offered for subscription by the prospectus or the purchase or acquisition of which has not been completed at the date of the issue of the prospectus, other than property –

(a) the contract for the purchase or acquisition whereof was entered into in the ordinary course of the company's business, the contract not being made in contemplation of the issue nor the issue in consequence of the contract, or

(b) as respects which the amount of the purchase money is not material.

11. The amount, if any, paid or payable as purchase money in cash, shares or debentures for any property to which the last paragraph applies, specifying the amount payable for goodwill, if any.

12. The amount, if any, paid within the two preceding years, or payable, as commission (but not including commission to sub-underwriters) for subscribing or procuring subscriptions, for shares or debentures of the company, and the rate of commission.

13. The amount or estimated amount of preliminary expenses. The persons by whom these expenses have been paid or are payable. Amount or estimated amount of the expenses of the issue and the persons by whom those expenses have been paid or are payable.

14. The amount or benefit paid or given within the two preceding years or intended to be paid or given to any promoter, and the consideration for the payment or giving of the benefit.

15. The dates of and parties to and general nature of every material contract, not being a contract entered into in the ordinary course of the business carried on or intended to be carried on by the company or a contract entered into more than two years before the date of issue of the prospectus.

16. The names and addresses of the auditors, if any.

17. The nature and extent of the interest of every director in the promotion of the company or in the property to be acquired by the company, or where the interest of such director consists in being a partner in a firm, the nature and extent of the interest of the firm, with a statement of all sums paid or payable to him, in cash, shares or otherwise, to induce him to become, or to qualify him as a director.

18. Where the prospectus invites the public to subscribe for shares, the voting, capital and dividend rights attached to the different classes of shares.

19. If the business of the company or the business of the business to be acquired has been carried on for less than 3 years, the length of time during which the business was carried on.

Prospectus – Underwriting

Reports to be set out in the prospectus
(as specified in Part II of the Third Schedule)

An **auditors' report** giving the profits, losses, assets, liabilities and dividends paid on the different classes of shares and particulars if dividends were not paid in each of the five financial years ("financial year" is defined in Part III of 3rd Schedule), immediately preceding the issue of the prospectus; a statement must be included if no accounts have been made up in respect of any part of the period of 5 years, ending on a date 3 months before the issue of the prospectus. A distinction is made between companies that have subsidiaries and those that don't. Part II 20(2) & (3).

An **accountants' report** on the profits and losses of a business, if the proceeds of the issue of the shares or debentures are to be applied in the purchase of the business, in each of the 5 financial years immediately preceding the issue of the prospectus. The assets and liabilities of the business at the last date to which the accounts were made up must be shown and the accountants reporting must be named in the prospectus.

Every prospectus delivered to the Registrar for registration shall have attached to it –

(a) Written consent from any person for the inclusion in the prospectus of any statement given by him as an expert; e.g. engineer, valuer, accountant, banker, attorney-at-law, or auditor: ss.41, 42.

(b) A declaration by every director testifying that he has read the provisions of the Act relating to the issue of the prospectus and all such provisions have been complied with: s.43(1b).

(c) Written statements signed by the accountant and auditors setting out the adjustments they made if any, in their reports and giving the reason therefor.

It is illegal to issue any form of application for shares or debentures of a company unless the above provisions are complied with: s.40(3). See also F 4.

Any condition purporting to bind an applicant for shares or debentures in a company to (a) waive compliance with the above provisions, or (b) affect him with notice of any contract, document or matter not specifically stated in the prospectus, is void: s.40(2).

3. DATING, SIGNING AND REGISTRATION

A prospectus must be:

(a) **Dated** — such date shall be taken as the date of publication unless the contrary is proved: s.39.

(b) **Signed** — by every person named therein as a director or proposed director or by his agent authorised in writing; and have attached any experts' consent, declaration by directors and proposed directors that the provisions of the Act are complied with, and signed statements by persons making adjustments to reports required by the Third Schedule:[4] s.43(1).

(c) **Delivered** — to the Registrar of Companies on or before the date of publication: s.43(1). The prospectus must **state on the face of it** that a copy has been delivered for registration: s.43(2). If a prospectus is issued without a copy being delivered to the Registrar, the company and every person **knowingly** a party to the issue, is guilty of an offence and is liable to a fine not exceeding Rs. 250/- per day from the date of issue until a copy is delivered to the Registrar: s.43(4).

The Registrar shall not register a prospectus **unless**,

(a) the copy is signed in the required manner;

(b) documents specified are included;

[4] Part II of the Third Schedule requires accountants and auditors to set out reports in the prospectus.

(c) date of delivery of the copy to the Registrar or a future date is inserted in such prospectus under s.39;

(d) where it bears a future date, such date is confirmed or altered by notice served on the Registrar: s.43(3).

4. EXCEPTIONS FROM STATUTORY REQUIREMENTS

The requirements of the Third Schedule need not be complied with when the form of application for shares or debentures is issued:

(i) in connection with a *bona fide* invitation to a person to enter into an **underwriting agreement** with respect to the shares or debentures: s.40(3)(a),

(ii) in relation to shares or debentures which are **not issued to the public:** s.40(3)(b),

(iii) in an offer made to **existing members or debenture holders,** whether or not they have the right to renounce in favour of other persons: s.40(5).

5. RESTRICTION ON ALTERATION OF TERMS MENTIONED IN PROSPECTUS OR STATEMENT IN LIEU OF PROSPECTUS (see F 9)

A public company limited by shares or by guarantee and having a share capital cannot, before the statutory meeting, vary the terms of a contract referred to in the prospectus or statement in lieu of prospectus without the approval of the statutory meeting: s.44.

6. EFFECT OF NON-DISCLOSURE IN PROSPECTUS

(1) If the non-disclosure has the effect of making the prospectus as a **whole** or in a **material particular** false, the subscriber

has the same remedies as if there was a misrepresentation – see below;

(2) If the non-disclosure does not have the above effect, the subscriber has no remedy unless the **facts undisclosed** are **required by the Act** (i.e. by s.40) to be disclosed.

If disclosure as required by the Act is not made, the subscriber may sue the persons responsible for the issue of the prospectus. A director or person responsible for the issue may escape liability for non-compliance with the provisions of s.40 if he can prove:

(a) he was not cognizant of the matters undisclosed; or

(b) he made an honest mistake of fact; or

(c) to the satisfaction of the court that the omission is immaterial or otherwise that, having regard to all the circumstances of the case, ought reasonably to be excused; or

(d) with respect to the matters specified in paragraph 17 of Part I of the 3rd Schedule, he had no knowledge of the matters undisclosed: s.40(4).

The plaintiff must, however, prove that he had relied on the prospectus and that had he known of the non-disclosure he would not have become a shareholder: Macleay v. Tait (1906) App. Ca. 24.

If application forms are issued unaccompanied by a prospectus in compliance with the provisions of s.40(1), the persons responsible are liable to a fine not exceeding Rs. 5,000/-[5]: s.40(3).

7. EFFECT OF MISREPRESENTATION

A statement included in a prospectus is deemed to be untrue if it is misleading in the form and context in which it is included: s.48(a).

[5] This amount appears to be greatly inadequate; perhaps if the statutes do not specify an amount payable as a fine but leaves it to an authority concerned, such as the Registrar, to review such fines from time to time, it would be a more effective punishment.

Civil Liability

A person who contracted to take shares or debentures in a company, being induced by a prospectus containing a material misrepresentation, has a remedy against the company or the persons responsible for the issue, or both.

(a) **Remedy against the company** may be rescission of the contract of allotment and damages for fraud.[6]

(b) **Remedy against the persons responsible for the issue** may be damages for fraud and compensation under s. 45.

Rescission of the contract to take shares:

A contract of allotment induced by an untrue statement in any material statement in any material particular in the prospectus, whether such statements were made fraudulently or innocently is **voidable at the option of the subscriber.** The subscriber must, however, prove that:

(a) the **company was responsible** for the prospectus;

(b) the prospectus contained a **misrepresentation** that was **material.**[7] Non-disclosure of a material fact amounts to misrepresentation if the omission makes what is disclosed misleading. "It is not that the omission of material facts is an independent ground for rescission, but the omission must be of such a nature as to make the statement actually

[6] There is a common law remedy, as well as relief under other statutes dealing with misrepresentation in contracts.

[7] In City of Edinburgh Brewer Co., Ltd. v. Gibsons' Trustee (1869) 7 m. 886, the misrepresentation was not "sufficiently material"; a statement of fact must be distinguished from a statement of opinion: Liverpool Palace of Varieties Ltd. v. Miller (1896) 4 S.L.T. 153 (O.H.); "An innocent misrepresentation is a sufficient ground for rescission. It is not necessary to prove knowledge of the untruth of the statement" per Lord Shaw of Dunfermline in Mair v. Rio Grande Rubber Estates Ltd. (1913) S.C. (H.L.) 74 at p. 81.

misleading" per Rigby L.J. in McKeown v. Boudard Peveril Gear Co., Ltd. (1896) 74 L.T. 712 at p. 713;

(c) he took the shares on the **faith of the prospectus,** in other words, he was induced by the representation made in the contract to purchase the shares.[8]

The right of rescission is **lost** if:

(a) The subscriber, after becoming aware of the misrepresentation, **affirms** the contract. Affirmation may be implied if he does any act which recognises his ownership of the shares, e.g. attendance of meetings, acceptance of dividends or attempts to sell the shares.

(b) It is not possible to restore the parties to the former positions. (i.e. when *restitutio in integram* is impossible.)

(c) Third parties' rights acquired after allotments are affected.

(d) There is undue delay in rescinding the contract.

(e) The company goes into liquidation.

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[8] Whether or not an allottee was induced to subscribe by reason of the misrepresentation is a question of fact depending on the circumstances of each case. It is not sufficient that the prospectus has been widely advertised in the locality if there is proof that the applicant relied not on the prospectus but on independent advice: M'Morland's Trustees v. Fraser (1896) 24 R. 65.; He is entitled to rely upon the prospectus, and is not bound to verify the statements it contains. Where, therefore, a prospectus simply gave the dates of and parties to contracts and stated where they could be inspected, without indicating that they were material contracts, the omission of the applicant to inspect them did not fix him with notice of their contents: Aaon's Reefs Ltd. v. Ywiss (1896) A.C. 273.; The false statement need not be the decisive inducing cause of the contract. It is enough that it was one of the contributory causes: Edgington v. Fitzmaurice (1885) 29 Ch.D. 459 (C.A.); a later purchaser on the Stock Exchange will usually not be able, on the ground of misrepresentation in a prospectus, to rescind the contract: Collins v. Associated Greyhound Racecourses Ltd. (1930) 1 Ch. 1 (C.A.)

Damages for fraud

At common law, damages are available for fraudulent misrepresentation as well as omission to state material facts depending on the circumstances.[9] To claim damages a subscriber must prove that:

(a) the prospectus contained a **material misrepresentation** of the facts;

(b) he took shares or debentures on the **faith of the prospectus** and that he actually **suffered loss** thereby;

(c) the **defendant was responsible** for the prospectus;

(d) the defendant was guilty of **fraud.**

The ingredients necessary to constitute a fraud was laid down by Pereira, J. in Usubu Lebbe v. Gabriel (1914) 17 M.R. 181:

(1) that a person charged should have acted with wrongful and unlawful intent,

(2) that he should have made a false representation, and

(3) that such false representation should have been made in order to prejudice either the person to whom it was directly made or some other person.

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[9] A prospectus, although it is composed of true statements may be fraudulent if by reason of omission, it is intended as a whole to give a false impression of the position of the company: Per James L.J. in Arkwright v. Newbold (1881) 17 Ch.D. 301 at p. 318; however, mere concealment even of a material fact, is not at common law a basis for an action for fraudulent misrepresentation unless the omission of what is not stated falsifies that which is stated: Honeyman v. Dickson (1896) 4 S.L.T. 150 (C.H.). A later purchaser of shares on the Stock Exchange is not the one to whom the prospectus was addressed and cannot bring an action for deceit: Peek v. Gurney (1873) L. R. 6 (H.L.) 377: When a prospectus is issued not only to induce applications for allotment of shares but also to induce purchases in the open market, its function is not ended and a purchaser on the strength of false statements in such a prospectus can sue those responsible for fraud: Andrews v. Mockford (1896) 1 Q B 372, 65 L J QB 302 – here the prospectus was supplemented by false statements published in a financial newspaper.

For the purposes of clarity the principle in Derry v. Peek (1889) 14 App. Cas. 337 may be followed which states that to prove fraud the plaintiff must show that the defendant made the misrepresentation (a) knowing it to be false, or (b) without belief in its truth or (c) recklessly, careless whether it were true or false. Further, the plaintiff must show that the defendant acted with the intention of deceiving. In other words, the plaintiff has to prove the state of the defendant's mind at the time. Such proof is difficult to obtain and led to statutory provisions revising the law and now incorporated in s.45.

Compensation under s.45

A person subscribing for shares or debentures in a company on the faith of an untrue statement in a prospectus or in any report or memorandum attached to or issued in connection with the prospectus, can recover compensation for loss or damage sustained from every director, every person named in the prospectus as a director, or every intending director, every promoter, and every person who authorised the issue of the prospectus, **unless** the person sought to be made liable **can prove** that:

(i) he had **withdrawn his consent** to be a director before the issue of the prospectus and it was issued without his consent;

or

(ii) he did **not know** of the issue and gave reasonable public notice that it was issued without his knowledge or consent;

or

(iii) after the issue of the prospectus and before allotment, on becoming aware of the untrue statements therein, he withdrew his consent and gave reasonable public notice of the **withdrawal** and the reasons therefor;

(iv) (a) as regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable ground to believe, and did believe up to the time of the allotment, that the statement was true;

(b) as regards every untrue statement purporting to be a statement by an expert or contained in what purports to be a copy of or extract from a report or valuation of an expert, it fairly represented the statement, or was a correct and fair copy of or extract from the report or valuation, and he had reasonable grounds to believe and did believe up to the time of the issue of the prospectus, that the person making it was competent to make it and that the person has complied with s.41 and had not withdrawn that consent before registration of the prospectus or allotment thereunder; and

(c) as regards every untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, it was a correct and fair representation of the statement or copy of or extract from the document.

In the case of **experts,** who have included statements in the prospectus in accordance with the provisions of s.41 which are considered untrue, will **not be liable,** if they prove that:

(a) having given their consent they withdrew them in writing before delivery of a copy of the prospectus for registration;

(b) after delivery of a copy of the prospectus for registration and before allotment, they on becoming aware of the untrue statement, withdrew their consent in writing and gave reasonable public notice thereof;

(c) they were competent to make the statement and that they had reasonable grounds to believe and did believe up to the time of allotment, that the statement was true.

For the purposes of this section:

The expression "promoter" means a promoter who was a party to the preparation of the prospectus, or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company.

The expression "expert" includes engineer, valuer, accountant, and any other person whose profession gives authority to a statement made by him.

Criminal Liability

Where a prospectus includes any untrue statement, any person who authorised the issue of the prospectus shall be guilty of an offence and shall be liable to a fine not exceeding Rs. 5,000/- or to imprisonment of either description for a term not exceeding 2 years or both: s.46(1).

There are two defences available,

(1) the statement was immaterial, or

(2) he had reasonable grounds to believe and did believe upto the time of the issue of the prospectus, that the statement was true. A person (an expert) is not deemed to have authorized the issue of the prospectus by reasons only of his having given his consent pursuant to s.41: s.46.

No prosecution under this section can be instituted except with the sanction of the Attorney-General s.46(3).

8. OFFERS FOR SALE

An offer for sale occurs when an issuing house[10] subscribes for an issue of shares or debentures and then invites the public to buy it from them at a higher price.

[10] An issuing house may be a specialised concern or department of a merchant bank, bank etc.

Prospectus – Underwriting

As it is possible to avoid giving, in the issuing house's offer to the public, the particulars required by the 3rd Schedule (as s. 40 and the 3rd Schedule apply only to prospectuses issued "by or on behalf of a company or promoter"), s.47 provides that when a company allots or agrees to allot shares or debentures with a **view to their being offered for sale to the public,** the offer of the allottee (i.e. the issuing house) to the public is **deemed to be a prospectus issued by the company.**

Unless the contrary is proved, an allotment is assumed to be made with a view to an offer to the public if,

(a) the offer is made within six months of the allotment or agreement to allot; or if

(b) at the date of the offer the whole consideration for the allotment had **not been received by the company:** s.47.

The document forming the offer of the allottees to the public must state the **contents of the prospectus** and a **copy signed by the directors** named therein must be **filed** before it is issued. Further, it must state,

(a) the net consideration received or receivable by the company in respect of the shares or debentures to which the offer relates; and

(b) the place and time at which the contract under which the share or debentures are allotted may be inspected.

The provisions of s.43 apply to an offer for sale as if the offerers were directors, so that the filed copy must be signed by the offerers[11] as well as by the directors.

In case of misrepresentation or omission, purchasers under the offer have rights against the offerers as well as the same rights against the company and its directors etc., as if they were allottees.

[11] Two of the directors, if the offer is made by a company and half of the partners if made by a firm.

9. STATEMENT IN LIEU OF PROSPECTUS

A statement in lieu of prospectus is required in the following instances:

(a) A public company having a share capital but which does not issue a prospectus on its formation or which has issued such a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, cannot make any allotment of shares or debentures **unless at least 3 days before the first allotment of shares or debentures a statement in lieu of prospectus** has been delivered to the Registrar of Companies: s.50.

The statement must be in the **form set out in the 4th Schedule**[12] signed by every person named therein as a director or a proposed director of the company or by his agent authorised in writing.

In the event of contravention of these provisions, a fine not exceeding Rs. 1000/- is imposed on the company and on every director who knowingly authorises the contravention.

Statements in lieu of prospectus are required when the company is able to raise the original capital privately without public subscription, and when the public subscription is poor, instead of allotting shares to such members of the public as apply for them, the company obtains the capital otherwise.

(b) When a private company ceases to be a private company it must, within 14 days, deliver to the Registrar of Companies a prospectus or statement in lieu of prospectus in the form and containing the particulars set out in Part I of the 2nd Schedule, and must include reports set out in Part II of the 2nd Schedule subject to the conditions in Part III of that schedule: s.32.[13]

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[12] Contains much the same information of a prospectus with the exception of the minimum subscription.

[13] See Q 3.

An applicant misled by material misrepresentation in the statement in lieu of prospectus cannot obtain compensation under ss.45, 46 as the section refers only to prospectuses. But the remedies of rescission under common law,[14] and of damages for fraud, if fraud is provable, would be available to him.

If a statement in lieu of prospectus, and reports and memoranda included in it delivered to the Registrar include any untrue statements, any person authorising it is guilty of an offence and is liable to a fine not exceeding five thousand rupees, or to imprisonment for not more than two years or to both unless he can prove either that the untrue statement was immaterial or that he had reasonable ground to believe it was true up to the time of delivery for registration: s.50(5) (6).

An allotment made in contravention of s.50 is voidable at the instance of the applicant within **one month** after the statutory meeting, or the allotment, as the case might be, even if the company is being wound up; a director who knowingly contravenes or authorises the contravention of the provisions of s.50 is liable to compensate the company and the allottee for any loss sustained thereby; any action for compensation under the section must be commenced within 2 years from the date of allotment: s.51.

10. RESTRICTIONS ON ALTERATION OF TERMS MENTIONED IN PROSPECTUS OR STATEMENTS IN LIEU OF PROSPECTUS: s.44

A company limited by shares or by guarantee and having a share capital cannot vary the terms of a contract referred to in the prospectus or statement in lieu of the prospectus without the approval of the Statutory Meeting. This provision does not apply to private companies.

11. PROSPECTUS OF OVERSEAS COMPANIES

A company incorporated abroad, (whether or not it has an established place of business in this country), issuing in Sri Lanka a prospectus offering for subscription its shares or debentures must (unless the offer is to a person whose ordinary business is to buy or sell shares or debentures) comply with s.405 which extends to such

[14] Re Blair Open Hearth v. Furnace Co., Ltd. (1914) ch. 390 (C.A.)

companies. By s.405, it is unlawful to issue a form of application for shares or debentures (other than to an underwriter or to existing share holders or debenture holders) unless a copy of the prospectus is registered with the Registrar of Companies before its issue and the prospectus states on the face of it that a copy has been so registered, and the prospectus is dated; further the prospectus must contain or have attached the constitution of the company, the enactments under which the company was incorporated, the address at which these documents may be inspected, the date and country of incorporation, the principal place of business in Sri Lanka, if any, and states the matters specified in Part I of the 3rd schedule and subject to the provision in Part III, sets out the reports specified in Part II, of that schedule.

(1) Any condition binding an applicant for shares or debentures to waive compliance with the above requirements or which purports to affect him with notice of any contract, document or matter not specifically referred to in the prospectus, is void.

(2) In the event of a failure to include in the prospectus a statement required by Paragraph 17 of the 3rd schedule, no director or other person will be liable unless it is proved that he had knowledge of the matters not disclosed.

A director or other person responsible for the prospectus will not incur liability for the contravention of the provisions of that section, if he proves that,

(a) he was not cognisant of any matter undisclosed; or
(b) it arose from a *bona fide* mistake of fact; or
(c) the matter contravened was, in the opinion of the court, immaterial or having regard to the circumstances, ought reasonably to be excused.

12. UNDERWRITING

In a public issue of shares or debentures, there being no assurance that all the shares or debentures or a sufficient number of them will be subscribed for, an insurance is taken to ensure adequate subscription. Such an insurance is known as underwriting.

An underwriting contract is made between the company and an 'underwriter' and is a conditional agreement by the underwriter to subscribe for a specified number of shares or debentures in case all or an adequate number of them are not taken up by the public.

The underwriter receives an underwriting commission as consideration. Sometimes the underwriter may contract to take shares 'firm' or 'absolute', i. e., he will take such shares whether the public subscribes for them or not, in consideration for his commission. He is then treated as an applicant for such shares. The underwriting commission is calculated on the number of shares underwritten, and becomes payable whether the underwriter is eventually called upon to take shares or not. The terms are contained in an underwriting letter addressed to the company, and becomes binding on the company on its acceptance by the company.

Sub-underwriting occurs when the principal underwriter enters into subsidiary contracts with others to share his liability to take the unsubscribed shares, in consideration of a commission. An **overriding commission** is a small commission paid to a principal underwriter for procuring such subsidiary contracts.

13. PAYMENT OF UNDERWRITING COMMISSION

By s.54, no company may apply any of its shares or capital money directly or indirectly in the payment of any commission, discount or allowance to any person in consideration for his subscribing, or agreeing absolutely or conditionally to subscribe or procuring subscriptions for any shares,[15] unless:

(1) the payment is authorised by the articles;
(2) the commission does not exceed 10% of the issue price of the shares, or the amount or rate authorized by the articles, whichever be the less;
(3) the amount or rate is disclosed in the prospectus or, in a private issue, the statement in lieu of prospectus or in the prescribed form of statement[16] and also in any circular or notice inviting subscriptions for the shares;

[15] s.54 refers only to shares and not debentures.
[16] Such statement must be registered with the Registrar before the payment of commission.

(4) the number of shares to be taken firm is similarly disclosed.

These provisions do not apply to commissions paid out of profits, provided payment is made *bona fide*, and does not result in an issue of shares at a discount, which is allowed only with court's sanction.[17]

S.54 permits the payment of brokerage.

All commissions paid in respect of shares or debentures, whether paid out of capital moneys or not, must be disclosed in the company's balance sheet (5th schedule)[18] annual return s.120(3)(f)[19] and in any prospectus or statement in lieu of prospectus issued within 2 years (3rd Schedule).[20]

14. FINANCIAL ASSISTANCE FOR PURCHASE OF SHARES

A company may not purchase its own shares.[21]

A company being authorised by its articles to purchase its own shares, a shareholder sold his shares to the company but did not receive full payment for them. The company went into liquidation, and the shareholder claimed from the liquidator, payment for his shares. Held, the claim failed, as a company has no power to buy its own shares although the articles allowed it: Trevor v. Whitworth (1887) 12 App. Cas. 409.

S.55 provides that a company may **not** give any financial assistance for the purchase or subscription of the company's shares to any person, either directly, indirectly, as a loan or guarantee or by provision of security. Exceptions are made, however, where:

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[17] See H 22.

[18] See K 2.

[19] See G 13.

[20] See F 3.

[21] Under s.216 a company may be ordered by court to purchase its own shares where protection from oppression and mismanagement is sought; the company must, however, reduce its capital proportionately – See N 3. In the United Kingdom under s. 54 of the Companies Act, 1948 it was unlawful for a company to give any financial assistance for the purchase of its own or its holding company's shares. However, since the passing of the 1981 Companies Act this provision is taking a different turn.

(1) the company is normally engaged in the lending of money, and the lending is in the **ordinary course of business;**

(2) the loan is for the purchase of **fully paid shares by employees** including salaried directors (or trustees on their behalf) **in accordance with a scheme currently in force;**

(3) the loan is to enable **employees other than directors** to purchase **fully paid shares.**

Contravention of the provisions of this section results in the company and every officer in default being liable to a fine not exceeding Rs. 1,000/- : s.55(2).

CHAPTER G

MEMBERSHIP

1. MEMBERSHIP

By s.28 a person becomes a member –

(a) by **agreeing** in any way to becoming a member, and
(b) by having his name **entered in the register of members.**

The subscribers to the memorandum are taken as having agreed to become members, and on the registration of the memorandum are to be entered as members in the register.

The register is, however, only *prima facie* evidence of members inserted therein s.115. The Court has power to rectify the register under s.113.[1]

2. WHO MAY BE MEMBERS

(a) A **registered company** may become a member if a right is given in the memorandum to hold shares. It cannot, however, hold its own shares. Nor can a subsidiary, by s.55, hold shares in its holding company.[2] By s.29 a subsidiary Company cannot be a member of its holding company and any allotment or transfer of shares in a company to its subsidiary shall be void except:
   (i) where the subsidiary is concerned as legal representative;
   (ii) where the subsidiary is concerned as a trustee (unless the holding company or subsidiary thereof is beneficially interested under the trust);
   (iii) where the subsidiary is a member of the holding company on 2 July 1982 but without voting rights except as trustee under (ii) above.

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[1] See G 8.
[2] The corresponding s.46 in the Companies Ordinance did not have this restriction.

(b) A **firm** should not be registered as a member as it is not a legal entity. The partners should be registered as joint holders. In Weikersheim's Case (1873) 8 Ch. 831, it was held that though a firm's name was entered on the register, the partners were the individual owners. Besides, the company may be placed in difficulties not knowing whether the firm's regulations permit the holding of shares and by not knowing who the persons are who constitute the firm especially when changes occur: Niemann v. Niemann (1889) 43 Ch. D. 198.

(c) A **married woman** may be a member. She is in the same position as an unmarried woman or a man, after the passing of the Married Woman's Property Ordinance No. 18 of 1923. Only her separate estate is liable for calls.

(d) **Non-resident individuals, companies or institutions** may become members by purchasing securities up to 40% of the issued share capital in any listed public company registered in Sri Lanka, provided that –

(i) in the case of GCEC/FIAC approved companies, the originally agreed ratios between non-resident and resident shareholdings are not exceeded;

(ii) in the case of banking companies incorporated in Sri Lanka, the ratios between non-resident and resident shareholdings do not exceed the limits placed by the Monetary Board of the Central Bank of Sri Lanka in terms of s.19 (4) of the Banking Act No: 30 of 1988;

(iii) in the case of insurance companies, the non-resident shareholdings are within the limits approved by the government of Sri Lanka or any authority acting on its behalf;

(iv) in the case of companies where the non-resident holdings exceeded 40% as at 5th June 1990, the issue or sale of shares does not exceed the percentage of the non-resident holding that existed on 5th June 1990;

All such purchases must, however, be made on the trading floor of the Colombo Stock Exchange: Gazette Extraordinary No: 633/7 of 23/10/90 & 633/9 of 25/10/90.

(e) A **bankrupt** may become a member of a company unless the articles have some specific provision to the contrary.

(f) A **minor** may be a member unless the articles forbid. A member who is a minor[3] can, however, repudiate his shares before or within a reasonable time after attaining majority.[4] Such a privilege is granted to a minor because of the deficiency in soundness and strength of judgement expected of a person at such time of life.[5] If a minor repudiates, he cannot, however, recover the money paid for the shares if the shares had any value.[6]

3. JOINT HOLDERS

Shares may be allotted to and registered in the names of two or more persons jointly, the articles providing for the effecting and delivery of the share certificate, the payment of dividends, the sending of notices, the method of voting etc: Table 'A' Clauses 8, 17, 64, and 135. Articles usually provide that the first-named person shall receive the dividends, notices of meetings etc., on behalf of all, and that in voting the senior members vote (reckoned by the first registered) shall be counted. All joint holders should be required to join in any transfer of the shares, and on the death of any of the joint holders the shares vest in the survivors. One or more joint holders may be corporate bodies.

4. RIGHTS OF A MEMBER

Membership of a company gives the member various rights, which may be equitable, contractual or statutory.

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[3] If the minor requires court intervention he must repudiate the contract to take shares within 3 years of attaining majority: Silva v. Mohamadu (1916) 19 N. L. R. 426.

[4] Sande, Frisian Decisions 2.9.22; Nadaraja, op. cit. at p. 81. The guardian of a minor can repudiate during minority: Rode v. Minister of Defence (1943) C.P.D. at 44-45.

[5] *Ob fragile et infirmum aetatis cousilium.*

[6] Steinberg v. Scala (Leeds) Ltd., (1923) 2 Ch. 452 (C.A.)

Equitable rights: Such rights may be restricted by the terms of his contract with the company, i.e. by the memorandum and articles. In the absence of such restriction, a member has the equitable right to share in the profits and any assets remaining on a winding-up, to attend general meetings, and to transfer his shares to whom he wishes.

Contractual rights: Equitable rights may be affected by the contractual rights; thus dividends may be payable only on shares carrying no arrears in calls, preference shareholders may not have the same rights of attending and voting at general meetings as ordinary shareholders, and the sharing in the profits may be restricted for some classes of shareholders. The memorandum and articles, particularly the latter, give him many rights. Thus, taking Table A as an example, he has a right to a share certificate under seal (art. 8); he has a right to a duplicate on giving an indemnity (art. 9); he has a right to proper notice of calls (art. 15); to appoint a proxy (art. 68) etc.

Statutory rights: The statutory rights given by the Companies Act are numerous. A member is entitled to receive the statutory report, annual report and accounts; he may with other members requisition a general meeting or appeal to court to cancel an alteration of the objects; he may present a winding-up petition in certain circumstances etc.

5. LIABILITY OF MEMBERS

In a company limited by shares, the liability is to pay **any amount remaining unpaid** on the shares. On an allotment of shares offered by means of a prospectus, amounts payable on **application** and **allotment** and any **instalments** specified in the terms of issue must be settled. Any further amounts, i.e. **calls** must be paid. In a winding-up, the member must pay such further amounts as is called up by the liquidator (if the shares are not fully paid up). Once the shares are fully paid up, however, a member's liability ends even though the company is unable to pay its debts.

If a member transfers partly paid shares, he **remains contingently liable** in the event of the company being wound up within **one** year. He is liable in such case only if,

(a) the **existing members are unable** to give the contributions required of them; and
(b) the debts incurred are those incurred **before he ceased to be a member,** i.e. he is not liable for debts incurred after he transferred the shares.

A member's liability cannot be increased by alteration of the memorandum of articles, unless he **consents in writing:** s.24.

A member may lose the limitation of liability if the company carries on business for more than six months with less than the **statutory minimum:**[7] s.33.

6. TERMINATION OF MEMBERSHIP

Membership ends when a person's name is removed from the register of members for any proper cause. This may occur on –

(a) **transfer;**
(b) **transmission;**
(c) **forfeiture, surrender** or **enforcement of a lien;**
(d) **redemption** of shares;
(e) issue of **share warrants;**
(f) shares being disclaimed or transferred on a liquidation.

The register is, however, only *prima facie* evidence: s.115. By s.113, application may be made to court for rectification of the register.[8]

7. REGISTER OF MEMBERS

By s. 108 the register must state -

(1) the name, address, nationality and principal occupation of each member;
(2) the shares held and their distinctive numbers, and the amount paid on the shares;
(3) the date of entry of members on the register;
(4) the date when he ceased to be a member.

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[7] See B 10.
[8] See G 8.

If the shares have been converted into stock, the amount of stock is substituted in item (2) above.

A trustee, in respect of purchase of shares by an employee, may be entered on the Register of Members, though in general, trusts are not recognised by s.114 (See G 11).

If the number of members is more than fifty, an index must be kept, unless the register is self-indexing s.109.

8. RECTIFICATION OF REGISTER OF MEMBERS

(1) If the name of any person is, without sufficient cause, entered in or omitted from the register of members of a company; or

(2) default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member;

the person aggrieved, or any member of the company, or the company may apply to the court for rectification of the register; the court may order, not only the rectification of the register but also the payment by the company of any damages sustained by any party aggrieved: s.113.

Rectification of the register may be ordered even if winding-up has commenced: Re Sussex Brick Co. (1904) 1 Ch. 598.

9. INSPECTION, COPIES AND CLOSING OF REGISTER

The register of members must be kept at the registered office. Except when closed, the register and index must during business hours, be kept open for at least two hours daily to the inspection of members free, and to other persons on a payment of not more than one rupee. Any person may demand to be supplied with a copy of the register or any part of it on payment of not more than one rupee for every hundred words, such copy to be sent within 10 days of request. If inspection is refused or any copy is not sent within the proper time, the company and every officer in default are liable to a maximum fine of Rs. 1,000/- and a further default fine of Rs. 250/- for every day during which the default continues, and the Court may order inspection or copies to be sent: s.111.

A company may close its register for not more than 30 days in each year upon giving notice,

(a) in the Gazette, and
(b) in some newspaper circulating in the district where the registered office is situated: s.112.

In practice, most companies do not close the Register of Members. Instead they only close the share transfer books (share transfer register) of the company which is not a statutory book. Therefore the notice requirement does not apply.

If the company is a quoted company, the Stock Exchange has to be informed.

10. BRANCH REGISTER

A company having a share capital, if authorised by its articles, may keep a branch register in any other country, of members resident in that country. The company must notify the Registrar within one month, the situation of the office where the branch register is kept and any change in its situation and if the register is discontinued of its discontinuance: s.116.

The branch register is deemed to be a part of the company's principal register of members and must be kept in the same manner; the requirements as to closing, inspection and copies being the same, except that the advertisement before closing the register should be inserted in a newspaper circulating in the district where the branch register is kept. A copy of every entry in the branch register must be transmitted to the registered office and a duplicate of the branch register must be kept at the same place as the principal register. The shares registered in the branch register, shall be distinguished from the shares registered in the principal register. If the branch register is discontinued all entries shall be transferred to the principal register. The articles of a company may make any provisions for maintaining branch registers so long as such provisions are not in contravention of the Act: s.117. Transfers executed in countries outside Sri Lanka would be exempt from stamp duty chargeable in Sri Lanka: s.118.

11. NOTICE OF TRUSTS

It sometimes happens that persons not beneficially entitled to shares may be entered in the register as members, e. g., executors of wills, nominees, or trustees. Further, persons not registered may have equitable interests in shares e.g., lenders of loans secured by the shares. Such persons may send notices to the company of their interests in the shares. The company may **not,** however, recognize any such notice since, by s.114, "No notice of any trust expressed, implied, constructive, shall be entered on the register, or be receivable by the Registrar, in the case of companies registered in Sri Lanka". The effect of this provision is that:

(a) the company is entitled to treat every person on the register of members as the owner of shares notwithstanding that he may hold them on trust for another;
(b) the company is under no liability to the beneficiaries even if it knew of their interest in the shares, and the registered member acted in breach of trust and in fraud of the beneficiaries: Simpson v. Molson's Bank (1895) A. C. 270;
(c) the company is thereby prevented from being a trustee for the persons claiming equitable rights; the above provisions are subject to paragraph (b) of s.55 (1) which in effect allows the recognition of trusts created for the purchase of fully paid shares, in the company or its holding company, for the benefit of its employees, including salaried directors. (See F 14, G 2).

12. ANNUAL RETURN

Every company registered under the Act must file an annual return once at least in every year.

An annual return need not be filed by a company in the year of its incorporation and in the following year if it is not required by the Act to hold an annual general meeting in that year.[9]

In subsequent years, even if there is no annual general meeting, an Annual Return is required to be filed.[10]

[9] See I 3.
[10] If by the 31st December no annual general meeting is held, an annual return is filed as at 31st December with the word "No meeting Held" at the top.

Membership

Company **having a share capital:**

By s.120 the return must contain -

(1) The **address of the registered office.**

(2) **Particulars of directors** as in the Register of Directors.

(3) Total **indebtedness on charges** required to be registered with the Registrar.

(4) A **summary of share capital**, stating

(i) shares authorised, issued, forfeited;

(ii) amounts called up, paid and unpaid;

(iii) commissions and discounts respecting issues of shares and debentures;

(iv) share warrants outstanding, issued and surrendered since last return, and the number of shares comprised in each share warrant;

distinguishing the different classes of shares, and between shares issued for cash and shares issued as fully or partly paid.

(5) A **list of members,** together with a list of persons who have ceased to be members since the last return or date of incorporation in case of a first return, made up to the fourteenth day after the first or only ordinary general meeting in the year, with their addresses, nationalities, principal occupation, holdings of each class of share or stock and particulars of any transfers by them. An index must be provided unless the names are in alphabetical order.

(6) Name and address of the auditor.

The return must be in accordance with the form set out in the Sixth Schedule, or as near thereto as circumstances allow.

Company **not having a share capital:**

By s.121 the return must contain –

(1) The **address of the registered office.**

(2) **Particulars of directors** as in the Register of Directors.

(3) **Total indebtedness on charges** required to be registered with the Registrar of Companies.

Where a company fails to comply with the provisions in ss.120, 121, the company and every officer who is in default shall be guilty of an offence and liable to a default fine.

Documents to be annexed to the Annual Return

By s.124 an annual return must contain a **balance sheet** certified by a director and secretary, and a **directors' report**, and an **auditors' report.**

Private Companies

(a) A private company must have annexed to the Annual Return:
   (i) Balance Sheet & Profit and Loss Account[11] certified by a director and secretary;
   (ii) Auditors' Report certified by a director and the secretary;
   (iii) Directors' Report.

(b) A declaration signed by all the directors of the company stating that the requirements of the Act have been complied with: s.122.

(c) A certificate signed by a director and the secretary that the company has not since incorporation in the case of a first return, or since the date of the last return, in subsequent years, issued any invitation to the public to subscribe for shares or debentures: s.125.

(d) A certificate signed by a director and the secretary if the annual return discloses that the number of members exceeds fifty. The certificate must state that the excess consists only of persons not to be included as members under section 30(1)(b): s.125.

Documents which must be annexed by a private company to an annual return and filed with the Registrar, in compliance with the requirements of ss.123, 124, are open for inspection and for extracts to be taken **only** by members and creditors

[11] See Q 2.

of the company, unless the private company is a subsidiary of a public company: s.427 – see S 1.

13. FILING OF ANNUAL RETURN

The annual return must be completed each year within 42 days after the first or only general meeting and a copy signed by a director and by the secretary of the company sent forthwith to the Registrar – s.123(1)

The directors of a company failed to forward to the Registrar the annual return for a certain year. The directors on being charged by the Registrar pleaded that as no annual general meeting was held during such year, it was not possible to furnish the return. Held, the failure to hold the general meeting being due to the directors' fault, the directors cannot rely on their own default, and the directors must prove that there was adequate cause why they should be excused from not carrying out their statutory obligations: M. M. M. de Silva v. The Registrar of Companies (1955) 56 N.L.R. 519.

Where a company fails to comply with the above provision, the company and every officer who is in default will be guilty of an offence and liable to a default fine: s.123(2).

CHAPTER H

CAPITAL – SHARES

1. CAPITAL

The term 'capital' has many interpretations.

Nominal or Authorised Capital is the total value of shares which a company is allowed by its memorandum to issue.

The **Issued Capital** is that part of the nominal capital which is issued to the shareholders. Thus out of a nominal capital of Rs. 1,000,000 it is possible to issue only Rs. 20,000.

Subscribed Capital is that part of the issued capital which has been taken up by the shareholders.

Called-up Capital is the total amount called up on the shares issued, and **Uncalled Capital** the total amount not called up on the shares issued.

Paid-up Capital is that part of the issued capital which has been paid up or credited as being paid up by the shareholders.

Reserve Capital is the term given to any part of the uncalled capital which by special resolution has been decided shall not be called up except on winding-up.

Capital Reserves and revenue reserves are amounts set aside for accountancy purposes.

Capital Assets are the actual properties owned by a company, and are usually divided into:

(a) fixed capital which is acquired for long-term use, and

(b) circulating capital which is acquired for sale or resale at a profit.

Loan or Debenture Capital is not capital in the true sense but is money borrowed on security of debentures. The debenture holders are not members but creditors.

Equity Capital is discussed in H 4 below.

2. RESERVE CAPITAL

S. 61 states that a limited company may by **special resolution** resolve that any **uncalled part of its capital** (i.e., issued capital) shall not be capable of being called up except in the event and for the purposes of a winding-up. **Such a special resolution cannot be revoked.**

Reserve capital raises the financial stability of a company, as a fund of resources are available in a winding-up. Banks often create reserve capital.

Once reserve capital is created, a company cannot subsequently defeat this intention by pledging or otherwise disposing of such capital: Re Mayfair Property Company (1898), 2 ch. 28.

3. CLASSES OF CAPITAL

Prima facie all shares convey equal rights. A company is entitled to issue shares of different classes such as ordinary, preference, deferred and non-voting ordinary shares, carrying different rights. The names give but slight indication as to the rights of the different classes of shares, and reference must be made to the company's articles or terms of issue to know the actual rights.

The memorandum is required by s.3 to set out only the share capital with the division thereof into shares of a fixed amount. Hence, as the memorandum may not give the different classes of shares, reference must be made to the articles. Table A, art. 2 of the 1st Schedule, provides:

> "Without prejudice to any special rights previously conferred on the holders of any existing shares or class of shares, and shares in the company may be issued with such preferred, deferred or other special rights or such restrictions, whether in regard to dividend, voting, return of capital or otherwise as the company may from time to time by ordinary resolution determine."

If the articles do not provide for the issuing of different classes of shares, the articles may be altered by special resolution to do so, provided the memorandum does not prohibit: Andrews v. Gas Meter Co. (1897) 1 Ch. 361.

The reason for issuing shares of different classes are many :

In a **small company** original owners may hold only ordinary shares, and when further capital is required they may issue preference shares with restricted voting and dividend rights, thereby retaining in their own hands the voting power and the greater part of the profits.

In a **large company** there are usually other reasons. First, the company appeals to different types of investors, viz. those willing to share in the risk bearing of the ordinary shares in the hope of large returns in dividends and capital appreciation (i.e., higher market value of the shares), and those who prefer a more moderate but regular income and greater security in a winding-up than what ordinary shares offer. Secondly, since preference shares carry a fixed rate of dividend the company is able in prosperous years to pay a higher rate on the ordinary shares than would be otherwise possible. Thirdly, when more capital is required for a period only, redeemable preference shares may be issued, thereby not saddling the company permanently with capital on which dividend must be paid; the company may, however, obtain similar advantages by issuing debentures which usually carry a lower rate of interest than a fixed preference dividend.

4. ORDINARY SHARES

Ordinary shares usually form the bulk or the whole of the capital of a company. The ordinary shares are entitled, together with any deferred shares, to the whole of the dividend available for distribution after payment of the preference share dividend (unless preference shares have participating rights – see H 6 below), and to the balance of the assets in a winding-up after return of capital.

Ordinary capital together with any deferred capital is often termed **equity capital.** The ultimate control of a company usually rests

with the equity capital as the voting power of preference shareholders are restricted. Equity capital is the risk bearing capital.

5. DEFERRED SHARES

Deferred, founders' or management shares usually form only a small proportion of the capital of a company. They generally have the right to the whole or a part of the profits after a fixed dividend on the ordinary share is paid. The rights attaching to the deferred shares is determined by the memorandum, articles or terms of issue.

The number of founders' management or deferred shares, and the nature and extent of the interest of the holders in the property and profits of the company, must be set out in a prospectus; Third Schedule.

The modern tendency generally is not to issue deferred shares.

6. PREFERENCE SHARES

To ascertain the rights of the preference shareholders reference must be made to the memorandum or articles or terms of issue. These are, however, general rules which apply unless provided for otherwise:

Re **dividend:** Preference shares are entitled to a fixed dividend prior to any payment on other shares. The preference dividend is cumulative, i.e., dividends of previous years in arrears are payable before payment of dividend on other shares, unless preference dividends are declared "non-cumulative", i.e., arrears are not carried forward.

Preference shares may be **'participating'**, i.e., after a fixed dividend is paid on the preference and ordinary shares, the preference capital is entitled to share in the balance profits.

Re Voting: Since preference shareholders have preferential rights with regard to dividends and bear little of the risk of ordinary shares, their voting power is usually restricted. For instance, voting power of the preference shareholders may be exercisable when (a) their

dividend is in arrears, or (b) modification of the class rights is being resolved upon, or (c) a winding-up resolution is proposed.

Re **Winding-up:** Unless there is provision to the contrary, all shares rank equally in a winding-up as to return of capital and in the sharing of any excess after return of all capital – Re Fraser and Chalmers Ltd. (1919) 2 Ch. 114. If provision is made for the rights of a class on winding-up, *prima facie* the rights are deemed to be set out fully. Thus if it is provided that preference shareholders are to be given priority in return of capital, it is assumed that they are not to share in any excess after return of all capital, with the ordinary shareholders – Scottish Insurance Corporation v. Wilsons & Clyde Coal Co., Ltd. (1949) A.C. 462.

Unless there is provision, dividends in arrears need not be paid in a winding-up.

7. NON-VOTING SHARES[1]

Shares carrying the same dividend rights but without the voting power of existing shares, known as non-voting shares, are sometimes issued. Such shares are issued for various reasons:

(i) when the existing shareholders wish to retain their control of the voting power whilst being able to obtain more capital, fresh issues may be of non-voting shares;

(ii) for the preservation of the voting power between the various classes of shares, e.g., in the event of the proportion of ordinary shares voting power to that of the preference shares, being upset by a new issue (such as a bonus issue), non-voting shares could be issued;

(iii) in a take-over bid or a sale of one company's assets to another company, the compensation given to the existing shareholders may be in the form of non-voting shares, thereby vesting the control in the purchasing company.

[1] Non-voting shares are permitted to be dealt on the Exchange under specific circumstances: ss. 1-5, Rules and Regulations, Colombo Stock Exchange.

8. REDEEMABLE PREFERENCE SHARES

By s.57 a company limited by shares, if **authorised by its articles** may issue redeemable preference shares provided that :

(a) Shares shall be **redeemed only** (i) out of profits otherwise available for dividends or (ii) out of the **proceeds of a fresh issue of** shares made for the purpose.

(b) Shares must be fully paid up.

(c) If shares are redeemed out of profits a sum equal to the amount of the shares redeemed be transferred out of profits available for dividend to a **capital redemption reserve fund.** Such fund shall be capable of reduction only as if it were paid-up capital except as provided in this section. S.57(5) permits fully paid bonus shares to be issued[2] out of the fund.

(d) Any **premium** payable on redemption is **provided out of profits** or out of the companies **share premium account** before the shares are redeemed.

Every balance sheet must state what part of the issued capital consists of redeemable preference shares and the earliest date on which they may be redeemed.

9. MODIFICATION OF CLASS RIGHTS

The rights of different classes of shares may be altered in accordance with the provisions governing their alteration and reference must be made to the memorandum, articles, terms of issue or wherever else such provision for alteration is found. Modification is subject, however, to s. 73. This section provides that where the share capital is divided into classes and either the memorandum or articles etc. authorise the variation of rights with the consent of a specified proportion of the holders or consent of a resolution of the holders and such variation is made, holders of not less than fifteen percent of the

[2] This provision was in the Ordinance.

issued shares of the class, who did not consent or vote in favour, may within 21 days appeal to court. The variation is then of no effect unless confirmed by the court. The decision of the court on such application is final. The company must within 15 days file a copy of the court order with the Registrar of Companies.

Variation includes abrogation of class rights.

10. ALTERATION OF CAPITAL

By s.62 a company limited by shares or guarantee may, if authorised by the articles and by resolution in general meeting, alter its memorandum to,

(a) **increase** its share capital by the creation of new shares;

(b) **consolidate and divide** the shares into shares of larger amounts;

(c) convert paid-up shares into **stock** or re-convert;

(d) **subdivide** shares, but so that the proportion paid up and unpaid remain unaltered;

(e) **cancel** any unissued shares[3] (cancellation is also called "diminution").

An ordinary resolution would suffice unless the articles provide otherwise.

Upon an increase, notice thereof with particulars of the new shares and a copy of the resolution must be filed within 15 days with the Registrar of Companies: s.64. Upon any other alteration, notice must be filed within one month: s.63.

11. REDUCTION OF CAPITAL

It is a principle of company law that capital (i.e., issued capital) cannot be reduced except as permitted by the Act so that,

[3] Cancellation does not amount to a reduction of share capital: see H 11.

(a) protection would be given to persons dealing with the company by providing that the fund available for satisfying their claim will not be diminished except by ordinary business risks;

(b) there is assurance that the reduction is equitable as between the shareholders of the company.

S.67 states that a company may reduce its share capital provided,

(i) the articles authorise,

(ii) a special resolution is passed,

(iii) confirmation of court is obtained.

Reduction may be effected in many ways. The following are examples:

(a) returning any paid up capital which is in excess of the company's needs;

(b) annulling or reducing the liability of members having amounts not paid up on shares;

(c) cancelling any paid up capital which has been lost or is not represented by prevailing assets;

(d) subdivision of shares in which the amount unpaid is not equally divided between the resulting shares: Re Doloswella Rubber Estates (1917) 1 Ch. 213.

Under (a) and (b) creditors are entitled to object and if they do, the court would then, before giving the court confirmation order, settle the list of creditors entitled to object and ensure that they have been satisfied by being paid off, or being secured, or that they have agreed to the reduction. By s.72 if any officer of the company wilfully conceals the name of any creditor entitled to object to the reduction, or wilfully misrepresents the nature or amount of the debt or claim of a

creditor, or aids, abets, or is privy to any such concealment or misrepresentation he is guilty of an offence and liable to a fine not exceeding Rs. 1,000/- or imprisonment of either description for a term not more than one year or both a fine and imprisonment.

When the court makes its order, it may require the company to,

(a) add the words "and reduced" to its name for a period;

(b) publish the reasons and causes for the reduction and any other information the court thinks necessary: s.69(2).

The reduction takes effect on registration of the order and of a minute approved by the court with the Registrar of Companies. The Registrar's Certificate is conclusive evidence that all the requirements of the Act with regard to reduction of capital have been complied with: s.70.

Any reduction of capital[4] not in compliance with the above requirements is illegal and void. A company may not use its funds to purchase its shares, it amounting to an illegal reduction of capital: Trevor v. Whitworth (1887) 12 App. Cas. 409.

S.55(1) Prohibits a company from providing any financial assistance to purchase or subscribe for its own shares and prohibits a subsidiary company from providing such financial assistance to purchase or subscribe for shares in its holding company – for exceptions see F 14.

SHARES

A share is the interest of a shareholder in the company, measured by a sum of money (i.e., the nominal amount), for the purpose of liability in the first place and of interest in the second.[5] It carries with it the rights and obligations belonging to it as set out in the Companies' Act and in the company's memorandum and articles.

[4] The distinction between authorised capital and issued capital has to be remembered. What has been stated above applies only to issued capital.

[5] Borland's Trustee v. Steel Bros. (1901) 1 Ch. 279.

Every share must be distinguished by its number:[6] s. 74.

12. ACQUISITION OF SHARES

Shares may be acquired either,

(1) direct from the company, by

(a) subscription to the memorandum;

(b) allotment; or

(2) from another person, by

(a) transfer (i.e., by sale or gift)

(b) transmission (occurring by an operation of law on the death or disability of a member).

13. APPLICATION FOR SHARES

The contract to take shares is usually by application (i.e., the offer) and by an allotment (i.e., the acceptance). The application may be verbal or in writing; but, it is usual to have forms ready for applicants to fill up so that the conditions under which the shares applied for are clear and disputes are avoided.

Every application form issued for shares or debentures in a company must be accompanied by a prospectus which complies with the provisions of s.40 (*vide* Chapter F on prospectuses), unless the issue is,

(a) in connection with a *bona fide* invitation to a person to enter into an underwriting agreement;

(b) not a public issue: s.40(3).

An application may not be withdrawn until after the expiration of the third day from the date of the "opening of the subscription list" (*vide* H 15) or giving before the expiration of the 3rd day, by some

[6] At one period in English Company Law numbers could be dispensed with if all shares of a particular class were fully paid up and ranked *pari passu*.

person responsible under s. 45 for the prospectus, of a public notice having the effect of excluding or limiting the responsibility of the person giving it.s.52(5). See H 15 below.

14. ALLOTMENT OF SHARES

Allotment must be made within the prescribed time or when no time is prescribed within a reasonable time. What is a reasonable time depends on the circumstances of each case.

In June, M offered to take shares in the R Company. He was not communicated with till November when he received a letter of allotment. M refused to take the shares. Held, M was entitled to refuse as acceptance was not within a reasonable time and the offer was deemed to have lapsed: Ramsgate Victoria Hotel Co. v. Montefiore (1866) L.R.I. Ex. 109.

An allotment must not vary the terms of the application.

Since the use of the post is generally contemplated, an allotment letter sent by post takes effect **on posting** and not when it reaches the applicant. Thus, if the allotment letter is lost or delayed in the post the allotment is binding even though the applicant may be ignorant of the fact.

G applied for shares in H company. A letter of allotment was posted but never reached G. Held, allotment was binding: Household Fire Insurance Co. v. Grant (1879) 4 Ex. D. 216.

An allottee becomes a member when his name is entered on the register of members: s.28.

15. RESTRICTIONS ON ALLOTMENT

The restrictions given below apply only to a first allotment, subsequent allotments being exempt.

Capital – Shares

A **private company** may allot shares at any time, provided that it observes the limitation on the number of its members.

A **public company** which does not issue a prospectus on or with reference to its formation, or which having issued such a prospectus has not proceeded to allotment thereon, may not allot any shares or debentures unless at least **three days previously** it has filed **a statement in lieu of prospectus:**[7] s.50. These provisions apply only to a **first allotment.**

A public company in the case of a first allotment which issues a prospectus may not allot any shares unless, within 60 days from the date of closing of the subscription lists, the **minimum subscription** has been subscribed and the application moneys have been received.[8] This applies only to first allotment. The application moneys must be at least 5% of the shares: s.49(3). If this provision is not complied with the application moneys become immediately repayable and if repayment is not made within 75 days from the closing of the subscription list the directors become jointly and severally liable[9] to repay the money with interest at the legal rate from the expiration of the 75th day: s.49(4). Further, the directors are unable to make the declarations required by s.107[10] and thus will be unable to obtain the certificate to commence business.

Any condition requiring or binding any applicant to waive compliance with any of the above requirements is void: s.49(5). When a company issues a prospectus, no allotment of shares can be made until the commencement of the 3rd day after the prospectus is issued or such later time as specified in the prospectus; this date is known as "the opening of the lists". Public holidays are not counted in computing the "three days"; if the prospectus is advertised in a newspaper that date is taken as the date of issue: s.52(1) and (6).

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[7] The statement in lieu of prospectus must be in accordance with the Fourth Schedule and signed by a director or proposed director or agent (authorised in writing); s.50(1).

[8] For details of minimum subscription see F 2; cheques received in good faith by a company and the directors have no reason to suspect invalidity, are acceptable: s. 49(1).

[9] A director is not liable if he proves that the default in the repayment was not due to any misconduct or negligence on his part: s.49(4).

[10] See B 9.

16. EFFECT OF IRREGULAR ALLOTMENT

An allotment in contravention of s.49 and s.50 is voidable at the option of the applicant within one month after the statutory meeting or after allotment if later, and any director knowingly at fault is liable (action must be commenced within 2 years of allotment) to compensate the company and the allottee: s.51.

17. RETURN OF ALLOTMENTS

Within one month of allotment there must be filed,

(1) a Return of Allotments giving particulars of the shares allotted, the names, addresses and descriptions of the allottees, and the amount, if any, paid, due or payable on each shares;

(2) in the case of shares allotted for consideration other than cash, a contract in writing constituting the title of the allottee to the shares, and a Return duly stamped giving particulars of the shares so allotted, the extent to be treated as paid up thereon and the consideration for the allotment; if the contract is not in writing, particulars similarly stamped must also be filed.

In the case of non-compliance with this section, every officer of the company who is in default is liable to a fine not exceeding Rs. 500/- for every day during which the default continues. The court may, however, grant relief if it is satisfied that the default was accidental or due to inadvertence or if it is just and equitable to grant relief: s.53.

18. ISSUE OF SHARE CERTIFICATES – STAMP DUTY

A company must have a share certificate ready for delivery within two **months of allotment** or of lodgement of a valid transfer, not being a transfer which the company is entitled to refuse and does not register, unless the conditions of issue otherwise provide. In case of default, the company and every officer of the company who is in default is guilty of an offence and liable to a default fine. If the

company is served with a notice requiring it to make good any default and does not do so within ten days of service of notice, the court may, on the application of the person entitled to the certificate, order the company and any officer to make good the default and to bear the applicant's costs: s.80.

The articles usually allow the directors to issue a duplicate certificate in the event of the loss or destruction of the original, if certain conditions as to indemnity as the directors think fit are fulfilled. Table A, Clause 9 states,

> "Where a share certificate is defaced, lost or destroyed it may be renewed on payment of a fee of five rupees or such less sum, and on such terms, if any, as to evidence and indemnity and the payment of out-of-pocket expenses of the company of investigating evidence, as the directors think fit."

There has to be a statement in the share certificate stating that the **stamp duty** has been paid: s.13, Stamp Duty Act, No. 43 of 1982.

19. EFFECT OF THE SHARE CERTIFICATE

There is no requirement in the Act that share certificates issued by a company must be under its common seal, but s.81 provides that a share certificate under the common seal of the company, specifying the shares held by any member, is *prima facie* evidence of his title to the shares. Certificates are usually under seal.

The certificate, hence, is **not conclusive** evidence of title and does not prevent the true owner of the shares from proving ownership. If a member's name has been erroneously removed from the Register of Members, by s.113 he can request that his name be restored. Rights and privileges lost, such as dividends missed can be reclaimed.

Estoppel* as to statements in a certificate

On the issue of a share certificate the company is estopped from denying:

(i) the truth of the certificate to any person who has relied on the certificate and has entered into transactions thereby – Re Bahia v. San Francisco Railway (1868) L.R. 3 Q.B. 584;

and may be estopped from denying,

(ii) the title to the shares of the person to whom it has issued the certificate – Dixon v. Kennaway & Co. (1900) 1 Ch. 833;

(iii) the amount stated as paid up on the shares – Bloomenthal v. Ford (1897) A.C. 156.

If the parties concerned are **aware** of the untruth of the statements in a share certificate, there is **no estoppel** in their favour, there being no estoppel in favour of persons who know the untruth of statements.

Further, the company is **not estopped** when,

(1) the certificate is a forgery – Ruben v. Great Fingall Consolidated (1906) A.C. 439;

(2) the certificate is granted on a forged transfer – Sheffield Corporation v. Barclay, (1905) A.C. 392;

(3) the certificate is granted on a forged power of attorney – Starkey v. Bank of England (1903) A.C. 114.

* Definition of Estoppel: "The rule of evidence or doctrine of law which precludes a person from denying the truth of some statement formerly made by him or the existence of facts which he has by words or conduct led others to believe in. If a person by a representation induces another to change his position on the faith of it, he cannot afterwards deny the truth of his representation."

20. SHARE WARRANTS

A share warrant is a document issued by a company under its common seal stating that the bearer of the warrant is entitled to the shares specified thereon. It is a negotiable instrument, transferable by delivery. Share warrants may be issued only if the following conditions are satisfied:

(1) the articles must authorise;

(2) shares must be fully paid up;

(3) they are under the common seal of the company: s.83;

(4) the company must be a public company,[11] limited by shares.

Share warrants or shares to bearer may not be issued or transferred to foreigners or their nominees without the permission of the Central Bank: Part III Exchange Control Act, chapter 423 of 1986.

On issuing a share warrant, the company must strike out of its register of members the name of the holder of the shares as if he had ceased to be a member and make the following entries in the register:

(1) the fact of the issue of the warrant;

(2) a statement of the shares included in the warrant, distinguishing each share by its number;

(3) the date of issue of the warrant: s.110(1).

The bearer of a share warrant may, however, if the articles so provide, be deemed to be a member of the company either to the full extent or for any purposes defined in the articles: s.110(5).

A share warrant can, subject to the articles, be surrendered for cancellation, whereupon the holder is entitled to be entered in the register of members: s.110(2).

The company is responsible for any loss incurred by any person by reason of the company entering in the register the name of a bearer of share warrant in respect of the shares therein specified without the warrant being surrendered and cancelled: s.110(3).

Dividends may be paid by coupons or otherwise, attached to the share warrants: s.83.

[11] Private companies cannot issue share warrants as they must by s.30 restrict the right to transfer shares – See Q 1, 2.

Stock Warrants to bearer can be issued in the same manner and terms as share warrants.[12]

The annual return must give the following information of share warrants:

(1) the total amount of shares for which share warrants are outstanding at the date of return;

(2) the total amount of share warrants issued and surrendered respectively since the last return;

(3) the number of shares comprised in each warrant: s.120.

The differences between a share certificate and a share warrant are:

(1) the bearer of a warrant is not entered in the Register of Members: s.110;

(2) a warrant is a negotiable instrument;[13]

(3) the shares are transferable by delivery of the share warrant: s.83; in the case of a share certificate, a transfer must be executed, i.e. a formal transfer deed has to be executed;

(4) manner of payment of dividends differs; in share warrants, coupons for dividends being generally attached to the warrant: s.83;

(5) When a share qualification for directors is required by the articles, the holding of share warrants is insufficient: s.180.

Offences in connection with share warrants

If any person acts with intent to defraud with respect to share warrants, such as falsely obtaining share warrants or dividends

[12] Pilkington v. United Railways of Hawana (1930) 2 Ch. 108.
[13] Webb, Hale & Co. v. Alexandria Water Co. (1905) 93 L.T. 339.

receivable on them, he is liable to imprisonment for not less than 3 years nor more than 20 years. If a person forges or aids in forging share warrants or coupons, he is liable to imprisonment of not less than 3 years nor more than 14 years: s. 84.

21. SHARES AT A PREMIUM

There is nothing in the Act to prevent a company from issuing shares at a premium, i.e. for a consideration in cash or in kind, which exceeds the nominal amount of the shares. Provision in the articles is not required. Companies usually issue shares at a premium when the class already dealt in on the market is at a substantial premium, e.g., the market value of a Rs. 10/- share is Rs. 18/- a new issue of the same series may be issued at a premium of say, Rs. 4/- i.e., a share would be issued at Rs. 14/-.

S.58 deals with the premium received from the issue of shares. When a company issues shares at a premium a sum equal to the aggregate amount of the premium has to be transferred to an account called the "**Share Premium Account**".* This account is regarded as share capital, and the provisions relating to a reduction of capital apply except to:

(1) pay for fully paid bonus shares issued to the members;

(2) write off preliminary expenses of the company;

(3) write off commission paid on discount allowed on any issue of shares or debentures;

(4) provide for the premium payable on redemption of any redeemable preference shares or debentures.

* In accordance with the Fifth Schedule the Balance Sheet must disclose particulars of the Share Premium Account.

22. SHARES AT A DISCOUNT

When the market value of a company's share is lower than its nominal value, investors would not be willing to pay the full nominal

value in a new issue of the same series of shares. It becomes necessary, therefore, to issue shares at a discount in a new issue. By s.59 shares may **not** be issued at a discount except in accordance with its provisions. This restriction applies equally to any indirect attempt to achieve the same effect – e.g., the issue of debentures at a discount to be exchanged for fully paid shares of the same nominal value: Mosley v. Koffyfontein Mines (1904) 2 Ch. 108.

By s.59 shares of a class already issued may be issued at a discount provided:

(1) the issue is authorised by a resolution (i.e., ordinary resolution) of the company specifying the maximum rate of discount;

(2) the Court sanctions the issue;

(3) at least one year has elapsed since the company became entitled to commence business;

(4) the shares are issued within one month of Court's sanction, or within such extended time as the Court may allow.

Every prospectus relating to the issue of the shares must contain particulars of the discount allowed on the issue of the shares or of so much of that discount as has not been written off at the date of the issue of the prospectus: s.59(3). The balance sheet must also contain particulars: Fifth Schedule.

23. CALLS ON SHARES

If the full nominal value of a share is not required to be paid on application and allotment, the amount remaining unpaid may become payable (a) by **instalments,** i.e., if the amount and date payable is specified in the prospectus or terms of issue, or (b) by **calls** which are made by the directors as and when further capital is required.

The resolution making a call must comply with the articles, give the amount of the call, the class of shares affected, to whom payable and the place and date of payment. Table A, art. 15 states:

"The directors may from time to time make calls upon the members in respect of any moneys unpaid on their shares (whether on account of the nominal value of the shares or by way of premium) and not by the conditions of allotment thereof made payable at fixed times, provided that no call shall exceed one-fourth of the nominal value of the share or be payable at less than one month from the date fixed for the payment of the last preceding call, and each member shall (subject to receiving at least fourteen days' notice specifying the time or times and place of payment) pay to the company at the time or times and place so specified the amount called on his shares. A call may be revoked or postponed as the directors may determine."

"A call is deemed to have been made when the directors pass the resolution authorizing the call:" art. 16.

A call creates a debt due from the shareholder: s.22(2).[14] Articles may provide for payment of interest accruing from the date fixed for payment until actual payment.

If the articles authorise, a company may on an issue of shares discriminate between different shareholders in the amount payable and time of payments of calls, and may accept calls in advance: s.60.

Table A art. 20 gives such authorization. Such a power does not entitle the directors to make calls on all the members except themselves,[15] unless sanction of the other members is obtained.

If calls in advance are accepted the following consequences arise:

(a) the member's liability to the company ends or is reduced,

(b) the company cannot be enforced to repay the payment,[16]

(c) the member becomes a creditor to the extent of the payment in advance and interest on it can be paid out of capital,[16]

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[14] In English Company Law it is a speciality debt.

[15] Alexander v. Automatic Telephone Co. (1900) 2 Ch. 56.

[16] Lock v. Queensland Investment Co. (1896) A.C. 461. 1 Ch. 396.

(d) without consent of the member, the company cannot repay the advance payment,[17]

(e) in a winding-up the member is entitled to repayment of the advance with interest before a return of capital of other members but ranks after the creditors.[18]

24. LIEN

A company possesses a lien on its members shares only if the **articles so provide.** The articles may give a lien for unpaid calls or instalments or for some other debts due from a member to the company, i.e., in a capacity other than that of member, such as under a trading contract. Table A, art. 11 states,

"The company shall have a first and paramount lien on every share (not being a fully paid share) for all moneys (whether presently payable or not) called or payable at a fixed time in respect of that share, and the company shall also have a first and paramount lien on all shares (other than fully paid shares) standing registered in the name of a single person for all moneys presently payable by him or his estate to the company; but the directors may at any time declare any share to be wholly or in part exempt from the provisions of this rule. The company's lien, if any, on a share shall extend to all dividends payable thereon."

Enforcement of a lien

A lien may be enforced by a company by a sale of the shares if the articles authorise.

Table A, articles 12 - 14 states:

art. 12: The company may sell, in such manner as the directors think fit, any shares on which the company has a lien, but no sale shall be made unless a sum in respect of which the lien exists is presently payable, nor until the expiration of fourteen days from the date of a notice in writing, stating and demanding payment of such part of the amount in respect of which the lien exists as is presently payable, has been given to the registered holder for the time being of the share, or the person entitled thereto by reason of his death, insolvency, or bankruptcy.

art. 13: To give effect to any such sale the directors may authorise some person to transfer the shares sold to the purchaser thereof. The purchaser shall be

[17] London and Northern Steamship Co. v. Farmer (1914) 111 L.T. 204.
[18] Re Exchange Drapery Co. (1888) 38 Ch.D. 171.

registered as the holder of the shares comprised in any such transfer and he shall not be bound to see to the application of the purchase money, nor shall his title to the shares be affected by any irregularity or invalidity in the proceedings in reference to the sale.

art. 14: The proceeds of the sale shall be received by the company and applied in payment of such part of the amount in respect of which the lien exists as is presently payable, and the residue if any shall (subject to a like lien for sums not presently payable as existed upon the shares prior to the sale) be paid to the person entitled to the shares at the date of the sale."

On a sale of the shares, the amount of the lien must be retained by the company and the balance returned.[19]

The Colombo Stock Exchange provides that companies seeking official quotation must have their fully paid shares free from all lien.

25. FORFEITURE

Shares may be forfeited only if,

(a) there is non-payment of a call, instalment, premium or other sum due on a share;

(b) the articles authorise.

Forfeiture when exercised amounts to a reduction of capital and it, therefore, seems certain that the articles cannot authorise forfeiture except on the ground of non-payment of calls or instalments.[20] Articles cannot authorise forfeiture of shares for non-payment of other debts due to a company by a member[21] nor authorise forfeiture of shares of a member who sues the company or its directors.[22]

Table A articles 34 to 40 deal with forfeiture. Articles, like the provision in Table A may provide that on the failure of a member to pay the amount due on shares on the fixed date, the directors may serve a notice on him stating that the shares will be liable to forfeiture if

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[19] Contrast with procedure under forfeiture (H 25) where the member loses all the money paid on the shares.

[20] Charlsworth, page 295 – Twelth Edition

[21] Hopkinson v. Mortimer, Harley & Co., Ltd. (1917) 1 Ch. 646.

[22] Hope v. International Financial Soc. (1876) 4 Ch.D. 327.

payment is not made by a further date, not less than fourteen days ahead; if payment is not made on such date, the directors may resolve the shares forfeited.

The articles being the contract with the member and the only authority for forfeiture, and forfeiture being in the nature of a penal proceeding, the provisions of the articles must be strictly followed, if not the member is entitled to have the forfeiture set aside. A slight irregularity matters as much as the biggest: Johnson v. Lyttle's Iron Agency (1877) 5 Ch.D. 687.

Purchases of forfeited shares are protected from irregularities in the forfeiture if the articles, such as art. 39 of Table A provides that purchasers of forfeited shares shall be unaffected by any irregularity or invalidity in the proceedings in reference to the forfeiture, sale or disposal of the shares.

The directors cannot exercise their power of forfeiture for the benefit of some shareholders by relieving them of their liabilities, but must use it in good faith and for the benefit of the company.[23]

Effect of forfeiture

"The Company on forfeiture gets its shares back".[24] The forfeited shares may be re-issued on any terms provided payment or liability is secured only on the amount remaining unpaid on the shares.[25]

"The shareholder who has had his shares forfeited is wholly discharged from his liability".[24] The articles may, however, provide otherwise. A member whose shares have been forfeited remains liable for a year as a contributory on the B list in the event of a winding up.[26]

26. SURRENDER

A company's articles may provide for the surrender of shares. Table A does not provide for the surrender of shares.

A surrender of shares may be accepted if,

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[23] Re Gower's Case, (1868) L.R. 6 Eq. 77.
[24] *Per* Luxmoore, J. in Re Bolton (1930) 2 Ch. 48, (referred to twice on this page).
[25] Re Bolton (1930) 2 Ch. 48.
[26] See R 45.

(a) the shares are in a position to be forfeited and in avoidance of the formalities of forfeiture;

(b) new shares of the same nominal amount are exchanged in surrender of fully paid shares.

The surrender of shares has practically the same effect as forfeiture, the main difference being "that the one is a proceeding *in invitum* and the other a proceeding taken with the assent of the shareholder, who is unable to retain and pay future calls on his shares".[27]

A surrender of partly paid shares not in a position to be forfeited is invalid because,

(a) the shareholder is released from further liability in respect of the shares;

(b) it amounts to a reduction of capital without court sanction;

and

(c) in effect the company is purchasing its own shares.

If the articles authorise, like forfeited shares, surrendered shares may be re-issued.

27. TRANSFER OF SHARES

Shares are movable property transferable in the manner provided by the articles.[28] Every shareholder has a right to transfer his shares to anyone, unless the articles provide otherwise.[29]

" In the absence of restriction in the articles, the shareholders have by virtue of the statute a right to transfer his shares without the consent of anybody to any transferee, even though he be a man of straw.... notwithstanding that the transferee is not competent to meet the unclaimed liability upon the shares."[30]

Without a proper instrument of transfer a company cannot register a transfer, notwithstanding anything in the articles: s.75. A

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[27] *Per* Lord Watson in Trevor v. Whitworth (1887) App. Cas. 409 at p. 429.

[28] "Perhaps the most important characteristic of shares is their transferability": Farrar's Company Law,

[29] Weston's Case (1868) L.R. 4 Ch. App. 20, but see H 29.

[30] See Lindlar's Case (1910) 1 Ch. 312, at p. 316.

transfer must be stamped: Stamp Duty Act No. 43 of 1982. A Stamp Duty of 1% of the market value of the shares has to be paid. In a quoted company the market value is the price reached on the trading floor of the stock exchange. In other companies the price is arrived at from the share valuation in the accounts. Before registering a transfer in the register, a company must be satisfied that the transferee is a resident of Sri Lanka. In the case of non-residents, different regulations apply: see G 2 (d).

A private company must by the articles, restrict its right to transfer shares: s. 30.[31] A public company must normally be free from restriction in the right to transfer, if a stock exchange quotation is to be obtained.[32]

28. CERTIFICATION OF TRANSFERS

The certification of documents for the transfer of shares or debentures shall be deemed to be certified if,

(a) the words "certificate lodged" or similar words appear on the face of the document;

(b) the person issuing the document is authorised by the company to do so;

(c) the certification is signed by a person authorised to do so.

Certification is not a representation that the seller has any title to the shares; it is merely a representation by the company that the documents have been produced, which purport to give the transferor *prima facie* title to the shares. If a false certification is made negligently, the company is under the same liability as if it had been made fraudulently and the company will be liable to compensate any person who acts on the faith of a false certification.

Mechanical devices may be used for signing for purposes of certification.

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[31] See Q1.

[32] Because of such rules, securities quoted on the Stock Exchange are made more marketable.

29. EFFECT OF TRANSFER

"When a member transfers his shares he transfers all his rights and obligations as a shareholder as from the date of the transfer. He does not transfer his rights to dividends or bonuses already declared, nor does he transfer liabilities in respect of calls already made: but he transfers his right to future payments, and his liabilities to future calls". [33, 34]

The transferee does not become a member until his name has been entered on the register, and so long as the transferor's name remains on the register, he is entitled to all benefits and subject to all liabilities. In Musslewhite v. C. H. Musslewhite & Sons Ltd. (1962) Ch. 964, it was held that unpaid vendors of shares whose names remained on the register of members were members, till such time as their names were removed.

30. RESTRICTION ON AND REJECTION OF TRANSFERS

A shareholder has *prima facie* a right to transfer his shares when and to whom he pleases, unless,

(a) the articles contain restrictions;[35]
(b) the instrument of transfer is not a 'proper instrument of transfer' or contravenes some other statutory provision;
(c) the transferee is not entitled to hold the shares, e.g., an infant[36] or insane person; [37]
(d) an order of court[38] has imposed restrictions.

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[33] Per Lindley, L. J. in Taylor, Phillips and Rickard's Case (1897) 1 Ch. 298

[34] In respect of future calls, however, the transferor transfers his liability subject to the qualification that if the company commences to be wound up within an year from the date of the transfer, the transferor remains liable, up to the extent of the amount then remaining unpaid on shares.

[35] Table A, art. 24 states "The Directors may decline to register any transfer of shares, not being fully paid up shares, to a person of whom they do not approve, and may also decline to register any transfer of shares on which the company has a lien." The By-laws of the Colombo Stock Exchange require the articles of companies dealt with on the Exchange to be free of any restriction on the right of transfer and free of any lien.

[36] Re Curtis's Case (1868) 6 Eq. 455.

[37] Re Wilson's Case (1869) 8 Eq. 240.

[38] eg., under s.216, vide N 2, 3.

If the articles are silent the directors cannot refuse to register a transfer[39] unless under conditions as in (b), (c) & (d) are present.

Articles of **private companies** usually contain a **pre-emption** clause, e.g., that the shares may not be transferred to non-members without the approval of the directors, or that shares must be first offered to members before being offered to non-members. Such pre-emption clauses do not entitle the directors to refuse to register a transfer of shares from one member to another of the company[40] nor to refuse to accept the person duly nominated where new shares are being issued to members with a right to renounce the shares in favour of a third party.[41] Articles of private companies may contain a pre-emption clause empowering the directors to refuse to register any transfer of any share in their absolute discretion and without assigning any reason therefor. In such a case if the directors refuse to register a transfer, if the court is to interfere, it must be proved that the directors did not use their discretion *bona fide*.[42]

Articles, even of some **public companies**, may empower the directors to decline transfers of partly paid shares to persons whom they do not consider responsible, or transfers of fully paid shares on which the company has a lien, or transfers to persons whom they do not approve as being fit to be members of the company. In the latter case, if the directors are not required to disclose their reasons for refusing registration, the court will not compel them to state their reasons[43] unless the directors are not exercising their discretion *bona fide* for the benefit of the company.[44] If the directors state their reason for their refusal, the court can decide whether they are sufficient to justify the refusal.[45] If the directors' power to refuse is limited to particular grounds, the court may order the directors to state the ground upon which the transfer has been refused,[46] unless the articles provide that the 'grounds' and not merely the 'reasons' for the refusal need not

[39] Re Gilbert's Case (1870) 5 Ch. 559; Cawley & Co., (1889) 42 Ch. D. 209.
[40] Delavenne v. Broadhurst (1931) 1 Ch. 234.
[41] Re Pool Shipping Co. (1920) 1 Ch. 251.
[42] Re Coalport China Co. (1895) 2 Ch. 404; Re Smith & Fawcett Ltd. (1942) Ch. 304.
[43] Exparte Penney (1873) 8 Ch. 446.
[44] Re Smith & Fawcett Ltd., (1942) Ch. 304.
[45] Re Bede Steam Shipping Co. Ltd. (1917) 1 Ch. 123 (C.A.).
[46] Sutherland v. British Dominions Corporation (1926) Ch. 746.

be specified.[47] When the directors are empowered to refuse a transfer to a person whom they do not approve, their objection must be something personal to the transferee, e.g., that he cannot pay calls, or is a quarrelsome person, or is acting in the interests of a rival business and not on the ground of something which relates only to the transferor, e.g., that the transfer increases his voting power, nor on the ground that shareholders should be limited to a particular family, nor for the prevention of small holdings as it is an abuse of the power and will be overridden by court.[48]

When the Articles of Association impose restrictions on the transfer of shares, such restrictions generally depress the value of shares (e.g. for the purpose of computing estate duty): Mackie v. The Attorney General (1950) 52 N.L.R. 1.

If a director refuses to attend a board meeting to pass transfers and so makes it impossible to form a quorum, the court on being satisfied that the transfer would be passed if a board meeting was held, will rectify the Register of Members.[49]

Transfers of shares to non-residents are governed by additional regulations - see G 2 (d).

Notice of refusal to register a transfer must be sent to the transferee within 2 months of the lodgement of the transfer: s.78.

31. FORGED TRANSFERS

If a shareholder's signature on a transfer is forged, the transfer is void and does not affect the title of the shareholder.[50] If a company registers a forged transfer, the company will be compelled to reinstate the member and pay him any dividends that may have been declared in the meanwhile.[51] The person lodging the forged transfer and the broker who deposits the forged transfer in good faith are liable to the company for any loss it suffers.[52] A broker who wrongly represents

[47] Berry & Stewart v. Tottenham Hotspur Football Co. (1935) Ch. 718.
[48] Re Bell Brothers (1891) 65 L. T. 245; Bede Steam Shipping Co. (1917) 1 Ch. 123.
[49] Re Copal Varnish Co. (1917) 2 Cg. 349.
[50] Simm v. Anglo-American Telegraph Co, (1879) 5 Q. B. D. 188.
[51] Barton v. N. Staffordshire Ry. (1888) 38 Ch. D. 458.
[52] Sheffield Corporation v. Barclay (1905) A.C. 392.

that he has authority to act for the supposed transferor is liable even if he is acting in good faith,[53] and a person identifying a stranger impersonating the owner of the shares as the transferor is liable, if a fraud is being committed.[54]

On a transfer being lodged, companies with a view to prevent forged transfers, sometimes write to the member requiring him to reply within a specified time whether the transfer is with his approval and stating that if they do not hear from him within the time specified the transfer will be registered; under such circumstances, if the member neglects to reply he is not estopped from proving that the transfer is a forgery.[55, 56]

32. TRANSMISSION

Transmission may occur on the death (or liquidation, if the member is a company) or bankruptcy of a member.

Transmission differs from the transfer of shares. A transfer occurs by the act of a member, whilst transmission occurs involuntarily by the operation of law, either on the death or the bankruptcy of a member. Unlike in a transfer where the legal title passes from one party to another – the shares being taken out of the name of one and put in the name of the other – in transmission the title to the shares remain for sometime in the estate of the deceased or bankrupt member, and the shares are left in his name; the power to deal with the shares, however, devolves on the person administering the estate. Such person must produce to the company proof of their authority. S.82 provides that notwithstanding anything in the articles, the company is bound to accept production of the probate of the will, or in the case of the intestacy, letters of administration of the estate as sufficient evidence of the grant.

The legal representative may transfer a share of a deceased member as if he were a member at the time of execution of the

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[53] Starkey v. Bank of Engalnd (1903) A.C. 114.
[54] Bank of Engalnd v. Cutler (1907) 1 K.B. 889.
[55] Barton v. L & N. W. Ry (1890) 24 Q.B.D. 77.
[56] See also H 19 on 'estoppel' as to statements in share certificates.

transfer: s.76. He can, therefore, effect a transfer without first taking the shares into his name. He has in fact three alternatives:

(a) leave the shares in the deceased's name, and effect a transfer when necessary;
(b) transfer the shares to a third party by signing in his representative capacity, to a beneficiary under the will or to a purchaser;
(c) transfer the shares to himself.

Table A art, 29-33 deals with transmission.

"In case of the death of a member the survivor or survivors where the deceased was a joint holder, and the legal representative of the deceased where he was a sole holder, shall be the only persons recognized by the company as having any title to his interest in the shares; but nothing herein contained shall release the estate of a deceased joint holder from any liability in respect of any share which had been jointly held by him with other persons.

There shall be no restriction by way of limitation of number in regard to the persons to be registered as joint holders of a share where such persons are executors or trustees of deceased holder.

Any person becoming entitled to a share in consequence of the death, bankruptcy or insolvency of a member may upon such evidence being produced as may from time to time properly be required by the directors and subject as hereinafter provided, elect either to be registered himself as holder of the share or to have some person nominated by him registered as the transferee thereof, but the directors shall, in either case have the same right to decline or suspend registration as they would have had in the case of a transfer of the share by that member before his death, bankruptcy, or insolvency, as the case may be.

Where the person so becoming entitled elects to be registered himself, he shall deliver or send to the company a notice in writing signed by him stating that he so elects. Where he elects to have another person registered he shall testify his election by executing to that person a transfer of the share. All the limitations, restrictions and provisions of these rules relating to the right to transfer and the registration of transfers of shares shall be applicable to any such notice or transfer as aforesaid as if the death, bankruptcy or insolvency of the member had not occurred and the notice or transfer were a transfer signed by the member.

A person becoming entitled to a share by reason of the death, bankruptcy or insolvency of the holder shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the share, except that he shall not, before being registered as a member in respect of the share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company.

Provided always that the directors may at any time give notice requiring any such person to elect either to be registered himself or to transfer the share, and where the notice is not complied with within ninety days the directors may thereafter withhold payment of all dividends, bonuses or other moneys payable in respect of the share until the requirements of the notice have been complied with."

Whether the representative is registered or not, the company is not in any way bound to see that the shares are not dealt with contrary to the will or rules of intestacy.[57]

Until some person is entered on the Register of Members as a shareholder the estate of the former holder remains entitled to any benefit and liable to pay calls made,[58] e.g., if the articles require that the new shares issued must be offered to existing shareholders, the estate of a deceased member must be included[58] and in the case of a reconstruction order, the executors though not on the register of members, can dissent[59] the representative holders are however, not personally liable for calls, even if the company without their consent enter their names on the register of members.[60]

33. OBLIGATION TO NOTIFY COMPANY OF CHANGES IN MAJOR SHAREHOLDINGS

Any person who becomes the owner of more than one tenth of the issued share capital of the company has a duty to inform the company of the fact and the date on which he became the owner.

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[57] See G 11.

[58] James v. Buena Ventura Syndicate (1896) 1 Ch. 456; New Zealand Gold Extraction Co. v. Peacock (1894) 1 Q. B. 622; Baird's Case (1870) 5 Ch. 725.

[59] Llewellyn v. Kasintoe Rubber Estate (1914) 2 Ch. 670. This case was decided under s.192 of the English Companies Act 1908.

[60] Buchan's Case (1879) 4 A.C. 549, 583.

Thereafter any changes in the shareholding must be similarly notified to the company, so long as the person continues to hold more than one tenth of the issued capital. Notifications to the company must be done within fourteen days of the change in shareholdings. Bank holidays and public holidays are disregarded in counting the fourteen days: s.199.[61]

[61] The provisions of s.199 were introduced by the Act. The Ordinance did not contain similar provisions.

CHAPTER I

GENERAL MEETING – MAJORITY RULE AND MINORITY PROTECTION

1. CLASSES OF MEETINGS

The classes of meetings are –

(i) Statutory meeting,
(ii) Annual General Meeting, and
(iii) Extraordinary general meeting.

2. STATUTORY MEETING AND REPORT

S.126 provides that every public company with a share capital must hold a general meeting of the members of the company, not less than one month nor more than three months from the date at which it is entitled to commence business, and that such meeting is to be called "the statutory meeting". Where a company has failed to hold, within the prescribed period, the statutory meeting, the directors are *prima facie* guilty of having knowingly and wilfully permitted the default: Cumarasamy v. R. A. de Mel (1950) 52 N. L. R. 253.

At least 14 days before the statutory meeting the directors must send a report called the "statutory report" to every member. However, all members may agree to treat a shorter period of despatch as valid. A copy has to be filed with the Registrar of Companies. The statutory report must state:

(a) the number of shares allotted, distinguishing the number allotted wholly or partly paid - up for consideration other than cash and stating the consideration;
(b) the cash received distinguished as above;
(c) an abstract of cash received and paid to a date within seven days of the report, showing separately cash from shares, debentures and other sources, balance in hand, and an account or estimate of the preliminary expenses;
(d) names, addresses, descriptions of directors, auditors, managers and secretary of the company;

(e) particulars of any contract to be modified, together with particulars of the modification or proposed modification.

So far as the report relates to shares allotted and cash received in respect thereof, and receipts and payment on capital account, it must be certified correct by the auditors, and the report as a whole must be certified by not less than **two directors** of the company, or where there are less than two directors, by the **sole director and secretary.**

If the meeting is not held or the report not filed, a member may petition the Court for the company to be wound up, but the court may instead order the meeting to be held or the report filed: s.255.[1a]

The object of the meeting is to give the members an early opportunity of meeting the directors and of discussing any matter arising out of the formation of the company.

The following must be observed:

(i) the notice convening the meeting must state that it is a statutory meeting,
(ii) the statutory report must be sent to every member at least 14 days before the meeting,
(iii) a list of the members, with their descriptions and holdings, must be produced at the commencement of the meeting and remain open for inspection throughout the meeting,
(iv) no contract mentioned in the prospectus or statement in lieu may be modified prior to the statutory meeting except subject to the consent of the meeting; particulars of the contract and proposed modification must be given in the statutory report,
(v) the meeting may discuss any matter relating to the formation of the company or arising from the statutory report, but no resolution of which notice has not been given in accordance with the articles, may be passed.

In the event of default in complying with the provisions stated above, every director who is knowingly and wilfully guilty of the default or where the company is in default, every officer who is in

[1a] See R 5.

default, is guilty of an offence and is liable to a fine not exceeding Rs. 500/-.

3. ANNUAL GENERAL MEETING

Every company must in each year hold a general meeting called its annual general meeting in addition to any other meetings in that year. The notice calling the meeting must specify it as the annual general meeting. Not more than 15 months must elapse between the date of one annual general meeting and the next. When, however, a company holds its first annual general meeting within 18 months of its incorporation it need not hold it in the year of incorporation or in the following year: s.127(1).

When default is made in holding the meeting the Registrar may, on the application of any member, call or direct the calling of the meeting and give any directions he thinks necessary in respect of calling, holding and conducting of the meeting, the operation of the articles, and may permit one member present or by proxy to constitute a meeting: s.127(2).

Where a meeting is not held in the year when the default occurred, a meeting held will not be considered the annual general meeting unless at that meeting the company so resolves. A copy of such resolution must be sent to the Registrar within 15 days: s.127(3), (4).

It is the duty of directors to see that the annual general meeting is held and the annual return filed with the Registrar, and on failure to carry out these statutory duties, the burden is on the directors to establish that such default was not knowingly and wilfully committed: De Silva, M. M. M. v. Registrar of Companies (1955) 56 N.L.R. 519.

Where there is a default in holding the annual general meeting and the default is referred to the court, the charge should set out that the offender was "knowingly a party to the default": M. E. de Silva v. Croos (1952) 48 C. L. W. 15; 54 N.L.R. 96.

In case of default, the company and every officer who is in default is guilty of an offence and is liable to a fine not exceeding

Rs. 500/-. Where there is default in forwarding a copy of the resolution to the Registrar, the company and every officer who is in default is guilty of an offence and liable to a fine of Rs. 250/-: s.127 (5).

Notice and business of such meetings are discussed later.

4. EXTRAORDINARY GENERAL MEETING

Every general meeting of the company which is not the statutory meeting or the general meeting required to be held once a year by s.127, is an extraordinary general meeting.

Convening of such meetings:

(a) The articles generally provide that directors may convene such meetings whenever they deem it necessary.

(b) By s.128 the directors are **bound** to convene an extraordinary general meeting on the requisition, in the case of a company with a share capital of the holders of not less than one-tenth of the paid-up capital of the company carrying the right of voting at general meetings; the requisition must state the objects of the meeting and be signed by the requisitionists. If the directors do not, within twenty-one days of the deposit of the requisition at the registered office of the company proceed to convene the meeting, the requisitionists, or the holders of more than half their voting rights may convene it themselves within three months after such deposit. The conveners must, however, await such three months before convening the meeting themselves, otherwise their meeting would be invalid: Ceylon Textiles Ltd. v. Sir Chittampalam Gardiner (1952) 54 N.L.R. 313. The reasonable expenses of the requisitionists in convening the meeting must be repaid by the company, which can retain the amount out of any remuneration due to the directors who were in default.

(c) By s.130 (b), if the articles do not provide otherwise, two or more members holding not less than one-tenth of the issued share capital or if the company has no share capital, not less than 5% of the members of the company may call a meeting.

(d) By s.131 (1), if for any reason it is impracticable to call or conduct a meeting of a company in the manner prescribed by the articles or the Act, the **Court** may either on its own motion or on the application of any director or member, entitled to vote at the meeting, order a meeting of the company to be called and conducted in such manner as the court thinks fit, and may give such ancillary or consequential directions as it thinks expedient. Such direction could include a direction that one member of the Company present in person or by proxy be deemed to constitute a meeting.

5. LENGTH OF NOTICE FOR CALLING MEETING

The minimum period of notice for the calling of an Annual General meeting is, by s.129 –

21 days for a company, **other than** a private company;

14 days for a private company.

The minimum period of notice for the calling of a meeting **other than** an Annual General Meeting or a Meeting for the passing of **special resolution** is –

14 days for a company **other than** a private company or an unlimited company;

10 days for a private company or an unlimited company.

All notices must be in writing. If the articles provide for shorter notice than that specified above such provision is void s.129 (1). (However, there is no restriction to prevent the articles providing for longer notice.)

Shorter notice than those specified above is permitted under the following circumstances:

(a) For an Annual General Meeting, if it is agreed by **all the members** entitled to attend and vote at such meeting.

(b) For any other meeting, if so agreed by the members holding 95% in the nominal value of the shares giving a right to attend and vote at the meeting and where the company has no share capital, the members having 95% of the total voting rights.

None of the provisions of s.129 apply to **adjourned meetings. 28 days Special Notice** and **21 days notice** are required for certain resolutions see I 8, 21.

6. PERSONS ENTITLED TO NOTICE

S.130 provides that, unless the articles provide to the contrary, notice of the meeting of the company is to be served as required by Table A.

Table A provides:

art.132: A notice may be given by the company to any member either personally or by sending it by post to him or to his registered address or (if he has no registered address within Sri Lanka) to the address, if any, within Sri Lanka, supplied by him to the company for the giving of notice to him. Where a notice is sent by post, service of the notice shall be deemed to be effected by properly addressing, prepaying, and posting a letter containing the notice, and to have been effected in the case of notice of a meeting at the expiration of twenty four hours after the letter containing the same is posted, and in any other case at the time at which the letter would be delivered in the ordinary course of post.

art.133: Notice may be given by advertisement in any leading daily newspaper, in addition to the manner of notice hereinbefore provided.

art.134: Notwithstanding the provision of rule 132, any member where registered address is not within Sri Lanka, may name an address within Sri Lanka which, for purposes of notices shall be considered as his registered address.

art.135: A notice may be given by the company to the joint holders of a share by giving the notice to the joint holder first named in the register of members in respect of the share.

art.136: A notice may be given by the company to the persons entitled to a share in consequence of the death, bankruptcy or insolvency of a member by sending it through the post in a prepaid letter addressed to them by name, or by the title of representatives of the deceased. or, trustee of the bankrupt or insolvent, or by any like description, at the address, if any, within Sri Lanka supplied for the purpose by the persons claiming to be so entitled, or (until such an address has been so supplied) by giving the notice in any manner in which the same might have been given if the death or bankruptcy had not occurred.

General Meeting – Majority Rule and Minority Protection

art.137: Notice of every general meeting shall be given in any manner herein before authorized to –

(a) every member except those members who (having no registered address within Sri Lanka) have not supplied to the company an address within Sri Lanka for the giving of notices to them;

(b) every person upon whom the ownership of a share devolves by reason of his being a legal representative or a trustee in bankruptcy or insolvency of a member where the member but for his death or bankruptcy would be entitled to receive notice of the meeting;

(c) the auditor for the time being of the company; and

(d) the Registrar

No other person shall be entitled to receive notices of general meetings.

Unless the articles provide, if notice of a meeting is not given to every person entitled to notice, any business transacted at a meeting will be invalid.

X, a member of a club committee informed the Chairman that she would be unable to attend committee meetings. Hence, she was not informed of a meeting at which Y, a member was expelled from the Club. Held, the failure to give notice of the meeting to X invalidated the proceedings of the committee: Young v. Ladies' Imperial Club (1920) 2 K. B. 523.

To prevent such occurrence it is usually provided in the articles as in Table A, art 52, that the accidental omission to give notice to or the non-receipt of notice by any person entitled to receive notice shall not invalidate the proceedings at that meeting.

When notices were being sent for a meeting, a few members did not receive notices as their name plates were inadvertently not put into the addressograph machine. Held, the omission was accidental and within an article like Table A art. 52: Re West Canadian Collieries Ltd., (1962) Ch. 370.

Directors wrongly believed that unpaid vendors of shares were no longer members when their names still remained on the Register of Members. Held, the error was not an accidental omission within an article like Table A. art. 52 but an error of law: Musselwhite v. C. H. Musselwhite & Son Ltd. (1962) Ch. 964.

The auditors are entitled to attend any general meeting and to receive all notices and other communications relating to all general meetings which any member of the company is entitled to receive.[1]

7. NATURE OF NOTICE

Table A art. 51 provides that the notice shall state the place, date, hour of the meeting and in the case of special business, the general nature of that business. Special business is defined by art. 53 which states,

> "All business shall be deemed special that is transacted at an extraordinary general meeting and also that is transacted at an annual general meeting, with the exception of declaring a dividend, the consideration of the accounts, balance sheets, and the reports of the directors and auditors, the election of directors in the place of those retiring and the appointment of, and the fixing of the remuneration of, the auditors."

It has been said of notice of special business that it must state clearly and fairly the resolutions to be put forward and the business to be transacted at the meeting, so that every shareholder may decide whether he will attend or not. If such notice is not given, resolutions passed and business transacted at a meeting may be declared not binding. Thus, where in seeking the sanction of the company to the retention by the directors of remuneration they had received regularly, no proper statement was made on the amount[2] or where in a reconstruction directors did not state that they were participating in the purchase consideration to be received by the selling company[3] the resolutions passed were held to be invalid.

The notice of a special resolution or an extraordinary resolution must specify the intention to propose the resolution as a special resolution or an extraordinary resolution as the case may be: s. 137. It appears that the **exact wording** of the resolution to be proposed must be set out in the notice.

In the Moorgate Mercantile Holdings Ltd (1980) 1 All E. R. 40 it was said that there must be complete identity between the substance of the resolution as passed and the substance of the resolution set out in the notice.

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[1] See K 14.
[2] Baillie v. Oriental Telephone Co. Ltd., (1915) 1 Ch. 503. See E. 21 (1).
[3] Kaye v. Croyden Tramways (1898) 1 Ch. 358.

8. SPECIAL NOTICE

Special notice is required for 4 types of **ordinary resolutions** namely, to –

(1) appoint a director who is over seventy years of age: s.182 (2),
(2) remove a director before expiration of his period of office or to appoint somebody instead of the director so removed: s.185 (2),
(3) appoint as auditor a person other than the retiring auditor: s.157 (1),
(4) expressly provide that a retiring auditor shall not be re-appointed: s.157 (1).

Where a special notice is required the persons proposing the motion must give the company **28 days** notice of their intention to move the resolution. The company when giving the members notice of the meeting must give notices of the resolutions. If it is too late to include the resolution in the notice of the meeting the company may advertise or otherwise communicate to the members in any other way allowed by the articles, at least 21 days before the meeting: s.138.

9. CIRCULATION OF MEMBERS' RESOLUTIONS

Section 136 gives the members themselves the right to move a resolution at the annual general meeting.

It is the duty of the company to give notice to members entitled to receive notice of the annual general meeting of any resolution to be moved at such meeting and to circulate among members entitled to receive notice of any general meeting any statement pertaining to any resolution or any business to be dealt at such meeting.

The number of members necessary to make requisitions are –

(a) members who among them hold more than one-twentieth of the total voting rights of members who have the right to vote at such meetings; or
(b) a minimum of fifty members who individually hold shares on which there has been paid up an average sum of at least one thousand rupees.

The company is not bound to comply with the requisition unless:

(a) the requisition has been signed by the requisitionists;
(b) there is tendered a sum sufficient to meet expenses;
(c) the requisition is deposited at the registered office of the company,
    (i) six weeks before the meeting, where it requires notice of a resolution;
    (ii) one week before the meeting where it requires circulation of a statement.

The company need not circulate such a statement if the Court is satisfied that such circulation would result in unnecessary publicity for defamatory matter.

PROCEEDINGS AT GENERAL MEETINGS

10. QUORUM

A quorum is the minimum number of persons who must be present to conduct a meeting. Unless a quorum of members is present, the meeting is not properly constituted and no business can be validly transacted.

The quorum is usually prescribed by the articles and in the absence of such provisions s.130 (c) stipulates that two members in the case of a private company and three members in the case of a public company, as quorum for a general meeting.

Usually, a meeting infers the coming together of two or more persons and the general rule is that a meeting **cannot consist of one person** even though he holds proxies for all the absent members: Sharp v. Dawes (1876) 2 Q.B.D.26. However, there are some exceptions:

(a) where one member holds all the shares of a class, that one member present in person or by proxy, constitutes a class meeting: East v. Bennet Bros. (1911) 2 Ch. 163;
(b) articles may empower the directors to appoint a committee of one;

(c) if articles contain the provision of Table A art. 55 (see below) then, at an adjourned meeting, if only one member is present, he would constitute the quorum.[4]

The quorum should be present throughout the meeting, unless the articles, as does Table A, art. 54 require it to be present "when the meeting proceeds to business.": Re Hartley Baird Ltd., (1955) Ch. 143.

Many articles provide, such as Table A, art. 55, that "Where within half an hour from the time appointed for the meeting a quorum is not present, the meeting, if convened upon the requisition of members, shall be dissolved; in any other case it shall stand adjourned to the same day in the next week, at the same time and place or to such other day and at such other time and place as the directors may determine, and where at the adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting the members present shall be a quorum."

11. CHAIRMAN

A meeting is not properly constituted if the proper person is not in the chair. S.130 (d) provides that if the articles are silent, any member elected by the members may be chairman of a general meeting; articles may provide as Table A, articles 56 & 57 that the chairman of the board of directors shall preside at every general meeting of the company, or if there is no such chairman, or if he is not present within fifteen minutes after the time appointed for the meeting, or is unwilling to act, the directors present shall elect one of themselves to be chairman; where at any meeting no director is willing to act as chairman or where no director is present within fifteen minutes, the members present can choose one of their number to be chairman.

The chairman collects his authority from the meeting (Taylor v. Nesfield, 1855) which has in effect delegated to him the power of regulating the meeting, so far as it does not direct him otherwise.[5]

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[4] It has been held in Jarvis Motors (Harrow) Ltd. v. Carabott (1964) 1 W. L. R. 1101, that the similar provision in the Table A of the English Companies Act (1948) should be interpreted so that the plural "members" include a sole surviving 'member'. Assuming such an interpretation applies to Table A of the Act a single member could constitute the quorum of an adjourned meeting.

[5] See I 12.

General Meeting – Majority Rule and Minority Protection

It was held in National Dwellings Society v. Sykes (1894) 3 Ch. 159 that it was the duty of the chairman to,

(a) preserve order;
(b) see that the proceedings are conducted in a proper manner;
(c) ascertain the sense (i.e. decisions) of the meeting on any question properly put before it.

The Chairman's powers and duties in greater detail are:

(1) To see that the **meeting is properly constituted,** i.e., notices have been issued with proper authority; his own appointment is in order and that a quorum is present.
(2) To **maintain order.** He should restrain irrelevant or improper language, and may require disorderly persons to behave or leave, and if they refuse, to order their removal from the meeting. In the ejection of disorderly persons he is not liable for the consequences if only reasonable force is used. He may adjourn or terminate the meeting if it is so disorderly as to prevent the transaction of business.
(3) To **ascertain the sense of the meeting** by putting motions and amendments to the vote and ascertaining the result thereof.
(4) To **decide points of order.**
(5) To **conduct the proceedings regularly and enforce the regulations.** For instance, as the meeting is held to transact decisions, he should allow no discussion unless there is a 'motion before the meeting', and if regulations so require, motions and amendments should be submitted in writing.
(6) To **give all a reasonable and equal opportunity to speak,** within the time available, and to decide who shall address the meeting. In particular he must see that the views of a minority are reasonably heard. But since discussion is subordinate to the purpose of the meeting, which is to arrive at decisions, when all have been given a reasonable opportunity to speak, he may, with the consent of the meeting, apply the closure and put the question to the vote.
(7) To **see that all business transacted is within the scope of the meeting** as determined by the notice and the regulations.
(8) If an agenda is circulated, **to take the business in that order** unless altered with the consent of the meeting.

(9) To **adjourn the meeting** in proper circumstances and with the consent of the meeting, except where the regulations or circumstances, e.g., disorder, vests the power solely in him.
(10) To see that the **minutes** are a proper record of the proceedings of the meeting.
(11) To **use his casting vote** in case of an equality of votes, if empowered to do so by the articles, such as art. 61 of Table A.
(12) To **act *bonafide*** in the best interests of the company as a whole.
(13) To **decide incidental questions** arising from decisions during the meeting, e.g., whether proxies are valid.
(14) To do everything necessary to further the business of the meeting.

12. CONDUCT

The conduct of a meeting devolves on the meeting itself, subject to the provisions of the Act and the articles. In Carruth v. I.C.I. Ltd., (1937). A.C. 707; it was said:

"There are many matters relating to the conduct of a meeting which lie entirely in the hands of those persons who are present and constitute the meeting. Thus, it rests with the meeting to decide whether notices, resolutions, minutes, accounts and such like shall be read to the meeting or be taken as read; whether representatives of the Press, or any other persons not qualified to be summoned to the meeting, shall be permitted to be present or if present, shall be permitted to remain; whether and when discussion shall be terminated and a vote taken; whether the meeting shall be adjourned. In all these matters, and they are only instances, the meeting decides, and if necessary, a vote must be taken to ascertain the wishes of the majority. If no objection is taken by any constituent of the meeting, the meeting must be taken to be assenting to the course adopted."

13. ADJOURNMENT

A chairman cannot at common law, adjourn a meeting at his own will, except in case of disorder or for the conducting of a poll. If, in

any other case, he purports to do so, the meeting may elect another chairman and proceed with the business: National Dwelling Society v. Sykes (1894) 3 Ch. 159.

The power of adjournment rests with the meeting, subject to the two exceptions given above and any provisions in the articles or in the Act. The chairman, however, is not bound to adjourn a meeting, even if the majority desires him to do so[6] unless the articles provide otherwise. Table A, art. 58 provides,

> "The chairman may, with the consent of any meeting at which a quorum is present (and shall if so directed by the meeting) adjourn the meeting from time to time and from place to place ...".

At a statutory meeting, the power of adjournment rests with the meeting: s.126 (8).

An adjourned meeting is a **continuation** of the original meeting. It follows that it has power only to conclude the **unfinished business** of the original meeting, unless articles provide otherwise. S.126 allows at any adjourned statutory meeting to consider resolutions not presented at the original meeting, provided notice has been given before the adjourned meeting. By s.140 a resolution passed at an adjourned meeting is treated as being passed on that date and not at any earlier date.

Notice of an adjourned meeting is unnecessary unless the articles require or, unless the meeting was adjourned *sine die* (i.e., without fixing a date).[7] Table A requires notice to be given, as in the case of an original meeting, if the meeting is adjourned for 30 days or more.

Unless the articles allow, a meeting once convened cannot be postponed. The proper course is to hold the meeting and resolve to adjourn it.

14. VOTING

Show of hands – Unless the articles provide otherwise, the common law rule is that a resolution put to the meeting is decided in the first instance by a show of hands.[8] On a show of hands every

[6] Salisbury Gold Mining Co. Ltd., v. Hathorn (1897) A. C. 268.
[7] Wills v. Murray (1849) 4 Ex. 483.
[8] Re Horbury Bridge Coal Co. (1879) 11 Ch. D. 109.

person present and voting has usually one vote only, regardless of the fact that he may hold many shares or may hold proxies for absent members: s.130(f).

S.137(3) provides that on a show of hands the declaration of the chairman that an extraordinary or special resolution has been passed shall, unless a poll be demanded, be conclusive evidence of the fact without proof of the number of votes recorded for or against the resolution. Table A extends this provision to ordinary resolutions.

Article 59, Table A provides that a resolution shall be decided on a show of hands unless a poll is demanded by the proper persons.

Unless the articles provide otherwise, a member shall not be entitled to exercise his vote at a general meeting if the calls or other sums payable in respect of his shares are in arrears: s.130(e).

Poll – There is a common law rule[8a] that on the declaration of the result of voting on a show of hands, any member may demand a poll. This rule may be varied by the articles, subject to s.134(1)(b). Despite any provision to the contrary in the articles, a demand for a poll will be effective if made by –

(a) five or more members having the right to vote, or
(b) members or any single member holding one-tenth of the total sum on all shares conferring voting rights has been paid up: s.134(1)(b).

A company cannot by its Articles exclude the right to demand a poll at a general meeting except for:

(a) the election of chairman,
(b) the adjournment of the meeting: s.134(1)(a).

If properly demanded, the chairman must grant the poll, but is entitled to decide whether it shall be held forthwith or at the conclusion of the meeting, or at some later date; if held at a later date, members not present at the meeting may attend and vote. A chairman empowered to demand a poll and entrusted with proxies, must use such power and proxies if necessary to ascertain the sense of the meeting.

[8a] R. v. Vicar of St. Asaph, (1883) 52 L.J. (K.B.) 672; Campbell v. Maund, (1836) 5 Ad. and El. 865; R.V. Wimbledon (1882) 8 Q.B.D. 459.

The number of votes a member would have on a poll depends on the provisions of the Articles, (Table A, art. 63 states that on a poll every member shall have one vote for each share of which he is the holder); s.130(f) states that where the articles are silent, in the case of a company having a share capital, every member shall have one vote in respect of each share or each one hundred rupees of stock held by him, and in a company with no share capital, every member shall have one vote. A member entitled to more than one vote need not cast all his votes the same way: s.135.

A poll is necessary for,

(a) absent members to record their voting power by proxy, and
(b) for shareholders to exercise the voting power to which their holdings entitle them.

15. PROXIES

The term proxy has two meanings. It is the term given to,

(a) the **instrument authorising** another person to vote on behalf of an absent shareholder; and
(b) the **person so appointed** to represent the shareholder.

In common law there is no right to vote by proxy: Jackson v. Hamlyn. (1953) Ch. 577, but the Act gives such a right. Any member of a company limited by shares has a right to appoint another person to attend and vote at a meeting as his proxy. However, a proxy cannot –

(a) speak at a meeting unless the instrument appointing him authorises him to do so,
(b) vote except on a poll unless the articles provide otherwise: s.133 (1).

A member is not allowed to appoint more than one proxy to attend on the same occasion.

In every notice of a meeting of a company limited by shares, due prominence must be given to the statements that –

(a) a member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of him,

(b) a proxy need not also be a member: s.133(2).

If proxy forms are sent at company expenses, such forms cannot be sent only to some members and not to others; they must be sent to all members. Every officer who knowingly or wilfully authorises or permits this, is guilty of an offence and is liable to a fine not more than one thousand rupees: s.133(4).

Any provision in the Articles requiring that the instrument appointing the proxy be lodged more than 48 hours and not less than 24 hours before a meeting or adjourned meeting is void: s.133(3).

There are two forms of proxy in use – a **general proxy** appointing a person and permitting him to vote as he likes, and a **special proxy** directing a proxy to vote for or against a particular resolution; the latter type of proxy is usually called 'a **two-way proxy**'.[9]

Proxies must be in accordance with the Articles. Table A states,

Article 68	–	On a poll votes may be given either personally or by proxy.
Article 69	–	The instrument appointing a proxy must be in writing signed by the appointor; the proxy need not be a member.
Article 70	–	The instrument must be deposited at the registered office at least 48 hours before the holding of the meeting or adjourned meeting – 24 hours in the case of a poll – otherwise it is invalid.
Article 71	–	Prescribes the form of a general proxy.
Article 72	–	Prescribes the form of a special proxy.
Article 73	–	The instrument appointing a proxy is deemed to confer authority to demand poll.
Article 74	–	A vote by proxy is valid notwithstanding the previous death or insanity of the principal or revocation of the proxy, as long as no intimation in writing of such death, etc., has been received by the company at the registered office before the commencement of the meeting or adjourned meeting.

It is the duty of the chairman to decide on the validity of proxies. If the articles provide, as does Table A, article 67 that votes tendered at a meeting and not disallowed shall be deemed to be valid, the court will not review the chairman's decision, even if it is wrong, in the absence of fraud or bad faith on his part.[10] Where articles do not incorporate Table A a mere misprint or some quite palpable mistake on

[9] The London Stock Exchange requires two-way proxy forms to be sent to shareholders: Admission of Securities to Listing.

[10] Wall v. Exchange Investments Corporation (1926) Ch. 143.

the face of a proxy form does not entitle the company to refuse to accept the proxy.[11]

A shareholder who has appointed a proxy may attend and vote in person. His presence and vote has the effect of revoking the proxy.[12]

If the directors are satisfied that their policy is in the interests of the company, they are entitled to send out to the shareholders proxy papers in favour of the named directors at the company's expense: Peel v. L. & N. W. Ry. Co. (1907) 1 Ch. 5 (C.A.). Two-way proxy forms, sometimes in use, enable the member to instruct his proxy, to vote for or against the resolution.

16. COMPANIES WHICH ARE MEMBERS

A company or other corporate body that is a member or creditor may, by resolution of its directors or other governing body **appoint such person as it thinks fit** to act as its representative at any meeting of the company or class of members or creditors, as the case may be. Such a representative has **all the powers and rights of an individual member or creditor**: s.132. He is **not** a proxy. He may, of course, be required to produce evidence of his appointment, and it is usual to provide him with a copy of the director's resolution appointing him, authenticated by the signature of the chairman.

17. MINUTES

Every company must keep minutes of proceedings of general meetings and meetings of directors and also managers (if any) meetings entered in books kept for that purpose: s.141 (1).

Such minutes purporting to be **signed by the chairman** of the meeting at which the proceedings were had, or by the chairman of the next meeting are to be evidence, i.e. *prima facie* evidence, of the proceedings and until the contrary is proved, the meeting is deemed to have been held, all proceedings duly had and all appointments of directors etc., validly done: s.141(2),(3). In Re Fire Proof Doors (1916) 2 Ch. 142, outside evidence brought in was allowed as proof that a

[11] Oliver v. Dalgleish (1963) 1 W. L. R. 1274.
[12] Cousins v. International Brick Co., Ltd. (1931) 2 Ch. 90.

particular resolution was passed, though such fact was omitted from the minutes. Articles may, however, provide that minutes signed by the Chairman shall be "conclusive evidence without any further proof of the facts stated therein", in which event evidence cannot be brought in to contradict the minutes, unless they have been fraudulently written.[13]

An article may provide that –

> A declaration by the chairman that a resolution has been carried or lost and an entry to that effect in the minute book is conclusive evidence of that fact without proof of the number or proportion of the votes recorded in favour or against such resolutions: Art. 59.

Any alteration in the minutes done before signing should be initialled by the chairman. After signing, the minutes should not be altered. If it is necessary to amend or reverse a decision, it should be effected by another resolution at the meeting at which the minutes are to be signed or at a later meeting, and duly minuted. In Re Cawley & Co., (1889,) 42 Ch. D. 209, Esher, M. R., said "I trust I shall never again see or hear of the secretary of a company, whether under superior direction or otherwise, altering minutes of meetings, either by striking out anything or adding anything."

Minutes of meeting must be kept in a bound book unless regulations provide otherwise: s.106.[14]

18. INSPECTION OF MINUTE BOOKS

The books containing the minutes of any general meeting of a company must be kept at the registered office of the company, and must be during business hours (subject to such reasonable restrictions as a company may by its articles or in general meeting impose, so that not less than two hours in each day is allowed for inspection) be open to the inspection of any member without charge: s.142(1).

Any member is entitled to be furnished with a copy of such minutes within seven days of a request made to the company, at a charge not exceeding Rs. 1/- per hundred words. s.142(2).

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[13] Kerr v. Mottram (1940) 1 Ch. 657.

[14] In case of default every officer found guilty of the offence is liable to a fine not exceeding five hundred rupees.

In case of refusal or default the court may order immediate inspection of the books or direct that the copies required be sent to the persons requiring them. The company and every defaulting officer will be guilty of an offence and liable to a fine: s.142(3) (4).

Minute books of general meetings are open only to members. Not even members may examine minutes of directors' meetings. Directors may, of course, examine minutes of their own meetings so long as they are acting *bona fide* in the interests of the company. By s.159 auditors are empowered to inspect minute books of directors and general meetings at all times.

RESOLUTIONS

19. ORDINARY RESOLUTION

An ordinary resolution, which is not defined by the Act, is a resolution passed by a simple majority of those who vote (or of the votes cast, in the case of poll). All business, no matter how important, may be done by ordinary resolution unless the Act or the company's articles require some other form of resolution. It is used for the ordinary business of the ordinary general meeting required annually by s.127 and may be used, for other business such as for all alterations of capital under s.62, unless the articles require some other form of resolution.

20. EXTRAORDINARY RESOLUTION

An extraordinary resolution is one passed by a majority of not less than three-fourths of such members as, being entitled to do so, **vote in person** or where proxies are allowed, **by proxy or by an authorised representative**,[15] at a general meeting of which notice, specifying the intention to propose such resolution as an extraordinary resolution, has been duly given: s.137 (1). In the event of a poll, the majority is calculated according to the votes cast. Such resolutions are required by statute only for a few purposes, the principal being:

[15] Under s.132 a corporation who is a member of a company registered under the Act may appoint a representative.

(a) to wind up the company voluntarily when insolvent: s.308(1)(c),
(b) to sanction the exercise of certain powers of the liquidator in a members' voluntary winding up: s.333(1)(a),
(c) to sanction arrangement between a company being wound-up and its creditors: s.336(1),
(d) to dispose of books and papers of a company in a members' voluntary winding-up. s.367(1)(b).

Articles may, however, require the sanction of extraordinary resolutions in other instances as well.

21. SPECIAL RESOLUTION

A special resolution is one passed by such a majority as is required for the passing of an extraordinary resolution, at a general meeting of which not less than twenty-one days' notice in the case of a company other than a private company or 14 days' notice in the case of a private company, specifying the intention to pass the resolution as a special resolution has been duly given. However, all those entitled to attend and vote may agree to a shorter notice if:

(1) members holding not less than 95% of the nominal value of the shares, or

(2) in the case of a company which does not have a share capital, not less than 95% of the total voting rights at that meeting of all the members,

agree to a period of notice less than 21 days or 14 days as the case may be: s.137.

A special resolution is required to –

(1) alter the objects clause of the Memorandum of Association: s.7,
(2) alter or add to the Articles of Association: s.12,
(3) change the company's name: s.20,

(4) reduce capital: s.67(1),
(5) create reserve liability: s.61,
(6) make liability of directors or managers or any managing director unlimited: s.197(1),
(7) assign a director's or a manager's office: s.204,
(8) procure appointment of inspectors by the Registrar of Companies: s.162(a),
(9) procure winding up by Court: s.255(a),
(10) wind up voluntarily when solvent: s.308(b),
(11) sanction sale to another company for consideration, in a voluntary winding-up: s.317.

22. FILING OF RESOLUTIONS ETC

By s.139 a copy[16] of the following resolutions or agreements must be filed with the Registrar within 15 days of passing or making thereof, and the articles must have embodied or annexed such resolutions or agreements:

(i) special resolutions,
(ii) extraordinary resolutions,
(iii) resolutions agreed to by all members which if they had not been, would have been required to be passed as special or extraordinary resolutions,
(iv) resolutions and agreements binding all the members of some class of shareholders,
(v) resolutions for voluntary winding-up where, by provisions of the articles,
  (a) the period fixed for company's duration has expired, or
  (b) on the occurrence of an event, the dissolution of the company is to take place, and such event has occurred.

Failure to comply with these provisions results in fines on the company and officers responsible.

23. AMENDMENTS TO RESOLUTIONS

An amendment to a resolution must be voted upon first, provided it is pertinent to the resolution under consideration. If the chairman

[16] S.116 of the Ordinance required a **printed** copy to be filed. This had been dispensed with by s.139 of the Act.

refuses to put an amendment properly brought forward, the resolution, if passed, is not binding: Henderson v. Bank of Australasia (1890) 45 Ch. D. 330. Amendments must conform to the rules generally accepted with regard to them, be positive, within the scope of the meeting, and in compliance with the Act and the Articles of the company concerned. There appears to be little scope for amendment to resolutions on matters concerning 'special business' since the notice convening the meeting must state the exact nature of the business to be conducted at the meeting, and in the case of special and extraordinary resolutions since the notice must set out the exact wording of the resolutions for the information of the members.

MAJORITY RULE AND MINORITY PROTECTION

24. MAJORITY RULE

In a company it is generally the majority that rules. The majority decision expressed by the passing of resolutions, i.e., ordinary, extraordinary or special, usually prevails. Further, the majority can alter the rules governing the internal management of the company – the articles.

Another proof of the majority rule is the rule in Foss v. Harbottle[17] by which, subject to certain exceptions, if a wrong is done to a company or if there is an irregularity in its internal management which is capable of confirmation by a simple majority of the members, the court will not interfere at the suit of a minority of the members.

25. MINORITY PROTECTION

"A proper balance of the rights of the majority and minority shareholders is essential for the smooth functioning of the company".

Statutes and case law has to increasingly provide for the protection of the minority. The Act and the relevant case law attempt to maintain the balance by admitting on principle, the rule of the majority but limiting it, at the same time, by a number of well-defined minority rights.

Some of the various minority sections in the Act are:

[17] See I 26.

(a) s.7 whereby dissentient holders of 15% of the issued shares can apply for cancellation of an alteration of objects;
(b) s.73(1) whereby share class rights when varied in pursuance of a clause in the articles, dissentient holders of 15% of the issued shares of the class can apply for cancellation of the variation;
(c) s.161 permits not less than 50 members or of members holding not less than one-fifth of the issued shares to request the Registrar of Companies to carry out an investigation of the Company's affairs;
(d) ss.210 and 211 whereby a member or members may petition Court for relief or regulation of the company's affairs where oppression or mismanagement is believed to exist; the court is given wide powers and may give any order it deems necessary;[18]
(e) ss.220 to 223 provide protection for the minority with regard to insider dealing – see chapter O.

The doctrine of "fraud on the minority" is another protection given to the minority. Those who are in control of a company cannot, by the use of their voting power, do a wrong to a minority if it amounts to a fraud on the latter. In Cook v. Deeks (1916) 1 A.C. 554, the directors of a company appropriated to themselves property to which the company was entitled. By the exercise of their voting power, the directors sanctioned the transaction at a general meeting. Held, a single shareholder or a minority of the shareholders can obtain relief.

An alteration of articles must not be in fraud of the minority. In Greenhalgh v. Arderne Cinemas Ltd. (1951) 1 Ch. 286, it was held that an alteration of articles must be *bona fide* for the benefit of the company as a whole, i.e., each member must proceed upon what in his honest opinion, is for the benefit of the company as a whole. Whether an alteration is for the benefit of the company is for the members to decide and not the court; the court will not interfere unless no reasonable man would think the alteration would be for the benefit of the company, e.g., because it is discriminatory giving the majority some advantage denied to the minority and so amounts to a fraud on the minority.

[18] See N 2, 3.

The other exceptions to the rule in Foss v. Harbottle (given below) are further examples of minority protection.

26. THE RULE IN FOSS V. HARBOTTLE

The rule is that if a wrong is alleged to have been done to a company, the proper plaintiff is *prima facie* the company and not any individual member. Where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, it would be futile for individual members to litigate.

A member took proceedings against the directors of a company to compel them to make good losses sustained by the company owing to their fraud. Held, as there was nothing to prevent the company from taking the proceedings if it thought fit to do so, the action failed: Foss v. Harbottle (1843) 2 Ha. 461.; 67 ER 189.

The reasons for the rule are (1) litigation at the suit of a minority of the members is futile if the majority do not wish it, (2) to avoid the multiplicity of suits.

In MacDougall v. Gardiner (1875) 1 Ch. D 13 it was said, "If the thing complained of is a thing which, in substance, the majority of the company are entitled to do, or if something has been done irregularly, which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use having litigation about it, the ultimate end of which is that a meeting has to be called, and the majority gets its wishes".

Besides,

"... the effective working of a company demands that internal disagreements between shareholders among themselves, between shareholders and directors and among directors between themselves, are matters essentially for solution and settlement in a domestic forum. ... They are matters in which the Courts rarely interfere. If such questions could be brought up without restriction or limitation in review before the courts, many evils would result. Litigation would clog the effective working of a company. Moreover the Courts would be called upon to decide whether the judgement of directors or groups

of directors was sound, a function which they would properly be reluctant to exercise, particularly as they may be called upon to review decisions taken upon purely commercial matters". per L. M. D. de Silva J. in Ceylon Textiles v. Sir Chittampalam Gardiner (1952) 54 N.L.R. 313.

Generally, courts will not interfere; but there are exceptions to the rule:

(i) Where the act complained of is illegal, or *ultra vires* the company, it cannot be confirmed by the majority. In Parke v. Daily News Ltd. (1962) Ch. 927, a minority shareholder successfully brought an action to prevent the company from making *ultra vires* redundancy payments.

(ii) Where the articles require the sanction of some special majority, e.g. a special resolution, before an act can be validly done or sanctioned and only a simple majority has approved it, an individual member can sue. In Baille v. Oriental Telephone Co., Ltd.[19] (1915) 1 Ch. 503, a shareholder was able to restrain the company from acting on a special resolution of which insufficient notice had been given.

(iii) Where a fraud on the minority is being committed.[20]

(iv) Individual members may sue not in the right of the company, but in their own right in protection of their individual rights as members. In Pender v. Lushington (1877) 6 Ch. D. 70, a shareholder was able to compel the company to record his vote.

[19] See E 21, I 7.
[20] See I 25.

CHAPTER J

DIVIDENDS – SECRETARY

1. DIVIDENDS

No express provision is necessary for dividends to be declared and paid, in the case of a trading company: the *raison d'etre* of a trading company being to earn profits so that they may be distributed amongst it's members, it's power to pay dividends is implied.

Articles usually give the mode of payment.

Dividends must be distinguished from interest. Interest is a debt which like all debts is payable from the company's assets generally. A dividend, however, is a debt only **after** it has been declared by the company, and cannot be declared out of the assets generally – dividends can be declared only from assets legally available for dividend.

Some principles relating to dividends are:

(i) dividends may be paid **only** out of **trading profits** and other **surpluses**,

(ii) dividends must **not be paid out of issued capital** since it would result in an illegal reduction of capital,

(iii) dividends must **not be paid out of borrowed money:** Verner v. General & Commercial Investment Trust, (1894) 2 Ch. 239.

2. ASSETS AVAILABLE FOR DISTRIBUTION

The following principles are generally applicable:

Re Presents Losses

Dividends may be paid out of revenue profits without first setting off **losses** of **fixed capital**, the company not being a debtor to

capital. In Lee v. Neuchatel Asphalte Co. (1889) 41, Ch.D. 1 (C.A.) there were current profits but much capital had been lost and assets were not equal to the share capital. It was held, that dividends could be declared before providing for the capital losses.

A **loss of circulating capital** during the years must, however, be made good before distribution of dividends. In Verner v. General & Commercial Investments Trust (1894) 2 Ch. 239 it was held, that there must be an excess of current receipts over current payments before dividends can be declared from profits.

Re Past Losses

A company can pay dividends from profits of any one year without first setting off losses of former years: Ammonia Soda Co. v. Chamberlain (1918) 1 Ch. 266 (C.A.).

Re Reserves

A reserve fund is accumulated profits and until irrevocably capitalised may be divided amongst the shareholders as dividend.[1] Thus where a reserve existed in the form of excessive depreciation of goodwill, the excess so written off could be written back to the profit and loss account and distributed as dividend — Stapley v. Read Brothers, Ltd. (1924) 2 Ch. 1.

Re Appreciations

Dividends may be paid from **profits realised on its capital assets.** In Lubbock v. British Bank of South America (1892) 2 Ch. 198 where capital assets were sold at a profit, it was held that such profit may be distributed as dividend.

A **reserve resulting from a revaluation of the assets,** if *bona fide* and not likely to fluctuate in the short term, may, if authorised by the articles, be distributed as dividend — Dimbula Valley (Ceylon) Tea Co., Ltd. v. Laurie (1961) Ch. 353.

[1] Re Hoare & Co., Ltd. (1904) 2 Ch. 208 (C.A.)

3. EFFECT OF PAYING DIVIDENDS OUT OF CAPITAL

If dividends are paid out of capital, all directors who are knowingly parties to such payment are jointly and severally liable to replace the amount of dividends so paid with interest.[2] But a director who believed honestly and without negligence that they were being paid out of profits will escape liability.[3] Directors called upon to repay dividends improperly paid out of capital may recover from a shareholder who at the time the shareholders received the money had notice that it was paid out of capital.[4] Such shareholders cannot on behalf of the company, maintain an action against the directors to replace the dividends so paid, at any rate until they have repaid the money they have received.[5]

4. PAYMENT OF DIVIDENDS

Dividends are paid in the manner laid out in the articles. Table A provides:

(a) no dividend shall be paid otherwise than out of profits;

(b) the company at a general meeting may declare dividends, but no dividend shall exceed the amount recommended by the directors;

(c) the directors may pay such interim dividends as they consider to be justified by the profits;

(d) before recommending dividends, the directors may transfer to reserve such sums as they consider desirable;

(e) no dividend shall bear interest against the company;

(f) directors may deduct from the dividend payable, sums of money presently payable by the member to the company on calls or otherwise in relation to the shares;

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[2] Flitcroft's Case (1882) 21 Ch.D. 519.
[3] Dovey v. Corey (1901) A.C. 477.
[4] Moxham v. Grant (1900) 1 Q.B. 88 (C.A.)
[5] Towers v. African Tug Co. (1904) 1 Ch. 558.

(g) there will be no forfeiture of unclaimed dividends before the expiration of 6 years after the declaration of dividend.

A company cannot be compelled to declare a dividend in the absence of anything to the contrary in the articles.[6] No dividend is legally due until properly declared, when it becomes a debt due from the company.

The directors should not rely on the chairman's or auditor's opinion of the value of the assets and investments but should have a complete and detailed list prepared for their perusal and study before recommending a dividend.[7]

When preference shareholders are entitled to receive a fixed dividend each year from the profits, 'profits' mean profits 'available for dividend', i.e., the residue after the transfer to reserves or the wiping out of past losses with current profits, if the directors so desire, even though such actions may prevent the payment of the fixed preferential dividend.[8]

Articles may empower the directors to pay such interim dividends as appear to them to be justified by the profits, as Table A, art. 115 which states, "the directors may from time to time pay to the members such interim dividends as appear to the directors to be justified by the profits of the company." When this power is given by the articles, a resolution by the company in general meeting requiring the directors to declare an interim dividend is inoperative.[9]

S.60 permits a company, if authorised by the articles, to pay dividends in proportion to the amounts paid up on the shares: Table A, art. 118 provides "Subject to the rights of persons, if any, entitled to shares with special rights as to dividends, all dividends shall be declared and paid according to the amounts paid or credited as paid on the shares in respect whereof the dividend is paid, but no amount paid or credited as paid on a share, in advance of calls shall be treated for

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[6] Bond v. Barrow Haematite Steel Co. (1902) 1 Ch. 353.
[7] Re City Equitable Fire Insurance Co., Ltd. (1925) Ch. 407.
[8] Re Buenos Ayres Great Southern Railway (1947) Ch. 384.
[9] Scott v. Scott (1943) 1 AII E.R. 582.

the purposes of this rules as paid on the share. All dividends shall be apportioned and paid proportionately to the amounts paid or credited as paid on the shares, during any portion or portions of the period in respect of which the dividend is paid; but where any share is issued on terms providing that it shall rank for dividend as from a particular date such share shall rank for dividend accordingly." Where the articles make no such provision, dividends must be paid on the nominal value of the shares irrespective of the amount paid up.[10]

Dividends must be paid in cash unless the articles authorise payment otherwise. A shareholder can restrain the company from paying dividends in ways other than in cash.[11] The articles should, accordingly contain authority for the directors to pay dividends by means of warrants etc. sent through the post. Table A, art. 121 provides, "any dividend, interest or other money payable in cash in respect of shares may be paid by cheque or warrant sent through the post directed to the registered address of the holder . . . etc."

A general meeting declaring a dividend or bonus may direct payment of dividend or bonus wholly or partly by the distribution of specific assets and in particular of paid-up shares, debentures or debenture stock of any other company or in any one or more of such ways.

5. CREATION OF RESERVES

Reserves may be created at any time, and power in the articles to create such reserves is not necessary.[12] Articles, however, often provide for the creation of reserves as Table. A, art. 117:

"The directors may before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for any purpose, to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the directors may from time to time think fit. The directors may also without placing the same to reserve carry forward any profits which they may think prudent not to divide".

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[10] Oak Bank Oil Co. v. Crum (1883) 8 App. Ca. 65.
[11] Wood v. Odessa Waterworks Co. (1889) 42 Ch.D. 636.
[12] Burland v. Earle (1902) A.C. 83 (P.C.)

6. WHEN INTEREST MAY BE PAID ON CAPITAL

S.66 provides statutory authority for an exception to the rule that dividends may not be paid out of capital. It states that where shares are issued to provide for the cost of construction of works or buildings or provision of plant, which cannot be made profitable for a lengthened period, interest may be paid on so much of the issued capital as is paid up, and charged to the cost of such works etc., provided that:

(a) the payment of such interest is **authorised by the articles or** by **special** resolution;

(b) it is **sanctioned by court,** which may hold an **enquiry** at the company's expense;

(c) such **payment does not continue beyond** the period determined by the court, or in the case beyond the half year next after the **half year in which the work is completed;**

(d) the **rate** of interest does not exceed the amount prescribed by regulation;

(e) such payment does **not operate in reduction of the amount paid up on the shares.**

7. CAPITALIZATION OF PROFITS OR ISSUE OF BONUS SHARES

It is not unusual for a company to convert accumulated profits which might lawfully have been distributed as dividends into shares by increasing the capital where the articles of association permit such increase: Per Pulle J. in Sooranammah v. Amirnathapillai (1950) 53 N.L.R. 334.

The following must be observed in a capitalization of profits:

(a) A basic rule of company law is that a company cannot purchase nor pay for its own shares even out of profits, but it can set off a debt to a member in respect of dividends. Hence, bonus shares may be formed and distributed amongst the shareholders only against **dividends due.**

(b) Dividends are payable in cash[13] unless articles provide otherwise, so that **provision in the articles** is necessary before bonus shares may be declared.

(c) As the allotment is for consideration other than cash, a **contract** constituting the title of the allottees must be filed with the return of allotments: s.53; for the purpose, the board generally appoints a trustee for the recipient shareholders, the trustee nominating the participants and contracts with the company on their behalf.

(d) Unless the articles provide otherwise, capitalization being a distribution of profits, it is governed by the **dividend rights** of the shares.

When the articles, as in article 129 and 130 of Table A provides for capitalization, they will give the authority required. Usually the authority required is the same as in a declaration of dividend.

Table A article 129 provides, "the company in general meeting may, upon the recommendation of the directors, resolve that it is desirable to capitalise any part of the amount for the time being standing to the credit of any of the company's reserve accounts or to the credit of the profit and loss account or otherwise available for distribution and accordingly that such sum be set free for distribution amongst the members who would have been entitled thereto if distributed by way of dividend and in the same proportions on condition that the same be not paid in cash but be applied either in or towards paying up any amounts for the time being unpaid on any shares held by such members respectively or paying up in full unissued shares or debentures of the company to be allotted and distributed credited as fully paid up to and amongst such members in the proportion aforesaid, or partly in the one way and partly in the other, and the directors shall give effect to such resolution:

Provided that, a share premium account and a Capital Redemption Reserve Fund may, for the purposes of this rule, only be applied in the paying up of unissued shares to be issued to members of the company as fully paid bonus shares".

[13] See J 4.

Where bonus shares are to be issued the company's nominal share capital must be sufficient. The board must allot the shares in the proportions specified by the articles.

COMPANY SECRETARY

8. SECRETARY

Every company must appoint a Secretary.[14]

With every memorandum delivered for registration to the Registrar, there shall also be delivered the prescribed form containing the name of the first secretary consenting to act as secretary of the company: s.175.

If a new secretary is appointed a letter from the new appointee to the Registrar accepting such appointment must accompany the prescribed notification to the Registrar: s.194(2).

Qualifications[15]

By s.176,[16] every public company and every private company with a turnover of more than Rs. 1,000,000/- or paid-up capital of more than Rs. 500,000/- must have a qualified person as secretary. The prescribed qualifications are:

(a) an attorney-at-law of the Supreme Court,

(b) membership of the Institute of Chartered Accountants of Sri Lanka,

(c) membership of the Institute of Chartered Secretaries and Administrators,

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[14] The English Companies Act 1985 by s.283 and earlier Acts state categorically "every company must have a secretary". The Companies Act of Sri Lanka in effect provides for this, as such secretary must be named in the memorandum and subsequent changes recorded in the Register of Directors & Secretaries.

[15] The Companies Ordinance did not prescribe qualifications for a company secretary. The English Companies Acts have prescribed qualifications even as far back as the 1948 Companies Act.

[16] The prescribed qualifications and the prescribed amount of paid-up capital of private companies referred to in s.176 were declared by Gazette notification, and have been included above.

(d) membership of the Chartered Institute of Cost and Management Accountants.

If either a director of a corporate body or partner of a firm has any one of the prescribed qualifications such corporate body or firm may act as secretaries: s.176.

Prohibitions

Re Appointment —

No company can,

(a) have as secretary to the company, a corporation the sole director of which is a sole director of the company; or

(b) have as sole director of the company, a corporation the sole director of which is secretary to the company: s.177.

Re Functioning —

Any provision requiring or authorising any act to be done by or to a director and the secretary cannot be satisfied by such act being done by or to the same person acting both as director and as, or in place of the secretary: s.178.

Register of Directors and Secretaries

S.194 requires the above register to be maintained, giving particulars of directors and secretaries, and naming the first directors and secretary/secretaries appointed and any subsequent changes thereof; the register must be available for inspection by members – vide L 9.

Powers and duties

Some of the powers and duties of a secretary are as follows:

(1) The secretary could give the statutory declarations required by s.17(2) declaring the compliance with the requirements of the Act. This declaration has to be produced to the Registrar before he can issue the certificate of incorporation.

(2) A document or record of proceedings requiring authentication by a company can be signed by the secretary; it does not have to be under the company's common seal: s.38(1).

(3) The statutory declaration must be signed by the secretary and delivered to the Registrar to obtain sanction to commence business: see B 9.

(4) The annual return which has to be forwarded to the Registrar has to be signed by the secretary, (as well as a director): s.123(1).

(5) The secretary (and a director) must certify as true copies the documents which have to be annexed to the annual return: s.124.

(6) (a) The secretary (and a director) must sign the certificate sent by a private company to the Registrar certifying that the company has not issued any invitation to the public to subscribe for shares or debentures of the company: s.125.

(b) If the number of members exceeds fifty the secretary (and a director) must certify that the excess consists wholly of persons who are not to be included in reckoning the number of fifty: s.125.

(7) In a limited company where the director's or manager's liability is unlimited a notice in writing has to be given by the secretary (or a promoter, director, manager) that his liability is unlimited; this notice has to be given before the person accepts the office or acts therein: s.196(2).

Although a secretary has extensive powers and duties, there are a number of acts which he may not do. He may not:

(1) borrow money on the company's behalf,

(2) bind the company on trading contracts,

(3) strike a name off the register of members,

(4) summon a general meeting on his own authority.

Any act of a secretary (as well as that of a director or manager) is valid notwithstanding any defect that may afterwards be discovered in his appointment or qualification: s.193.

The changing role of a Secretary[17]

The secretary is the chief administrative officer of the Company. Until recently his important status was not recognised by the courts. Lord Esher in Barnett, Hoares & Co. v. South London Transways Co. (1887) 18 QBD 815, stated that "A secretary is a mere servant, his position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all, nor can any one assume that statements made by him are necessarily to be accepted as trustworthy without further inquiry."

A landmark in the transformation of the status of the secretary to a status of some importance is the case of Panorama Developments (Guildford) Ltd. v. Fidelis Furnishing Fabrics Ltd. (1971) 2 Q. B. 711 – A company secretary hired a car purportedly on behalf of the company. But in fact the secretary used it for his own private purposes. Held, the secretary has an ostensible authority to enter into contracts for hire of cars on behalf of the company and the company was liable to pay for the hire. Lord Denning said:–

"Times have changed. A company secretary is much more important a person nowadays than he was in 1887. He is an officer of the company with executive duties and responsibilities. This appears not only in the modern Companies Acts but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representation on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff, and ordering cars and so forth. All such matters now come within the ostensible authority of a company's secretary."

[17] 'The position of a company's secretary had changed a great deal in the last 100 years' – Charlsworth - 13th Edition.

CHAPTER K

ACCOUNTS – AUDITORS

1. Companies are required to:

(a) Keep **proper books of account.**

(b) Lay a **profit and loss account and a balance sheet** before the company in general meeting (containing information required by the Act) at least once every calendar year. The balance sheet, the directors' and auditors' report and statement regarding accounts of any subsidiary, must be annexed.

THE BOOKS OF ACCOUNT must be kept showing:

(i) all **sums of money** received and expended, and the matters in respect of which the receipt and expenditure takes place;

(ii) all **sales** and **purchases;**

(iii) the **assets** and **liabilities:** s.143(1).

The books of account must give a true and fair view of the state of the company's affairs and explain its transactions: s.143(2).

The auditors, the Registrar of Companies, the directors or other officers duly authorized have a right to inspect the books of account at any time.

If the bookkeeping functions are performed in a foreign country, there must be available in Sri Lanka such information which is necessary to make a profit and loss account and balance sheet in conformity with the requirements of the Act: s.143(3). This provision does not apply to offshore companies and companies incorporated abroad carrying on business within Sri Lanka.

If a director fails to take reasonable steps or wilfully defaults in keeping proper books of account, he will be guilty of an offence and in respect of each offence he is liable to a fine not exceeding Rs. 2,000/- or imprisonment of either description for a term not exceeding 6 months, or both a fine and imprisonment.

A charge made against a director that he had failed to take reasonable steps to comply with these provisions of the Act could be successfully resisted, if he proves to the satisfaction of court, that he had reasonable grounds to believe, and did believe, that a competent and reliable person was in charge of the duty of seeing that the requirements were complied with and that person was in a position to discharge that duty. The court would not sentence a director to imprisonment unless the court is of the opinion that the offence was committed wilfully.

Further, if in a **winding-up** it is found that proper books of account have not been kept throughout the two years immediately preceding, every officer of the company who is in default shall be liable on conviction to imprisonment for not more than one year. If the officer can prove that he acted honestly and in the circumstances the default was inevitable, he would not be liable: s.357(1).

The books must comply with conditions which are as above, and must include annual stocktakings and (except in retail trade) particulars of goods sold and purchased and sufficient information of buyers and sellers so as to enable them to be identified: s.357(2).

There is sufficient compliance with the provisions of s.143 if the books of account contain an account record of each and every transaction which the section requires to be recorded. It cannot be said that the books are not 'proper books' so long as they correctly embody at all relevant times such information as is necessary to enable an auditor periodically to prepare the accounts, profit and loss account and balance sheet as required by the Act: Heen Banda v.Herath (1949) 51 N.L.R. 305.

The following particulars of directors must be included in the accounts:

(a) Aggregate amount of emoluments.

(b) Aggregate amount of pensions for directors past or present.
(c) Aggregate amount of compensation for loss of office for directors past or present.
(d) The number of directors who have waived their rights to receive emoluments: s.200.

Particulars must also be shown of loans to an officer of the company or to any person who, after taking the loan became, during that year, an officer of the company. This excludes:

(a) Loans made in the ordinary course of business where the business includes the lending of money.
(b) Loans which do not exceed Rs. 20,000 if certified by the directors and if it is accepted practice to give such loans to employees: s.201.

PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

Within **eighteen months of incorporation** and subsequently once at least in every **calendar year,** the directors must lay before a general meeting a **profit and loss account** or an income and expenditure statement (in the case of a company not trading for profit) for the period and a **balance sheet** at the closing date thereof. The accounts must be made up to a date not earlier than the meeting by nine months, or twelve months if the company has business or interests outside Sri Lanka: s.144. The Registrar may extend these periods of 9, 12 & 18 months. A **directors' report** must be attached to every balance sheet: s.152.[1] The auditors' report and the profit and loss accounts must also be attached to the balance sheet: s.151(3).[2]

The profit and loss account and balance sheet must comply with the detailed requirements of the Act.[3]

When there is non-compliance with the provisions of s.144, the burden of proof is on the directors to show that all reasonable steps have been taken to comply with the section: Muthiahpillai v. Robert de Silva (1965) N.L.R. 230. A director would not be sentenced to imprisonment unless the court is of the opinion that offence was committed wilfully.

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[1] See K 2.
[2] See K 13.
[3] See K 2.

2. CONTENTS AND FORM OF ACCOUNTS

The **balance sheet** and **profit and loss account** must give a true and fair view of the state of affairs of the company at the end of its financial year;[4] and they must comply with the requirements of Part I of the **Fifth Schedule:** s.145.

BALANCE SHEET

2. The **authorized share capital, issued share capital, liabilities** and **assets** shall be **summarised** with such particulars as are necessary to **disclose the general nature of the assets and liabilities**, and there shall be specified –

(a) any part of the issued capital that consists of **redeemable preference shares** and on which the company has power to redeem those shares;

(b) so far as the information is not given in the profit and loss account any **share capital** on which **interest has been paid out of capital** during the financial year, and the rate at which interest has been so paid;

(c) the amount of the **share premium account;**

(d) particulars of any **redeemed debentures** which the **company has power to reissue.**

3. There shall be stated under **separate headings,** so far as they are not written off –

(a) the **preliminary expenses;**

(b) any **expenses** incurred in connection with any **issue of share capital or debentures;**

(c) any sums paid by way of **commission** in respect of any **shares or debentures;**

(d) any sums allowed by way of **discount** in respect of any **debentures;** and

(e) the amount of the **discount** allowed on any **issue of shares at a discount.**

4. (1) The **reserves, provisions, liabilities** and **fixed and current assets** shall be **classified under headings** appropriate to the company's business :

Provided that –

(a) where the amount of any class is **not material** it may be included under the **same heading as some other class;** and

(b) where any **assets of one class** are **not separable from assets of another class,** those assets may be included under the same headings.

(2) **Fixed assets** shall also be **distinguished** from **current assets.**

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[4] The auditors must state that the accounts give a true and fair view of the company's state of affairs in their report laid before the annual general meeting – see K 14.

(3) The **method** or methods **used to arrive at the amount of the fixed assets** under **each heading** shall be stated.

5. (1) The method of arriving at the amount of any fixed assets shall subject to the provisions of sub-paragraph (2), be to take the difference between –

(a) its **cost** or, if it stands in the company's books at a valuation, the amount of the valuation; and

(b) the **aggregate amount provided** or **written off** since the date of acquisition or valuation, as the case may be, for **depreciation** or **diminution** in value, and for the purpose of this paragraph the **nett amount at which any assets** stand in the company's books on the appointed date (after deduction of the amounts previously provided or written off for depreciation or diminution in value) shall, where the figures relating to the period before that date cannot be obtained without unreasonable expense or delay be treated as if it were the amount of a valuation of those assets made on that date and where any of those assets are sold, the said nett amount less the amount of the sales shall be treated as if it were the amount of a valuation so made of the remaining assets.

(2) The provisions of sub-paragraph (1) shall **not** apply –

(a) to assets for which the figures relating to the period beginning on the appointed date, cannot be obtained without unreasonable expense or delay; or

(b) to assess the replacement of which is provided for wholly or partly –

(i) making provision for renewals and charging the cost of replacement against the provisions so made; or

(ii) by charging the cost of replacement direct to revenue; or

(c) to any investments of which the market value (or, in the case of investments not having a market value, their value as estimated by the directors) is shown either as the amount of the investments or by way of note; or

(d) to goodwill, patents or trade marks.

(3) For the assets under each heading whose amounts arrived at in accordance with the provisions of sub-paragraph (1) there shall be shown –

(a) the aggregate of the amounts referred to in clause (a) thereof; and

(b) the aggregate of the amounts referred to in clause (b) thereof.

(4) As respects the assets under each heading whose amount is not arrived at in accordance with the provisions of sub-paragraph (1) because their replacement is provided for as referred to in sub-paragraph (2) (b), there shall be stated –

(a) the means by which their replacement is provided for; and

(b) the aggregate amount of the provisions (if any) made for renewals and not used.

6. The aggregate amounts respectively of **capital reserves, revenue reserves** and **provisions** (other than provisions for depreciation, renewals or diminution in value of assets) shall be stated under **separate headings**:

Provided that –

(a) the provisions of this paragraph shall not require a separate statement of any of the said three amounts which is not material; and

(b) the Registrar may direct that it shall not require a separate statement of the amount of provisions where he is satisfied that this is not required in the public interest and would prejudice the company, but subject to the condition that any heading stating an amount arrived at after taking into account a provision (other than as aforesaid) shall be so framed or marked as to indicate that fact.

7. (1) There shall also be shown (unless it is shown in the profit and loss account or a statement or report annexed thereto, or the amount involved is not material) –

(a) where the amount of the capital reserves, of the revenue reserves or of the provisions (other than provisions for depreciation, renewals or diminution in value of assets) shows an **increase** so compared with the amount at the end of the immediately preceding financial year, the source from which the amount of the increase has been derived; and

(b) where –

(i) the amount of the capital reserves or of the revenue reserves shows a **decrease** as compared with the amount at the end of the immediately preceding financial year; or

(ii) the amount at the end of the immediately preceding financial year of the provisions (other than provisions for depreciation, renewals or diminution in value of assets) **exceeded the aggregate of the sums** since applied and amount still retained for the purpose thereof,

the application of the amounts derived from the difference.

(2) Where the heading showing any of the reserves or provisions aforesaid is divided into sub-headings, the provisions of this paragraph shall apply to each of the separate amounts shown in sub-headings instead of applying to the aggregate amount thereof.

8. (1) There shall be shown under **separate heading** –

(a) the aggregate amounts respectively of the company's **trade investments, quoted investments** other than the trade investments and unquoted investments and other trade investments;

(b) if the amount of the **goodwill** and of any **patents** and **trade marks** or part of that amount is shown as a separate item in or is otherwise ascertainable from the books of the company, or from any contract for the sale or purchase of any property to be acquired by the company, or from any documents in the possession of the company relating to the stamp duty payable in respect of any such contract or the conveyance of any such property, the said amount so shown or ascertainable and as so shown or ascertained as the case may be;

(c) the aggregate amount of any **outstanding loans** under the authority of the provisions of paragraphs (b) and (c) of the proviso to subsection (1) of section 55 of the Act;

(d) the aggregate amount of **bank loans** and **overdrafts**;

(e) the **net aggregate amount** which is **recommended for distribution by way of dividend.**

(2) Nothing in the provisions of sub-paragraph (1)(b) shall be taken as requiring the amount of the goodwill, patents and trademarks to be stated otherwise than as a single item.

9. Where **any liability** of the company **is secured otherwise than by operation of law on any assets** of the company, the **fact that that liability is so secured shall be stated** but it shall not be necessary to specify the assets on which the liability is secured.

10. Where any of the company's **debentures are held by a nominee of or trustee** for the company, the **nominal amount of the debentures** and the **amount at which they are stated in the books** of the company shall be stated.

11. (1) The matters referred to in this paragraph shall be stated by way of note, or in a statement or report annexed if not otherwise shown.

(2) The **number, description** and **amount** of any **shares in the company** which any person has an **option to subscribe for**, together with the following particulars of the option, that is to say –

(a) the **period** during which it is exercisable;

(b) the **price** to be paid for shares subscribed for under it.

(3) The amount of any **arrears of fixed cumulative dividends** on the company's shares and the period for which the dividends or if there is more than one class each class of them are in arrears the amount to be stated before deduction of income tax except that in the case of tax-free dividends, the amount shall be shown free of tax and the fact that it so shown shall also be stated.

(4) Particulars of any **charge on the assets** of the company, to secure the liabilities of any other person, including where practicable, the amount secured.

(5) The general nature of any **other contingent liabilities** not provided for and, where practicable, the aggregate amount or estimated amount of those liabilities, if it is material.

(6) Where practicable the **aggregate amount or estimated amount,** if it is material of **contracts for capital expenditure** so far as not provided.

(7) Where in the opinion of the directors any of the **current assets have not a value**, on **realisation** in the ordinary course of the company's business, at least equal to the amount at which they are stated, the fact that the directors are of that opinion.

(8) The **aggregate market value** of the company's **quoted investments,** other than trade investments, where it differs from the amount of the investments as stated.

(9) The **basis** on which **foreign currencies have been converted** into rupees where the amount of the assets or liabilities affected is material.

(10) The **basis** on which the **amount,** if any, set aside for **Sri Lanka income tax is computed.**

(11) Except in the case of first balance sheet laid before the company after the appointed date, the corresponding amounts at the end of the immediately preceding financial year for all items shown in the balance sheet.

PROFIT AND LOSS ACCOUNT

12. (1) There shall be shown –

(a) the **amount charged to revenue** by way of provision for **depreciation** renewals **or diminution** in value of **fixed assets;**

(b) the amount of the **interest** on the company's **debentures** and other **fixed loans;**

(c) the **amount of the charge** for Sri Lanka **income tax** and other Sri Lanka **taxation on profits,** including, where practicable as Sri Lanka income tax any **taxation imposed elsewhere** to the extent of the relief, if any, from Sri Lanka income tax and **distinguishing where practicable between income tax and other taxation;**

(d) the **amounts** respectively provided for **redemption of share capital** and for **redemption of loans;**

(e) the amount of material, set aside or proposed to be **set aside,** to, or **withdrawn from reserves;**

(f) subject to the provisions of sub-paragraph (2), the **amount** if material, **set aside** to provisions **other than** provisions for **depreciation, renewals** or diminution in value of assets or, as the case may be, the amount, if material, withdrawn from such provisions and not applied for the purpose thereof;

(g) the amount of **income** from **investments, distinguishing between trade investments and other investments;**

(h) the aggregate amount of the **dividends paid** and **proposed.**

(2) The Registrar of Companies may direct that a company shall not be obliged to show an amount set aside to provisions in accordance with the provisions of sub-paragraph (1)(f), if the Registrar is satisfied that that is not required in the public interest and would prejudice the company, but subject to the condition that any heading stating an amount arrived at after taking into account the amount set aside as aforesaid shall be so framed or marked as to indicate that fact.

13. Where the **remuneration of the auditors** is not fixed by the company in general meeting, amount thereof shall be shown under a separate heading, and for the purpose of this paragraph any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration".

14. (1) The matters referred in this paragraph shall be stated by way of note, if not otherwise shown.

(2) If **depreciation or replacement of fixed assets** is provided for by some method **other than a depreciation charge** or **provisions for renewals** or **is not provided for,** the **method by which it is provided** for or the fact that it is **not provided** for, as the case may be.

(3) This **basis** on which the charge for Sri Lanka **income tax is computed.**

(4) Whether or not the amount stated for **dividends** paid and proposed is for dividends **subject** to **deduction of income tax.**

(5) Except in the case of the first profit and loss account laid before the company after the appointed date, the corresponding amount, for the immediately preceding financial year for **all items shown in the profit and loss account.**

(6) Any material respects in which any items shown in the profit and loss account are **affected** –

(a) by **transactions** of a sort **not usually** undertaken by the company or otherwise by circumstances of an exceptional or non-recurrent nature; or

(b) by any **change** in the **basis of accounting.**

(7) Whether a **director** of the company is, **directly or indirectly, interested in any contract with the company** and if so, the **nature** of his interest.

Group Accounts

A holding company having subsidiaries must present at the annual general meeting group accounts setting out the state of affairs and the profit and loss of the company and its subsidiaries, unless –

(i) the company* itself is a wholly-owned subsidiary of another company;

(ii) it is impracticable or of no real value to the members because of the insignificant amounts involved or would involve expenses or delay out of proportion to their value to the members;

(iii) the result would be misleading or harmful to the business of the holding company or any of its subsidiaries (written approval of the Registrar is required);

(iv) the business of the holding company and that of the subsidiaries are so different that it is difficult to treat as a single undertaking: s.146.

*A company is deemed to be a wholly-owned subsidiary of another if it has no members except that other and the other's wholly-owned subsidiaries and it's or their nominees: s.146(4).

The form of group accounts

A consolidated balance sheet and a consolidated profit and loss account are required of the holding company and the subsidiaries.

The same or equivalent information may, however, be given in a form that would be 'readily appreciated' by members: s.147.

Contents of group accounts

The group accounts must comply with the requirements of Part II of the Fifth Schedule or give the same or equivalent information: s.148.

PART II

SPECIAL PROVISIONS WHERE THE COMPANY IS A HOLDING OF SUBSIDIARY COMPANY, MODIFICATIONS OF AND ADDITIONS TO REQUIREMENTS AS TO COMPANY'S OWN ACCOUNTS

15. (1) The provisions of this paragraph shall apply where the company is a holding company, whether or not it is itself a subsidiary of another body corporate.

(2) The aggregate amount of assets consisting of shares, in or amounts owing (whether on account of a loan or otherwise) from, the company's subsidiaries, distinguishing shares from indebtedness, shall be set out in the balance sheet separately from all the other assets of the company and the aggregate amount of indebtedness (whether on account of a loan or otherwise) to the company's subsidiaries shall be so set out separately from all its other liabilities and –

(a) the reference in Part I to the company's investments shall not include investments in its subsidiaries required by the provisions of this paragraph to be separately set out; and

(b) the provisions of paragraph 5, sub-paragraph (1)(a) of paragraph 12, sub-paragraph (2) of paragraph 14 shall not apply in relation to fixed assets consisting of interests in the company's subsidiaries.

(3) There shall be shown by way of note on the balance sheet or in a statement or report annexed thereto the number, description and amount of the shares in and debentures, of the company held by its subsidiaries or their nominees, but excluding any of those shares or debentures in the case of which the subsidiary is concerned as personal representatives or in the case of which it is concerned as trustee and neither the company nor any subsidiary thereof is beneficially interested under the trust, otherwise than by way of security only for the purposes of a transaction entered into by it in the ordinary course of business which includes the lending of money.

(4) Where group accounts are not submitted, there shall be annexed to the balance sheet a statement showing -

(a) the reason why subsidiaries are not dealt with in group accounts;

(b) the nett aggregate amount, so far as it concerns members of the holding company and is not dealt with in the company's accounts, of the subsidiaries' profits after deduction of the subsidiaries' losses (or *vice versa*) –

(i) for the respective financial year of subsidiaries ending with or during the financial year of the company; and

(ii) for their previous financial years since they respectively become the holding company's subsidiary;

(c) the net aggregate amount of the subsidiaries' profit after deducting the subsidiaries' losses (or *vice versa*) –

(i) for the respective financial years of the subsidiaries ending with or during financial year of the company; and

(ii) for their previous financial years since they respectively become the holding company's subsidiary,

so far these profits are dealt with or provision is made for those losses in the company's accounts;

(d) any qualifications contained in the report of the auditors of the subsidiaries on their accounts for their respective financial years ending as aforesaid, and any note or saving contained in those accounts to call attention to a matter which, apart from the note or saving, would properly have been referred to in such a qualification, in so far as the matter which is the subject of the qualification or note is not covered by the company's own account and is material from the point of view of its members; or in so far as the information required by this sub-paragraph is not obtainable, a statement that it is not obtainable:

Provided that the Registrar may on the application or with the consent of the company's directors, direct that in relation to any subsidiary this sub-paragraph shall not apply or shall apply only to such extent as may be provided by the direction.

(5) The provisions of paragraphs (b) and (c) of the sub-paragraph (4) shall apply only to profits and losses of a subsidiary which may properly be treated in the holding company's accounts as revenue profits or losses, and the profits or losses attributable to any shares in a subsidiary for the time being held by the holding company or any other of its subsidiaries shall not (for that or any other purpose) be treated as aforesaid so far as they are profits or losses for the period before the date on or as from which the shares were acquired by the company or any of its subsidiaries, except that they may in a proper case be so treated where –

(a) the company is itself the subsidiary of another body corporate; and

(b) the shares were acquired from that body corporate or a subsidiary of it,

and for the purpose of determining whether any profits or losses are to be treated as profits or losses for the said period the profit or loss for any financial year of the subsidiary may, if it is not practicable to apportion it with reasonable accuracy by reference to the facts, be treated as accruing from day to day during that year and be apportioned accordingly.

(6) Where group accounts are not submitted, there shall be annexed to the balance sheet a statement showing, in relation to the subsidiaries (if any) whose financial years did not end with that of the company –

(a) the reasons why the company's directors consider that the subsidiaries' financial years should not end with that of the company; and

(b) the date on which the subsidiaries' financial years ending last before that of the company respectively ended or the earliest and latest of those days.

16. (1) The balance sheet of a company which is a subsidiary of another body corporate, whether or not it is itself a holding company, shall show the aggregate amount of its indebtedness to all bodies corporate of which it is a subsidiary or a fellow subsidiary and the aggregate amount of indebtedness of all such bodies corporate to it, distinguishing in each case between indebtedness in respect of debentures and otherwise.

(2) For the purpose of this paragraph a company shall be deemed to be a fellow subsidiary of another body corporate if both are subsidiaries of the same body corporate but neither is the others.

CONSOLIDATED ACCOUNTS OF HOLDING COMPANY AND SUBSIDIARIES

17. Subject to the provisions of the following paragraphs, the consolidated balance sheet and profit and loss account shall combine the information contained in the separate balance sheets and profit and loss accounts of the holding company and of the subsidiaries dealt with by the consolidated accounts, but with such adjustments (if any) as the directors of the holding company think necessary.

18. Subject as aforesaid and to Part III the consolidated accounts shall, in giving the said information, comply, so far as practicable with the requirements of the Act as if they were the accounts of an actual company.

19. The provisions of sections 145 and 148 of the Act shall not by virtue of the provisions of paragraphs 17 and 18 apply for the purpose of the consolidated accounts.

20. The provisions of paragraph 7 shall not apply for the purpose of any consolidated accounts laid before a company with the first balance sheet so laid after the appointed date.

21. In relation to any subsidiaries of the holding company not dealt with by the consolidated accounts –

(a) the provisions of sub-paragraphs (2) and (3) of paragraph 15 shall apply for the purpose of those accounts as if those accounts were the accounts of an actual company of which they were subsidiaries; and

(b) there shall be annexed in the like statement as is required by the provisions of sub-paragraph (4) of paragraph 15 where there are no group accounts but as if reference therein to the holding company's accounts were references to the consolidated accounts.

22. In relation to any subsidiaries (whether or not dealt with by the consolidated accounts), whose financial years did not end with that of the company there shall be annexed the like statement as is required by the provisions of sub-paragraph (6) of paragraph 15 where there are no group accounts.

Financial year

The financial years of the holding company and its subsidiaries must coincide, unless on application or consent of the directors the Registrar directs that (a) the submission of accounts at the annual general meeting, (b) the holding of an annual general meeting (c) the making of an annual return, be adjusted as to timing: s.149.

For the definition of a holding and subsidiary company vide Q 5.

Special provisions governing bank, insurance and other specified companies

Part III of the Fifth Schedule gives exceptions for special classes of companies:

PART III

EXCEPTIONS FOR SPECIAL CLASSES OF COMPANY

23. (1) A banking or discount company shall not be subject to the requirements of Part I other than –

(a) as respects its balance sheet, the requirements of paragraphs 2 and 3, paragraph 4 (so far as it relates to fixed and current assets), paragraph 8 (except sub-paragraph (1), (d), paragraph 9 and 10, and paragraph 11 (except sub-paragraph (8); and

(b) as respects its profits and loss account, the requirements of sub-paragraph (1)(a) of paragraph 12, paragraph 13 and sub-paragraphs (1), (4) and (5) of paragraph 14,

but where in its balance sheet capital reserves, revenue reserves or provisions (other than provisions for depreciation, renewals or diminution in value of assets) are not stated separately, any heading stating an amount arrived at after taking into account such a reserve or provision shall be so framed or marked as to indicate that fact and its profit and loss account shall indicate by appropriate works the manner in which the amount stated for the company's profit or loss has been arrived at.

(2) The account of a banking or discount company shall not be deemed, by reason only of the fact that they do not comply with any requirements of the said Part I from which the company is exempt by virtue of the provisions of this paragraph, not to give the true and fair view required by the Act.

(3) In this paragraph the expression "banking or discount company" means any company which satisfies the Registrar that it ought to be treated for the purpose of this Schedule as a banking company or as a discount company.

Accounts – Auditors

24. (1) In relation to an insurance company which is subject to and complies, with the requirements of any written law relating to insurance as respect the preparation and deposit of a balance sheet and profit and loss account the provisions of paragraph 23 shall apply as it applies in relation to banking or discount company, and such an insurance company shall also not subject to the requirements of sub-paragraph (1)(a) and (3) of paragraph 8 and sub-paragraphs (4) to (7) and sub-paragraph (10) of paragraph 11:

Provided that the Registrar may direct that any such insurance company whose business includes to a substantial extent business other than insurance business shall comply with all requirements of the said Part I or such or them as may be specified in the direction and shall comply therewith as respects either the whole of its business or such part thereof as may be so specified.

(2) Where an insurance company is entitled to the benefit of the provisions of this paragraph, then any wholly owned subsidiary thereof shall also be so entitled if its business consists only of business which is complementary to insurance business of the classes carried on by the insurance company.

(3) For the purpose of the provisions of this paragraph a company shall be deemed to be the wholly-owned subsidiary of an insurance company if it has no members except the insurance company and the insurance company's wholly-owned subsidiaries and its or their nominees.

25. (1) A company to which this paragraph applies shall not be subject to the following requirements of this Schedule, that is to say –

(a) as respects its balance sheet those of paragraph 4 (except so far as the said paragraph relates to fixed and current assets) and paragraphs 5, 6 and 7; and

(b) as respects its profit and loss account those of sub-paragraphs (1)(a), (e) and (f) of paragraph 12,

but a company taking advantage of this paragraph shall be subject, instead of the said requirements, to any prescribed conditions as respects matters to be stated in its accounts or by way of note thereto and as respects information to be furnished to the Registrar or a person authorised by them to require it.

(2) The accounts of a company shall not be deemed, by reason only of the fact that they do not comply with any requirements of Part I of the Schedule from which the company is exempt by virtue of this paragraph, not to give the true and fair view required by the Act.

(3) The provisions of this paragraph apply to companies of any class prescribed for the purpose thereof and a class of companies may be so prescribed if it appears to the Registrar desirable in the national interest:

Provided that, if the Registrar is satisfied that any of the conditions prescribed for the purposes of this paragraph has not been complied with in the case of any company, they may direct that so long as the direction continues in force the provisions of this paragraph shall not apply to the company.

3. SIGNING OF BALANCE SHEET

Every balance sheet of a company must be signed on behalf of the board by two directors of the company, or if there is only one director, by that director. In the case of a banking company the balance sheet must be signed by the secretary or manager, if any, and where there are more than 3 directors by at least 3 of them and where there are not more than 3 directors by all of them: s. 153.

4. DIRECTORS' REPORT

Every company must attach to the balance sheet laid before the general meeting a report by the directors as to the **state of the company's affairs,** the **dividends,** if any, which they recommend, and the amount they propose to **carry to reserves.**

The report must also state whether any director is directly or indirectly interested in any contract or proposed contract with the company. If so, the report must state the nature of the interest and whether it was declared by the director at a meeting of the directors: s.152, (vide L 6).

5. COPIES OF ACCOUNTS AND AUDITORS' REPORT

The **balance sheet, profit and loss account,** statement of accounts of subsidiaries (if any), **directors' report** and **auditors' report,** must be:

(i) **Laid before the company** in general meeting, and copies must be sent to all **debenture holders and all members of the company** and all other persons entitled to receive notice of general meetings at least 14 days before the meeting in the case of a private company and 21 days for a public company. A shorter period of despatch may be treated as valid if so agreed by all the members: s.154 (1).

(ii) Supplied on demand and without charge to any member or debenture holder: s.154(2).

(iii) Filed with the annual return: s.124.

The auditors' report must be read before the company in general meeting and must be open to inspection by any member: s.159(2).

Members who have not supplied their addresses and, in the case of joint holdings, more than **one** of the joint holders, are **not** entitled to receive these documents: s.154(1)(b). Such members may, however, demand copies – vide (ii) above.

6. SPECIAL PROVISIONS APPLICABLE TO BANKING, AND INSURANCE COMPANIES – DEPOSIT, PROVIDENT AND BENEFIT SOCIETIES

S.155 stipulates that such companies before commencing business and in every year on the 31st of March and on the 30th of September make a **statement** in the prescribed form.

A copy of the statement must be displayed in a conspicuous place in the registered office, branch offices and place of business. Every member and creditor is entitled to a copy at a charge of not more than ten rupees.

Insurance companies are, however, exempted if they are conforming to the regulations of another written law.

7. FALSIFICATION OF ACCOUNTS

The Penal Code Ch.19 s.467 states,

"Whoever being a clerk, officer or servant or being employed or acting in the capacity of a clerk, officer, or servant, wilfully and with intent to defraud destroys, alters, mutilates, or falsifies any book, paper, writing, valuable security or account which belongs to or is in the possession of his employer, or has been received by him for or on behalf of his employer, or wilfully and with intent to defraud makes or abets the making of any false entry in, or omits or alters or abets the omission or alteration of any material particular from or in any such book, paper, writing, valuable security or account, shall be punished with imprisonment of either description for a term which may extend to seven years or with fine, or with both".

AUDITORS

8. PERSONS QUALIFIED TO BE AUDITORS

Only registered auditors or members of the Institute of Chartered Accountants are qualified to be auditors: s.158.

Any person who acts as an auditor without being registered is liable to a fine not exceeding rupees five hundred or to imprisonment not exceeding one year or to both: s.156.

9. PERSONS NOT QUALIFIED FOR APPOINTMENT

(a) An officer or servant of the company,

(b) A partner of or in the employment of an officer or servant of the company,

(c) A body corporate: s.158. [5]

10. APPOINTMENT OF AUDITORS

By s.156(5)(a), the **first auditors** may be appointed by the **directors** before the first annual general meeting, to hold office until the next meeting; if the directors fail to exercise this power, the first auditors may be appointed by the company in general meeting.[6]

Subsequently, auditors must be appointed at **each annual general meeting** to hold office till the next annual meeting: s.156(1).

A retiring auditor is deemed to be re-appointed without passing a resolution to such effect unless:

(a) he is not qualified for appointment,

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[5] Any person acting in contravention of this provision shall be guilty of an offence and liable to a fine not exceeding one thousand rupees: s.158(3). "...for the punishment to be meaningful the fine must not only deprive the wrongdoer of his gain but must go beyond this": Rides & French in "Regulation of an Insider" – Macmillan Press p. 423. This punishment seems highly inadequate.

[6] See K 11 also.

(b) a resolution has been passed appointing as auditor another person instead of him (28 days special notice is required: see I 8),

(c) a resolution has been passed expressly providing that he shall not be re-appointed,

(d) he has given notice in writing stating his unwillingness to continue as auditor: s.156(2).

When no appointment of auditors is made: If at an annual general meeting the retiring auditor is not re-appointed and neither is any other person appointed as auditor, it is the duty of the company to **notify the Registrar of Companies within one week** of the meeting at which the former auditor retired. The Registrar may appoint a person to fill the vacancy: s.156(3).

Casual vacancies (i.e., vacancies occurring during the year by death, resignation, etc.) may be filled by the directors, but till this is done, the surviving or continuing auditors, if any, may act: s.156(5)(b).

11. SUPERSESSION OF AUDITORS

The first auditors, appointed by the directors before the first annual general meeting, may be removed at a general meeting **held before such meeting** and superseded by the appointment of any person nominated by a member. In a public company when the first auditors are to be removed before the first annual general meeting, and another auditor is to be appointed, notice of such must be given to members at least fourteen days before the meeting to which it relates. In the case of a private company notice of nomination must be given to members seven days before the meeting: s.156(5).

Where a firm is appointed as auditors, such appointment is valid notwithstanding a change in the partners of the firm, so long as at least one person in the original partnership remains: s.156(7).

Special notice (i.e. 28 days notice to the company) is required for a resolution at an annual general meeting appointing as auditor another person other than the retiring auditor or providing expressly that a retiring auditor shall not be re-appointed: s.157.

The retiring auditor or auditors to be removed may make representations to the company and its members.[7]

12. POSITION OF AUDITORS

An auditor is not considered an 'officer' for the purposes of s.158. However, an auditor is treated in the same way as an officer by s.205 (provisions relieving officers and auditors from liability) and s.447 (relief of officers and auditors). He is an officer of the company for the purpose of a summons under s.359[8] or for the purpose of offences under sections 354, 355, 356, 357 and 360 of the Act (sections concerned with offences by officers of companies in liquidation), although an auditor appointed *ad hoc* for a limited purpose, e.g., appointed by the directors for a private audit, is not.[9]

An auditor is an agent of the company for the purposes of s.164 (2), dealing with investigations[10] and may be examined on oath by an inspector.

To the company and to third persons with whom he is not in contractual or fiduciary relationship, the auditor owes a duty of care if he knows as a reasonable man that he is being trusted or that his skill and judgement are being relied on and he does not declare that he is not responsible for information or advice given by him.[11] For breach of his duty, if there is damage, there is an action for negligence. However, the Auditor is liable only if reliance on the accounts caused loss to the other person: JEB Fasteners Ltd v. Marks Bloom & Co. (1981) 3 ALLER 289.

Apart from s.156, the Act or Table A does not provide for the resignation nor for the dismissal of the auditor nor for his ceasing to hold office on becoming bankrupt or insane. His position in these matters is generally similar to that of a director.

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[7] See K 14, under 'Rights' for further provisions.
[8] Re London and General Bank (1895) 2 ch. 166 (C.A.).
[9] R. V. Shacter (1960) 2 Q. B.; 252 (C.C.A.).
[10] See N 5, 6.
[11] Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd. (1964) A.C. 465.

13. REMUNERATION OF AUDITORS

The remuneration of auditors is fixed by the company in general meeting. The directors may fix the remuneration, (a) in the case of first auditors appointed before the first annual general meeting, and (b) when filling a casual vacancy. The directors or the Registrar of Companies may fix remuneration in the instances when the Registrar appoints the auditor: s.156(6).

The auditors are entitled to remuneration for fulfilment of their duties. If they fail to make their report to the members they are not entitled to remuneration.[12]

14. DUTIES AND RIGHTS OF AUDITORS

Duties

The principal duties of auditors are prescribed by s.159 which requires that the auditors shall make a report to the members on the accounts examined by them and on every balance sheet, profit & loss account and group accounts laid before the company in general meeting during the tenure of their office.

The report shall be read before the general meeting and shall be open to inspection by the members. Where an auditor qualifies a statement with reference to the report, that report shall form part of the audit report. The report must contain statements as to matters specified in the seventh schedule.

The report must state:

(a) Whether or not they have obtained all the information and explanations they have required.
(b) Whether, in their opinion, the books of account referred to in the report are properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, as shown by the books of the company, and that the accounts give the information required by the Act.

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[12] Liquidator Turret Motors v. Charles (1943) 44 N.L.R. 451.

(c) Whether in their opinion the group accounts have been properly prepared in accordance with the Act as to give a true and fair view of the state of the company and its subsidiaries.

(d) Whether any director is directly or indirectly interested in a contract with the company. If so, the nature of his interest and any comments they consider necessary to make thereon.

If the accounts do not give the statutory particulars as to loans of officers and directors, as directors' emoluments etc., i.e., including fees, percentages and other payments made or consideration given directly or indirectly, the auditors must include such particulars in their report: ss.200 & 201. Certain contents of the statutory report require to be certified as being correct by the auditors. s.126(4).

The duty of the auditor is to investigate the affairs of the company and to report thereon, and if any loss arises to the company from the neglect of this duty, the auditors may be held personally liable; their examination must be not merely to ascertain what the books show, but also to ascertain that the books show the true financial position.

"The duty of the auditor is not to confine himself merely to the task of verifying the arithmetical accuracy of the balance sheet, but to inquire into its substantial accuracy, and to ascertain that it . . . was properly drawn up, so as to ascertain a true and correct representation of the state of the company's affairs."[13]

Auditors must exercise reasonable care and skill, but they are not insurers, and do not guarantee that the books show the true position. In the absence of anything suspicious, an auditor is only bound to be reasonably cautious and careful and may accept the word of tried servants of the company on matters where their duty does not conflict with their self-interest (e.g., he may accept without investigation a manager's statement as to stock, but not a cashier's account of receipts and payments). But if there is anything suspicious he must probe it thoroughly.

[13] *Per* Stirling J. in Leeds Estate Co. v. Shepherd (1887) 36 Ch. D. 787 at p. 802.

"Auditor is not bound to be a detective, or ... to approach his work... with a foregone conclusion that there is something wrong. He is a watch-dog, but not a bloodhound".[14]

"An auditor ... is not bound to do more than exercise reasonable care and skill in making inquiries ... He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs ... he must be honest, i.e., he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true ... Where there is nothing to excite suspicion, very little inquiry will be reasonably sufficient ... Where suspicion is aroused more care is obviously necessary; but, still, an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion.[15]

The standard of skill and care required of an auditor has risen over the years in line with the rise in professional standards. In the case of Re Thomas Gerrad & Son Ltd. (1968) Ch. 455, Pennyquick J. commenting on Re Kingston Cotton Mill (1896) stated that "The standard of reasonable care and skill are, upon the expert evidence, more exacting today than those which prevailed in 1896."

Auditors may have additional duties given them by the articles or terms of appointment. Their statutory duties may not, however, be varied.

The auditors must acquaint themselves with their duties under the articles and the Act.

They must act honestly, and with reasonable care and skill.

The auditors' duty of disclosure is to the members, and disclosure to directors only is not sufficient. Disclosure to members is satisfied, however, if their report is sent to the secretary to be laid before the members in general meeting.[16]

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[14] *Per* Lopes L. J. in Re Kingston Cotton Mill Co. (No. 2) (1896) 2 Ch. 279.

[15] *Per* Lindley L. J. in Re London and General Bank (No. 2) (1895) 2 Ch. 673 (C. A.) at p. 68.

[16] Re Allen, Craig & Co. (London) Ltd. (1934) Ch. 483.

Rights

Auditors of a company have the right of access at all times to the books, accounts and vouchers and all documents and records of the company, and are entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of their duties: s.159(3).[17]

The auditors are entitled to attend any general meeting of the company at which any accounts have been examined or reported on by them are to be laid before the meeting and may make any statement or explanation they desire with respect to the accounts: s.159(4).

A retiring auditor is entitled to receive a copy of the resolution passed at the annual general meeting not re-appointing him. If the retiring auditor makes representations to the company in writing and requests the notification to be sent to the members, the company must (unless representation received less than 14 days from the date of the notice) send copies to all members; if copies are not sent to the members the auditor may (without prejudicing his right to speak) require the representation to be read out at the meeting: s.157.[18]

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[17] "The auditor cannot require the information to be furnished in any particular form or that it should be certified in some way, as by the board of directors. There is no power to require the information to be supplied in writing; but auditors can reasonably say that they are not in a position to perform their duties without making further inquiries if they are asked to act on unrecorded oral statements. If proper information is not given, the auditors' remedy is to qualify their report" – Charlsworth, 13th Edition.

[18] See K 11.

CHAPTER L

DIRECTORS

1. MANAGEMENT OF A COMPANY

The evolution of the company law has resulted in the separation of ownership from management. In registered companies, the ownership is vested in the shareholders, whilst management is delegated to a small body of persons commonly called 'directors' but who may also be called governors, committee of management or in the case of private companies governing directors. The exact name by which a person occupying the position of director is immaterial, since in accordance with s.449 (interpretation section of the Act) 'director' includes any person occupying the position of director by whatever name called. By the same section managing agents, however, are to be distinguished from directors.

A public company must have at least two directors and private companies, at least one director: s.174. Apart from these statutory requirements, the number of directors and the manner of their appointment are governed by the company's articles. The articles usually provide for the minimum and maximum number of directors, and often provide that if the number is at any time reduced below the stated minimum the remainder may act, but only for the purpose of filling vacancies up to the required minimum or for the calling of a general meeting.

2. APPOINTMENT OF DIRECTORS

(a) The **first directors** may be appointed by being named in the articles or in the manner set out therein; Table A, article 76 states,

> "The number of the directors and the names of the first directors shall be determined in writing by the subscribers of the memorandum of association or a majority of them."

If the articles are silent the subscribers to the memorandum would appoint them.

Directors

With every memorandum delivered to be registered a statement containing the particulars of the person or persons who are to be the first director or directors and containing signatures of the first director or directors consenting to act as first directors of the company, have to be sent. Any appointment by any articles delivered with the memorandum of a person as director shall be void unless he is named as a director in the prescribed statement: s.175.

A person cannot be appointed as a director by the articles or named as a director in a prospectus or statement in lieu of prospectus unless, before the registration of the articles, the issue of the prospectus or the registration of the statement in lieu of prospectus, he has by himself or by his agent authorised in writing,

(i) signed and delivered to the Registrar a consent in writing to act as director; and either –

(ii) signed the memorandum for a number of shares not less than the qualification, if any, and paid or agreed to pay for them; or

(iii) delivered to the Registrar an undertaking in writing to take and pay for his qualification shares, if any; or

(iv) delivered to the registrar a statutory declaration that the qualification shares, if any, are registered in his name: s.179.

This section does not apply to –

(i) a company not having a share capital;

(ii) a prospectus issued by or on behalf of a company after one year since it was entitled to commence business: s.179(5).

(b) **Subsequent appointments** are governed by the articles. In public companies it is usually stated as in Table A that at the first annual general meeting all the directors shall retire and at every subsequent meeting one third and that the members may re-elect the retiring director or elect other persons in their place.

Directors

When a new director is appointed the 'prescribed form' that has to be sent to the Registrar must be accompanied by a letter from the new appointee accepting the appointment of a director: 194(2). See L 9 (ii).

(c) **Casual vacancies,** i.e., vacancies occurring due to any other cause other than retirement by rotation, such as resignation, death or disqualification are usually filled by the directors appointing persons thereto, under powers given them by the articles. Such persons usually hold office only until the next ordinary general meeting, when the members may re-elect them if they wish.

(d) the articles may also provide for,

(i) the **assignment** of a director's office to another, in which case a **special resolution** of the company in general meeting is required by s.204;

(ii) 'additional' directors, e.g., technical advisers;

(iii) 'alternate' or 'substitute' directors, to act in place of directors temporarily absent;

(iv) 'nominee' directors to represent particular interests such as debenture holders.

S.193 provides that the acts of a director are valid notwithstanding any defect that may afterwards be found in his appointment or qualification. The section operates only if there has been a defect, **not if there had been no appointment at all.** Further, its effect is only to validate the director's acts and does not make him a director entitling him to directors' fees etc., (if he has rendered services, however, such as that of a managing director, he may be able to claim remuneration from them on a *quantum meruit*).

S.184 provides for the appointment of directors to be voted on individually in companies other than private companies.

Directors

3. RESTRICTION ON APPOINTMENT

The following persons are disqualified by statute from appointment as directors:

(i) Uncertified insolvents or undischarged bankrupts, except with leave of court: s.192.

(ii) Directors who have failed to obtain or retain their qualification, until again qualified: s.180.

(iii) Fraudulent persons disqualified from acting by court except with leave of the court: s.186.

(iv) Persons who have exceeded the age limit.

A director of a public company (or of a private company which is a subsidiary of a public company) shall retire at the conclusion of the next annual general meeting held after he reaches the age of seventy years. If such a director is to be reappointed or a director over seventy years of age is to be appointed, it should be with the sanction of a resolution of which **special notice** must be given: ss.181, 182 (see I 8).

If **a person** is to be appointed a director of a company when he is **more than seventy years of age** or such lower age as may be specified in the company's articles of association, such person **has an obligation to notify his age to the company.** A director need not however notify his age each time he is reappointed as a director: s.183.

(v) No company shall have as sole director of the company a corporation the sole director of which is secretary to the company: s.177.

Articles may contain other restrictions too.

Directors

4. SHARE QUALIFICATION

A share qualification is a specified number of shares a person must have to qualify him as a director. A share qualification is **not** required by the Act. Articles of public companies, however, usually require a share qualification.

The following applies to a share qualification:

(a) The qualification must be disclosed in the prospectus: Third Schedule.

(b) A person may not be appointed a director by the articles of a public company or named as a director or proposed director in a prospectus or statement in lieu, unless, before the registration of the articles or the publication of the prospectus or the filing of the statement in lieu, he has by himself or his agent authorized in writing – (i) signed and filed with the Registrar a consent to act as director, and (ii) taken his qualification shares from the company, or signed and filed an undertaking to do so, or signed the memorandum for sufficient number: s.179.

(c) Directors must acquire, their qualification shares within two months after their appointments or such shorter time, if any, as is prescribed by the articles. If they do not acquire the necessary shares within that period, or at any time ceases to hold them, they vacate office, and become liable to a fine of not more than Rs. 250/- for every day they act as directors, and cannot be reappointed until they are qualified again: s.180.

(d) A public company cannot commence business until every director has paid on his shares (if payable in cash) the same amount as is payable by members of the public on application and allotment: s.107(1)(b) – vide B 9.

(e) The holding of a share warrant is insufficient: s.180(2).

5. REMUNERATION OF DIRECTORS

Since the directors are not servants of the company but managers or controllers they are not entitled to any remuneration in the absence of agreement. They have, therefore, no claim for payment unless, as usual there is provision for payment in the articles. Table A, art. 77, provides 'remuneration of directors shall from time to time be determined by the company in general meeting'.

If, however, a director holds another office, such as that of the managing director, he is a servant of the company as regards that position and is entitled to a fixed remuneration by his contract of employment with the company: Anderson v. James Sutherland (Peterhead) Ltd. (1941) 1 S.C. 203.

Where articles, such as art. 77 of Table A empower and the company pays remuneration to directors the court will not investigate the reasonableness of the amount payable unless a dissenting shareholder files action. The power of the company to pay such remuneration is not subject to any *bona fide* test: Re Halt Garage (1964) Ltd. (1982) 3 All E.R. 1016.

Once remuneration is voted to the directors it becomes a debt due from the company and is consequently payable not only out of profits but from capital as well, and may be sued for even though there are no profits and proved in a winding-up.[1]

If a director is remunerated for his services he is not entitled to his travelling and other expenses in attending board and other meetings unless expressly authorised by the articles or the company in general meeting: Young v. Naval etc. Socy. (1905), I.K.B. 687.

Article 77 of Table A does state that the directors may be paid for travelling, hotel and other expenses properly incurred by them in attending and returning from meetings of the directors or any committee of the directors or general meetings of the company or in connection with the business of the company.

The directors cannot vote remuneration to themselves or appoint one of their number to a salaried post, unless authorised by the articles

[1] Re Lundy Granite Co. (1872) 26 L.T. 673.

or the company in general meeting. "Directors have no right to be paid for their services and cannot pay themselves or each other or make presents to themselves out of the company's assets, unless authorised so to do by the instrument which regulates the company or by the shareholders at a properly convened meeting."[2]

In Kerr v. Marine Products Ltd. (1928) 44 T.L.R. 292 where the articles were the same as Table A art. 77, with the addition that payment may be made for travelling etc., the directors appointed K, one of the co-directors, as 'overseas director' to Australia on a salary of £1,800 a year, it was held that the appointment was *ultra vires* the board, and K cannot recover arrears of salary and was liable to refund the salary already received.

Article 77 states that remuneration shall deem to be accrued from day to day, with the result that remuneration is definitely apportionable.

A director cannot be paid a remuneration which is free of income tax. A provision for payment to directors tax free has the effect as if the payment as a gross sum, subject to income tax: s.187.

In Owens v. Multilux Ltd. (1974) S.L.T. 189 (N.I.R.C.) a provision in a contract between the company and managing director for a "salary of £ 2,500 per annum net of deductions" was held to give the managing director a legal right to payment only of a gross sum of £ 2,500 per annum subject to income tax.

6. DISCLOSURE OF INTERESTS IN CONTRACTS

By s.203 a director who is either directly or indirectly interested in a contract or a proposed contract is under duty to disclose the nature of his interest at the first available board meeting. A general notice that he is a member of a specified company is deemed to be sufficient notice required by this section, if at a later time a contract is entered into with that company. No such notice shall be of effect unless it is given at a meeting of the directors or director concerned takes reasonable steps to ensure that it is taken up on the agenda and read at

[2] Re George Newman & Co. (1895) 1 Ch. 674 (C.A.).

the next meeting of the directors held after such a notice is given. A director who fails to comply with these provisions shall be liable to a fine not more than Rs. 1,000/-.[3] See also L 13(c).

7. LOANS TO DIRECTORS

By s.188 company cannot give a loan to any of its directors or to any director of its holding company. A company also cannot guarantee a loan given to such director; nor can it provide security for a loan made to a director by any other person.

The exceptions to this basic rule are:

(a) A subsidiary company may give a loan to the holding company which is its director.

(b) A company may give a director a loan or guarantee a loan if the funds are to be used for company purposes or are necessary for the proper performance of his duties. Such a loan or guarantee must be sanctioned by a general meeting of the company at which the particulars of such must be disclosed. If a loan or guarantee is given by the company to a director and approval of the company at or before the annual general meeting of the company is not obtained, the loan must be repaid or the guarantee discharged within six months of the conclusion of the meeting. In such an event, the directors become personally liable to compensate the company for any loss suffered by the company therefrom.

(c) If the business of the company is money lending or giving guarantees it may give a loan or guarantee in the ordinary course of business to a director.

Refer F 14 and G 11 for other instances in which loans may be granted to directors.

The accounts that have to be laid before every company at a general meeting has to contain particulars of loans made to directors: s.201.

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[3] Whether this sum would act as a deterrent is questionable.

8. COMPENSATION FOR LOSS OF OFFICE, OR ON RETIREMENT

Payments to a director for loss of office or on retirement must be disclosed to members of the company and approved by the company. This requirement does not apply and payment may be made as aforesaid provided payment is being made in accordance with a scheme that is uniformly applicable to that company. If payment is made in contravention of this provision the director shall hold the payment in trust for the company: s.189.

It was held in Re Duomatic Ltd. (1969) 2 Ch. 365 that whilst the payment is still a proposed payment, disclosure must be made to **all** members including those with no right to attend and vote at general meetings; however, Lord Denning in Wallersteiner v. Moir (1974) 1 W.L.R. 991 (C.A.) at p. 1016 stated that he imagined that payment could be later approved by the company in general meeting. Payments to a managing director is exempted: Lincoln Mills v. Gough (1964) V.R. 193.

If a payment is made to a director for loss of office, or as consideration for retirement from office as a result of a transfer of shares in the company, such director must take steps to ensure that the particulars and amount of such payment be disclosed in the offer made to shareholders. If this disclosure is not made to shareholders or is not approved at a meeting of the shareholders, the payment shall be considered to be held in trust for those members who are selling their shares: s.190.

The provisions of section 191 seek to avoid the possibility of directors circumventing the provisions of sections 189 and 190 by selling their shares at a price greater than the market value or receiving any other valuable consideration instead: s.191(2).

In an action for recovery of the money held in trust by a director pursuant to section 189 or 190 it is a valid defence to show that:

(a) the payment was not made,

(i) in pursuance of any arrangement entered into as part of the agreement for the transfer in question; or

(ii) within one year before or two years after the agreement on the offer leading thereto; and

(b) the company or any person to whom the transfer was made was not privy to such agreement: s.191(1).

9. REGISTER OF DIRECTORS,[4] THEIR SHAREHOLDINGS AND PUBLICATION OF DIRECTORS' NAMES, ETC.

Every company must, by s. 194 –

(i) keep at its registered office a register of its directors[5] and secretaries,

(ii) file with the Registrar of Companies within 14 days of the appointment of the first directors or any subsequent appointment the contents of the register which must contain the following information about the directors:

(a) present name and surname;

(b) any former name and surname;

(c) usual residential address;

(d) nationality, (if that is not the nationality of origin, his nationality of origin);

(e) business occupation, (or if he has no business occupation but holds any other directorship, particulars of such directorship);

(f) if a corporation, its name and registered or principal office.

It is not necessary for the register to contain particulars of directorships held by a director of a company, in other companies of which such company is the wholly-owned subsidiary or such other companies are the wholly-owned subsidiaries either of such company or of another company of which such company is the wholly-owned subsidiary.

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[4] The Register includes directors **and secretaries** see J 8.

[5] See footnote 5b on page 190.

The register must be available for inspection for at least two hours during the business hours, free to members and on a charge of not more than Rs. 10/- to others.

By s.198[5a] every company must maintain a **Register of Directors' Shareholdings.** This register must show the number, description and amount of shares or debentures of the company held by each director of the company or the company's subsidiary or holding company or a subsidiary of the holding company.

With regard to each director of the company, the information shown in the register shall also include shares held by :

(a) a director's spouse

(b) a director's child, stepchild, adopted child

(c) a corporate body controlled by a director of the company

(d) a corporate body of which one-third of the voting strength at a general meeting is held by a director of the company.

It must also include information of shares held in trust and information of any shares or debentures in respect of which the director or his spouse, child, stepchild or adopted child has the right to become the holder whether on payment or not.

The register shall be open for inspection by any member fourteen days before and three days after the annual general meeting. Bank holidays and public holidays are excluded in counting the days in this connection. The register must be available for inspection at the annual general meeting.

The Registrar of Companies may at any time inspect or ask for a copy of this register.

[5a] See footnote 5b on page 190.

By s.195 every company must state the following particulars of directors[5b] in all **trade catalogues, trade circulars, show cards** and **business letters** at which the **company's name appears:**

(1) the directors' present names (or the initials thereof) and surnames;

(2) the director being a corporation, the corporate name.

This section applies to:

(1) companies registered under this Act;

(2) companies registered in Sri Lanka as offshore companies;

(3) companies incorporated outside Sri Lanka which has an established place of business within Sri Lanka.

10. POSITION OF DIRECTORS

It is not easy to lay down the exact position of directors. They are not servants of the company but in some sense they may be called managing partners or agents or trustees of the company though yet they are not in the full sense anyone of those things.[6] "Perhaps the nearest analogy to their position would be that of the managing agent of a mercantile house to whom the control of its property and very large power for the management of its business are confided, but there is no analogy that is absolutely perfect. Their position is peculiar because of the very general extent of their power and the absence of control".[7] "It does not matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of

[5b] For the purpose of this section "directors" include any person in accordance with whose directions or instructions the directors of the company are accustomed to act: ss.194(6), 195(4), 198(10).

[6] Re Forest of Dean Coal Co. (1878) 10 Ch.D. 450 and Faure Electric Accumulator Co. (1889) 40 Ch.D. 141.

[7] Per Kay J. In Faure Electric Accumulator Co. (1889) 40 Ch.D. 141 at page 151.

themselves and all the other shareholders in it".[8] In some respect they may be said to be,

(a) **quasi trustees; and**

(b) **agents for the company.**

Directors as quasi-trustees

Directors have some attributes of trustees,[9] at least with respect to assets which come under their direction.[10]

Directors are said to be trustees (i) of the company's assets and (ii) of the powers entrusted to them.

(i) They are trustees of the company's assets because they must deal with them, control, protect and account for them. In other words, they are in charge of them.

(ii) Directors are trustees of the powers entrusted to them because they must act honestly and for the benefit of the company and its shareholders. They are not, however, liable for errors of judgement provided they acted *bona fide* in the interests of the company.

Directors are actually only quasi-trustees because the company's assets are vested in the company and not in them and their duties of care and skill are not the same as those of trustees.

"To my mind, the distinction between a director and a trustee is an essential distinction founded on the very nature of things. A trustee is a man who is the owner of the property and deals with it as a principal, or owner, and as master, subject only to an equitable obligation to account to some person whom he stands in the relation of

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[8] *Per* Jessel M. R., Forest of Dean Coal Mining Co. (1897) 10 Ch.D. 451 at page 453.

[9] Directors are not trustees for individual shareholders: Percival v. Wright (1902) 2 Ch. 421.

[10] Lands Allotment Co. (1894) 1 Ch. 631, 638.11 *Per* James L. J. Smith v. Anderson (1880) 15 Ch.D. at page 275.

trustee, and who is his *cestuis que trust* . . . The office of director is that of a paid servant of the company. The director never enters into a contract for himself, but he enters into contract for his principal, that is for the company. He cannot sue on such contract nor be sued on them unless he exceeds his authority".[11]

Directors are trustees of their powers. They must exercise the powers for the purposes they are given and act *bona fide* for the best interest of the company. In Piercy v. Mills & Co., Ltd. (1920) 1 Ch. 77, the share allotment was held invalid because the directors had issued shares merely to maintain their control of the company.

In rare circumstances directors may be held as trustees vis-a-vis shareholders. As in the case of Coleman v. Myers (1977) 2. N.Z.L.R. 225 where the directors of the family company were so treated. The decision is restricted to the facts, and should not be applied widely.

"It is sometimes said the Directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading. I can see but little resemblance between the duties of a director and the duties of a trustee of a will or of a marriage settlement. It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise. The position of a director of a company carrying on a small retail business is very different from that of a director of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of a director of one insurance company may differ from those of another. . . The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff": per Romer J. in Re City Equitable Fire Insurance Co., Ltd. (1925) Ch. 407, at p. 426.

Directors as agents

'Directors are agents through whom a company acts': *per* Selbourne L.C. in Great Eastern Railway Co. v. Turner (1872) L.R. 8 Ch. 149 at page 152.

Since the company has no physical existence, its affairs must be managed by human agents, who are the directors. As agents the directors incur no personal liability provided it is made clear that they

[11] *Per* James L.J. Smith v. Anderson (1880) 15 Ch.D. at page 275.

contract on behalf of the company.[12] They must, however, act within the scope of their authority, if not, the company may not be bound and they would be liable for breach of authority.[13] However, the company in general meeting may ratify their acts which are outside their authority, provided they are within the scope of the memorandum.

The directors, acting within their scope of authority, bind the company by contract even though the directors' motive is to derive a profit for themselves from such contracts.[14]

If directors are **specifically appointed** agents for the shareholders to negotiate a sale of the company's shares, the shareholders are liable for their fraud: Briess v. Woolley (1954) A.C. 333.

11. POWERS OF DIRECTORS AND HOW THEY ACT

Powers

The powers of directors are determined by the articles; articles often provide that the directors, may exercise all the powers of the company which are not by the Act or by the articles themselves required to be passed by the company in general meeting.

If the directors act within the powers given to them by the articles, the members in general meeting cannot interfere with the directors in their *bona fide* execution of those powers, except by special resolution, i.e., by altering the articles: Gramophone Ltd. v. Stanley (1908) 2 K.B. 89: Salmon v. Quin & Axtens Ltd. (1909) 1 Ch. 311. Of course, articles may provide that the company in general meeting may, by ordinary resolution, override the directors.

If they *exceed* the powers devolved on them by the articles, the action can be *ratified* by an ordinary resolution of the company: Grant v. United Kingdom Swichback Co. (1888) 40 Ch.D. 135.

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[12] They may incur personal liability under s.104 where it is said in reference to the publication of the company's name that an officer liable shall be also liable to a holder of a bill of exchange, promisory note, cheque or order for money or goods for the amount thereof unless duly paid by the company.

[13] The company may be bound by Turquand's Rule. See E 23.

[14] Hambro v. Burnard (1904) 2 K.B. 10.

Directors

In Bamford v. Bamford (1970) Ch.212 in order to prevent a take-over bid, the directors allotted 500,000 shares to another company. The articles provided that the unissued shares were to be at the directors' disposal. Two shareholders brought an action claiming that the allotment was invalid, because it was not made *bona fide* in the interest of the company. Held, assuming that the allotment was *intra vires* the company and directors, but not *bona fide* in the interest of the company and therefore voidable, it could after full disclosure be ratified by an ordinary resolution at a general meeting.

Powers to manage the business of the company does not give the directors power to fix their own remuneration: Foster v. Foster (1916) 1 Ch. 532, nor appoint themselves to salaried positions in the company: Kerr v. Marine Products Ltd. (1928) 44 T.L.R. 292.

Unless the articles such as Table A, art.107 empower the directors to appoint a managing director, the directors cannot appoint one.[15] When a director is appointed as managing director it does not entitle him to be managing director as long as he is a director. The board has the power and must retain the power of appointing and removing the managing director. If a managing director is appointed by the articles he can be removed by alteration of the articles, the articles always being subject to alteration but if he has a contract with the company independently of the articles, he can sue the company for damages for breach of such contract. If a managing director is appointed for a specified number of years or for life, his appointment ceases if he ceases to be a director.

The directors must not improperly refuse to exercise a power to initiate proceedings in court in the company's name; otherwise minority shareholders' action may be brought as an exception to the rule in Foss v. Harbottle, see I 26: Cook v. Deeks (1916) 1 A.C. 554, see L 13.

In Re A Company: F.F.I. (U.K. Finance) Ltd. v. Lady Kagan (1982) 132 N.L.J. 830 where the directors required the company to plead guilty to a charge of conspiracy to defraud, the court granted an injunction to prevent it, as it would be detrimental to the company, i.e., the loss of a potential civil action against an individual defrauder.

[15] Per Swinden Eady J. in Boschoeck Proprietary Co., Ltd. v. Fuke (1906) 1 Ch. 148 at p. 159.

How Directors act

The directors must act collectively at properly constituted board meetings. They cannot delegate their powers and duties to committees or to a managing director unless authorized by the articles, such as in Table A, articles 102 and 107. They are entitled to reasonable notice of board meetings, unless the meetings are held at fixed intervals known to them; if proper notice is not given the meeting is invalid.[16] In the absence of an arrangement to meet, a casual meeting of the directors cannot be made a board meeting against the wish of anyone of them;[17] but, if all (and not merely a quorum) of the directors meet by chance, and none objects a board meeting may be held at such time though there were no prior arrangements. Notices of board meetings need not state the nature of the business and directors must deal with matters as they arise.

A quorum of directors is generally fixed by the articles and it must be present throughout the meeting to validate the proceedings unless the articles provide otherwise. Table A provides,

Art.100 (a): "The quorum necessary for the transaction of the business of the directors may be fixed by the directors, and unless so fixed shall be two."

Art.100 (b): "The continuing directors may act notwithstanding any vacancy in their body, but, if and so long as their number is reduced below the number fixed by or pursuant to the rules of the company as the necessary quorum of directors, the continuing directors or director may act for the purpose of increasing the number of directors to that number, or of summoning a general meeting of the company, but for no other purpose."

A quorum should be a "**disinterested quorum**", i.e., directors who are incompetent to vote as they are personally interested in the matter under discussion should not generally be counted in the quorum. If a "disinterested quorum" is absent proceedings may be invalidated.

A director paid with his own money some of the company's debts without the authority of the board of directors. In a purported adoption of his act by the board a "disinterested quorum" was not present. The company went into liquidation. Held, the director could not recover the amounts from the company: Re Cleadon Trust (1939) Ch. 286 (C.A.)

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[16] Re Homer Gold Mines (1888) 39 Ch. D. 546.

[17] Barron v. Potter (1914) 1 Ch. 895

Minutes of proceedings at directors' meetings must be entered in books kept for that purpose: s.141 (see I 17). Although s.142, which deals with inspection of minute books, (see I 18), is silent on the matter of inspection of minutes of proceedings at directors' meetings, it was held in M'Cusker v. M'Rae, (1966) S.C. 253 that the court may, on the petition of a director presented to the *nobile officium* request a company to make them available for inspection by the director and by a named auditor on his behalf.

Table A, articles 99 to 106 deal with proceedings of directors.

12. DELEGATION OF POWERS

Directors as agents and trustees of the powers and having duties devolved on them **cannot delegate** their powers and duties unless **expressly** provided for in the articles. Accordingly, articles usually provide for the delegation to committee of directors and managing directors of certain functions. Table A, art. 102 provides for delegation to committee and Table A, art. 107 provides for delegation to a managing director. Directors have, however, **implied power** to engage secretaries, clerks and other agents etc., as are necessary to carry on the company's business.

13. DUTIES OF DIRECTORS

(a) fiduciary duties

The directors must exercise their powers for the purpose for which they were conferred and *bona fide* for the benefit of the company as a whole.[18] Directors like other persons in fiduciary positions are in positions of trust, and must act in accordance with this trust placed on them. They must not act nor place themselves in such a position so that their personal interest would clash with that of the company or the shareholders.[19] Nor must they make use of their position, power or knowledge for their personal gain. Directors are

[18] e.g. not for the benefit of his fellow directors: Lee v. Chou When Hsien (1985) B.C. L.C. 45 (P.C.).

[19] per Viscount Finlay and Lord Shaw in Hindle v. John Cotton Ltd. (1919) 56 S.L.R 625 (H.L.) at p.631.

"fiduciary donees of their powers" and as such "are bound to exercise them so as not to give themselves an advantage over the other shareholders."[20]

The directors of R.Co., bought shares in a subsidiary company knowing that when such subsidiary company was sold they would make a substantial profit. Held, the directors must return such profits, as it was only through the position they held and the knowledge they gained as directors that they were able to obtain the shares: Regal (Hastings) Ltd. v. Gulliver (1942) 1 A 11 E.R.378.

Directors must act for the benefit of the company in every exercise of their duties such as allotting shares,[21] making calls,[22] forfeiting shares[23] or approving transfers.[24] Where an issue of shares was motivated by self-interest because the directors wished to retain control of the company, it was held to be invalid: Bamford v. Bamford (1970) Ch. 212 (C.A.); Teck Corporation v. Millar (1972) 33 D.L.R. (3d) 288. However, the exercise of the directors' powers must be judged whether it has been *bona fide* for the benefit of the company by applying these tests —

(1) is the transaction necessarily incidental to the carrying on of the company's business;
(2) is it a *bona fide* transaction;
(3) is it done for the benefit and prosperity of the company; Rolled Steel Products (Holdings) Ltd. v. British Steel Corporation (1984) B.C.C.C. 466 (C.A.)

Where a director on a contract gained an undisclosed commission and bonus, it was held that such secret benefits must be

[20] per Rigby L. J. in Alexander v. Automatic Telephone Co. (1900) 2 Ch. 56 at p.72.
[21] Parker v. McKenna (1874) L.R. 10 Ch. 96.
[22] Gilbert's Case (1870) 5 Ch. 559.
[23] Harris v. North Devon Railway Co. (1855) 20 Beau 384.
[24] Bennett's Case (1867) De G.M. & G 284.

returned to the company: Boston Deep Sea Fishing Co. v. Ansell (1888) 39 Ch. D. 339.

Similarly, a director must not obtain any secret benefit from the promoters: Archer's case (1892) 1 Ch. 322.

The Act provides for the maintenance of this fiduciary position of directors in two respects – by requiring the disclosure of interest of directors in contracts: s.203,[25] and disclosure on payment of compensation to directors: s.189.[26]

(b) Duties of care and skill

Directors' duties have been summarized as follows:-

(a) They must act honestly.
(b) They must exercise the degree of skill which may reasonably be expected from a person of their knowledge and experience, and of a person in such a position: Lister v. Romford Ice and Cold Storage Co. Ltd., (1957) A. C. 555.
(c) They are not liable for *bona fide* errors of judgement. It was held in Pavlides v. Jenson (1956) Ch. 565 that if the directors by their negligence had sold the company's mine at an undervalue, the company was entitled to decide by a majority vote of the members that legal action should not be taken against them.
(d) They are not bound to give continuous attention to the company's affairs: Romer J. in Re City Equitable Fire Insurance Co. Ltd. (1925) Ch. 407 at p.428.
(e) In case of duties properly left to some official of the company, they are, in the absence of grounds for suspicion, justified in trusting that official to perform his duties honestly: Romer J. as in (d).
(f) Apart from the general duties summarized above, their duties depend on the nature of the company's business and the manner in which the work is distributed between the directors and the other officials of the company, provided that the distribution is reasonable and not inconsistent with the provisions of the articles. Relief of the directors'

[25] Vide L 6.
[26] Vide L 8.

liability for breach of duty in connection with both their fiduciary duties and duties of care can be had if the company by a majority vote decides not to take legal action against them, as in Pavlides v. Jenson.

(c) Contracts of directors with company (Read in conjunction with L 6)

Unless the articles specifically authorise, the directors cannot make contracts with the company either on their own behalf or on behalf of any company or firm in which they are interested as shareholders or directors, without the sanction of the company in general meeting.[27]

X was a director of company T and a shareholder of company T and Company B. At a board meeting of company T at which a quorum was not present without X, X voted for the purchase of shares in company B. Held, the contract was voidable at the option of the company.[27]

"No man can ... acting as an agent, be allowed to put himself into a position in which his interest and his duty will be in conflict."[28]

Articles may athorise directors to make contracts in which they are personally interested on disclosing their interest to the board. However, terms of the articles must be strictly complied with[29] and disclosure must be full and fair,[30] and to a disinterested board.[31] By s.203 a director who is either directly or indirectly interested in a contract or a proposed contract must declare the nature of his interest at the first available board meeting.[32] If a director does not disclose his interest in a contract as required by statute, the contract is *prima facie* voidable by the company.[33]

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[27] Transvaal Lands Co. v. New Belgium Co. (1914) 2 Ch. 488.
[28] Per Lord Caine L. C. in Parker v. McKenna (1874) L. R. 10 Ch. A pp. 96 at p.118.
[29] Toms v. Cinema Trust Co. (1915) W. N. 29.
[30] Costa Rica Railway Co. v. Forwood (1900) 1 Ch. 756.
[31] Lagunas Nitrate Co. v. Lagunas Syndicate (1899) 2 Ch. 392; Gluckstein v. Barnes (1900) A.C. 240; Erlanger v. New Sombrero Phosphate Co. (1879) 3 A.C. 1218.
[32] See L 6.
[33] Hely-Hutchinson v. Brayhead Ltd. (1968) 1 Q B 549 where it was too late to avoid because *restitutio* was impossible.

Directors

Directors may be forbidden to vote as directors on contracts in which they are interested, and if so forbidden should not be counted in the quorum.[34]

Provided proper disclosure is made of the fact that a director is the vendor the director may purchase property and resell it to the company without accounting for the profit he makes.[35]

A contract in which a director is interested may be confirmed by the company in general meeting, and the director concerned may vote in favour in his capacity as a shareholder.[36]

In Lindgren v. L & P Estates Ltd. (1968) Ch. 572 (C.A.) it was held that prospective directors of a company owe no duty to it, and that directors of a parent company owe no duty to, and are not debarred from contracting with a subsidiary having an independent board.

It must not, however, amount to a fraud on the minority: Cook v. Deeks (1916) 1 A.C. 554: see I 25.

(d) Director competing with company

Unless there is a service agreement with the company which binds him only to serve the company, there is nothing under the general law to prevent a director from becoming a director of a rival company or to compete in any other way with the company. But he should not disclose any confidential information belonging to the company to an outsider.[37] If he does so, he is risking an application under s.255[38] where members may petition court for a winding-up order under oppression or mismanagement.

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[34] Yuill v. Greymouth Point Elizabeth Railway (1904) 1 Ch. 32.
[35] Burland v. Earle (1902) A.C. 83 (P. C.) at page 93.
[36] N. W. Transportation Co. v. Beatty (1887) 12 App. case 589 (P.C.).
[37] Bell v. Lever Bros. Ltd. (1932) A.C. 161.
[38] See N 2.

14. VALIDITY OF ACTS OF DIRECTORS

The acts of directors or managers[39] are valid notwithstanding any defect that may afterwards be discovered in their appointment or qualifications: s.193. Table "A" art. 105 provides,

> "All acts done by any meeting of the directors or of a committee of directors or by any person acting as a director shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such director or person acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and was qualified to be a director."

The effect of these provisions are that though there may be a defect in the appointment of a director, his acts are valid. Anyone dealing with a company, therefore, is entitled to treat any director who appears to be duly appointed, as being so appointed.[40] If there has been no appointment at all, however, then these provisions do not apply.[41]

If the directors act in excess of their powers the company may be bound under the Rule in Royal British Bank v. Turquand (Vide E 23).

15. LIABILITY FOR ACTS OF CO-DIRECTORS

When a director is not aware of nor has taken any part in any act of his co-directors, he is not liable for such acts: Perry's Case, (1876) 34 L.T. 716; his fellow directors are not his servants or agents to impose liability on him: Callerne v. London and Suburban Bldg. Society (1890) 25 Q.B.D. 485 (C.A.). If a director does not attend board meetings he is not liable for the acts of the board at the meetings at which he was not present: Re Denham & Co. (1884) 25 Ch. D 725. When a director is guilty of fraud, if there are no circumstances to arouse the suspicions of the co-directiors, they are not liable for not discovering the fraud: Dovey v. Cory (1901) A. C. 477.

When one or more directors appear to have neglected his/their duties of care, he or all are jointly and severally liable, and thus if an

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[39] This applies to Secretaries as well.

[40] Dawson v. African Consolidated Land and Trading Co. (1898) 1 Ch. 6 and British Asbestos Co. Ltd. v. Boyd (1903) 2 Ch. 439.

[41] Morris v. Kanssen (1946) A.C. 459.

action is brought by the company against only one director the latter is not entitled to plead that all parties involved have not been called: Liquidators of Western Bank v. Douglas (1860) 20 D.447; however, the director sued is entitled to contribution from the other directors. When dividends were paid from capital or money was used for an unauthorised purpose, a director who was sued for the misapplication of company funds was entitled to contribution from the other directors who were parties to it: Ranskill v. Edward (1886) 31 Ch. D.100. If one director however misappropriates funds for his sole benefit he cannot get contribution from the others: Walsh v. Bardsley (1931) 47 T. L.R. 564.

16. DIRECTORS WITH UNLIMITED LIABILITY

The memorandum of a limited company may provide that the liability of its directors and managing directors be unlimited: s.196. If the memorandum does not so provide, a limited company, if authorised by its articles, may by special resolution, alter its memorandum so as to render unlimited the liability of its directors or managing directors or managers: s.197.

When a person is proposed as a director or a manager of a company having the liability of directors or managers unlimited, the proposer must add that the office will carry unlimited liability, and further, written notice must be given to such person, before acceptance of the office. Persons defaulting in giving such notice will be liable to a fine not exceeding Rs. 1,000/- and for any damage sustained by the person appointed: s.196.

17. DISCLOSURE OF REMUNERATION IN ACCOUNTS

S.200 requires any account laid before a general meeting or in a statement annexed thereto to contain the aggregate amount of –

(a) the directors' emoluments;
(b) the directors' or past directors' pensions;
(c) any compensation to directors or past directors for loss of office; and as well as
(d) the number of directors who have waived their rights to receive emoluments.

The above sums must include all relevant amounts paid by or receivable from,

(i) the company (ii) the subsidiaries
(iii) any other person.

If these requirements as to disclosure are not complied with the auditors must include this in their report.

See also K 2.

18. DUTY TO MAKE DISCLOSURE

S. 202 stipulates that it is the duty of every director to give notice to the company of such matters relating to himself for the purpose of,

(a) the register of directors' shareholdings – s.198 See (see L. 9)
(b) particulars to be shown in the accounts – s.200 (See L.17), s.201 (See K 2).

In the case of (a) notice must be given in writing within 14 days.

19. VACATION OF OFFICE

This occurs by –

(i) Death of the director.
(ii) Dissolution of the Company.
(iii) Retirement by rotation in accordance with the Articles; Table A articles 90 to 98 provide for rotation of directors.
(iv) Disqualification through non-compliance with statutory requirements, e.g. failure to retain share qualification: s.180(3).
(v) Retirement under age limit: s.181 (See L 22).
(vi) Assignment which can take place only if the articles or an agreement provides and sanction of a special resolution is obtained: s.204. Assignment is resignation and simultaneous appointment of another as director in place of the retiring director.
(vii) Removal: s.185 (See L 20).

20. REMOVAL OF DIRECTORS

A director may be removed before the expiration of his term of office by the sanction of an ordinary resolution of the company requiring special notice, i.e. 28 days.[42]

Such director has a right to:

(a) receive a copy of the resolution;
(b) speak at the meeting at which the resolution is considered;
(c) request the company to circulate to all members written representations as made by him, and the company shall comply with such request if the representations,
  (i) are received before fourteen days of the meeting; and
  (ii) are of reasonable length.

The company need not circulate such representations if they seek to secure needless publicity for a defamatory matter and the court is satisfied that it is so.

If representations are not circulated due to the default of the company or expiry of the time limit of 14 days – (c) (i) above – the director may, in addition to being heard orally, require that his representations be read out at the meeting.

The vacancy created by the removal of a director may be filled at the meeting at which the removal of the director was made or it may be filled as a casual vacancy. For purposes of determining the date of retirement by rotation, the new director who was appointed will be deemed to have been appointed on the date the director who was removed was appointed s.185.

21. DISQUALIFICATION OF DIRECTORS

Articles sometimes provide that directors shall vacate the office under special conditions. Table A, art. 89 provides,

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[42] In a private company the removal of a director holding office for life on the appointed date must be by special resolution.

The office of director shall be vacated if the director –

(a) ceases to be a director by virtue of the provisions of section 180 or 181: or
(b) becomes bankrupt or insolvent or makes any arrangement or composition with his creditors generally; or
(c) becomes prohibited from being a director by reason of any order made under section 186; or
(d) becomes of unsound mind or mentally deficient; or
(e) resigns his office by notice in writing to the company; or
(f) shall for more than six months have been absent without permission of the directors from meetings of the directors held during that period.

If a director of a company having Table A, article 89 in its Articles falls within these provisions there is an inference that he has vacated his office, even though he may be named as Life Managing Director in the Articles: Perera v. Perera (1963) 67 N.L.R.445.

22. AGE LIMIT[43]

A person of 70 years or more cannot be appointed director of a public company or of a private company which is a subsidiary of a public company unless approved by a resolution of the company in terms of s.182. A director on attaining the age of 70 years vacates office* unless the company in general meeting resolves that the age limit shall not apply; for the resolution to be valid special notice (28 days) must be given:[44] ss.181, 182.

*The office must be vacated at the conclusion of the annual general meeting commencing next after he attains the age of seventy years.

23. MANAGING DIRECTOR

The directors have no power to appoint a managing director unless the articles or memorandum so provide.[45] Table A art. 107 states 'The directors may from time to time appoint one or more of their body to the office of managing director for such period and such terms as they think fit . . . '

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[43] The Companies Act, 1982 introduced for the first time an age limit for directors.
[44] See I 8.
[45] Re Scottish Loan & Finance Co., Ltd. (1944) 44 S.R. (N.S.W.) Boshoek Proprietary Co., Ltd. v. Fuke (1906) 1 Ch. 461.

Directors

There are two functions and two capacities,

(a) as director, and
(b) as managing director.

"A managing director is usually under contract of employment or service with the company": per Jenkins L.J. in Goodwin v. Brewster (1951) 32 T.C. 80 at p. 96. A managing director may not be considered an employee in a family company unless there is a contract: Parsons v. Albert J. Parsons & Sons Ltd. (1979) 1 C.R. 271 (C.A.).

The powers and duties of a managing director depend on the articles and his contract of service with the company. Art. 109 of Table A states, "The directors may entrust to and confer upon a managing director any of the powers exercisable by them upon such terms and conditions and with such restrictions as they may think fit, and either collaterally with or to the exclusion of their own powers and may from time to time revoke, withdraw, alter or vary all or any of such powers."

C. was appointed a managing director of H. Co. His contract stated that he should perform the duties and exercise the powers in relation to the business of H. Co. and the business of its existing subsidiary companies which might periodically be assigned to him by the directors. The directors, later on decided that C. should only deal with a particular subsidiary company. C sued for damages for breach of contract. C's action was dismissed: Caddies v. Harold Holdsworth & Co. (Wakefield) Ltd. (1955) 1 All E.R. 725 (H.L.)

A discretionary power given to directors to dismiss a managing director must be used for the benefit of the company in good faith and not for personal gain such as appropriation of the managing director's shares: Hindle v. John Cotton Ltd. (1919) 56 S.L.R. 625 (H.L.)

Articles usually provide such as art. 107 that a managing director whilst holding office is not subject to retirement by rotation and that his appointment will automatically cease when he ceases to be a director.

A managing director has been held not to be a "servant" of the company so as to be entitled to preferential payment of his salary on a winding up: Re Newspaper Proprietary Syndicate Ltd. (1900) 2 Ch. 349, but as an "officer" for the purpose of handing over the company's assets to the liquidator: Dunlop v. Donald (1893) 21 R 125.

CHAPTER M

BORROWING POWERS – DEBENTURES : CHARGES

1. BORROWING POWERS

Unless prohibited by the memorandum or articles of association, every **trading** company has an **implied** power to borrow money for its business and to secure such loan by pledging its assets.[1] Non-trading companies cannot borrow unless express power is given in the memorandum.

A company with a share capital cannot borrow till the provisions of s.107 are complied with and it is entitled to commence business.[2]

The express or implied power to borrow may be limited by the memorandum or articles by restricting the amount which may be borrowed by the directors without the sanction of a general meeting. Table A art. 80 provides,

"The directors may exercise all the powers of the company to borrow money, and to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the company or any third party:

Provided that the amount for the time being remaining undischarged of moneys borrowed or secured by the directors as aforesaid (apart from temporary loans obtained from the company's bankers in the ordinary course of business) shall not at anytime, without the previous sanction of the company in general meeting, exceed a reasonable amount which if measured by reference to share capital shall be related to the issued and paid-up share capital of the company, but nevertheless no lender or other person dealing with the company shall be concerned to see or inquire whether this limit is observed. No debt incurred or security given in excess of such limit shall be invalid or ineffectual except in the case of express notice to the lender or the recipient of the security at the time when the debt was incurred or security given that the limit hereby imposed has been or was thereby exceeded."

A power to borrow includes the power to take a charge on the uncalled capital[3] unless there are provisions in the memorandum and

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[1] General Auction Estate Co. v. Smith (1891) 3 Ch. 432.
[2] See B 9.
[3] Re Pyle Works (1890) 44 Ch. D. 534 (C.A.)

articles. Capital which can only be called up in the event of a winding-up i.e. reserve capital[4] cannot be charged as security for a loan.[5]

A bank overdraft is borrowing.[6]

2. *ULTRA VIRES* BORROWING

(i) *Ultra vires* borrowing, i.e. borrowing beyond the powers of the company together with any security given for such borrowing is **void**[7] and incapable of ratification by the company even with the assent of every shareholder.[8]

The lender may, however, have the following remedies:

(a) obtain an injunction restraining the company from parting with such money;
(b) recover his money if still identifiable in the form of property, increase in assets etc;
(c) recover his money if any legal or *intra vires* debts of the company have been paid with the borrowed money;[9]
(d) obtain damages from the directors, e.g., for breach of warranty of authority unless the circumstances were such that he should have known of their lack of authority or could have discovered it on inspecting the company's registered documents;
(e) in a winding-up, when there is a surplus after the settlements of the creditors, the lender may be treated as co-owner of the surplus together with the shareholders.

(ii) If the borrowing is not *ultra vires* the company but *ultra vires* the powers devolved on the directors, it can be ratified and validated by the company.[10]

The lender may be able to recover money under the rule in Royal British Bank v. Turquand[11] if non-compliance with some internal regulation has rendered the loan *ultra vires* the directors.

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[4] See H 2.
[5] Re Mayfair Property Co. (1898) 2 Ch. 28 (C.A.).
[6] Brooks & Co. v. Blackburn Benefit Society (1884) 9 App. Cas. 857.
[7] Baroness Wenlock v. R. Dee Co. (1887) 19 Q.B.D. 155.
[8] Ashbury Railway Carriage Co. v. Riche (1875) L. R. 74 H.L. 653.
[9] Sinclair v. Brougham (1914) A.C. 398.
[10] Irvine v. Union Bank of Australia (1877) 2 App. Cas. 366 (P.C.).
[11] See E 23.

3. DEBENTURES

Legally, any bond containing an acknowledgement of indebtedness is a debenture; in practice, however, a debenture is a document usually under the company's seal stating a specified sum would be repaid with payment of a fixed rate of interest till such repayment. S.449 defines a debenture as including "debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not". Debentures may be secured on the company's property or undertaking, or be unsecured.

A debenture may be a single bond or one of a series. If many debentures are issued they may rank *pari passu*, i.e. equally, or may take priority as to security in the order of their date of issue or serial numbers.

A debenture is for a specified sum, such as Rs.100/- and is transferable only in its entirety. Debenture stock like share stock is transferable in fractional amounts.

Convertible debenture or debenture stock may be issued giving the holder a right to convert the debenture or debenture stock into shares or stock in the company at specified times or on the occurrence of specified events.

A secured debenture is generally referred to as **mortgage debenture** and an unsecured debenture as a **naked** or **unsecured debenture.**

Debentures may be **perpetual**, e.g., irredeemable except on a winding-up or the expiration of a specified period or in case of default in paying interest or complying with other conditions, or **redeemable**, e.g. , redeemable at a determinable time or at the company's discretion. S.87 states that debentures are not invalid merely because they are made irredeemable or redeemable on the happening of a contingency, however remote (e.g., the winding-up of the company) or on the expiration of a period, however long (e.g. 150 years after the issue of the debentures). The legal or contractual date for redemption may be postponed.

Debentures may be **registered** in which case interest is payable to registered holders named in bonds or stock certificates, or **bearer** in which case negotiable instruments transferable by delivery, interest being payable by coupons.

A contract with a company to take up and pay for any debentures of the company may be enforced by an order for specific performance: s.89.

Some of the differences between debentures and shares are:

(i) a debenture holder is not a member of the company;
(ii) a company may purchase its own debentures, though it cannot purchase nor give any assistance for the purchase of its shares, except to employees under certain circumstances – see F 14;
(iii) debentures may be issued at a discount without formalities whilst shares cannot be issued at a discount unless the provisions of s.59 are complied with;[12]
(iv) interest on debentures can be paid out of capital whilst interest on shares may be paid only under s.66.[13]

4. CHARGES SECURING DEBENTURES

Debentures may be secured by a charge on the assets of the company. Such charge may be (i) a fixed or specific charge or (ii) a floating charge, or (iii) a combination of the two.

Fixed Charges

A fixed charge is a mortgage of ascertained and definite property; such property though it usually remains in the company's possession, can be dealt with by the company only subject to the prior rights created by the charge and thus cannot be disposed of free of the charge without the consent of the holders of the charge.

Floating Charges

A floating charge is usually upon the undertaking and general assets of the company (it may include moveable chattels, book debts and uncalled capital), and permits the company to deal with the assets

[12] See H 22.
[13] See J 6.

in the ordinary course of business until the charge crystallizes or becomes fixed. It is a very wide charge and may extend to all the assets of the company; it usually includes the present and future assets of the class of assets specified. The charge floats over the assets charged, entitling the company to deal with them, dispose of them and create fixed charges in priority to the floating charge (unless the debenture or trust deed forbids), until crystallization of the floating charge.

Crystallization means the conversion of the floating charge into a fixed charge, and occurs if,

(a) the winding-up commences;
(b) the company ceases to carry on its business;
(c) the events specified in the debentures upon which the debenture holders or trustees may take possession or appoint a receiver, takes place.

A floating charge is **deferred** to the following:

1. fixed charges whenever created (unless the debentures provide that fixed charges may not be created) in priority to the assets charged under the floating charge, and the other party had knowledge of such provision; and

2. preferential debts under s.347.

A floating charge may be **invalidated** in the following circumstances:

1. If it is not registered with the Registrar of Companies within 21 days of creation: s.91.
2. In the event of a winding-up it is found to be a fraudulent preference of its creditors: s.348.
3. In the event of a winding-up if a floating charge was created within 12 months of the commencement of the winding-up, unless immediately after the creation of the charge the company was solvent (however, the amount of any cash paid to the company at the time or after the creation of the charge and the consideration for the charge and the interest on that amount at the legal rate, is excepted): s.350. In relation to a charge created more than 6 months before the appointed date (the 2nd July 1982), the provisions of s.350 shall have effect with the substitution, for the words twelve months, of the words six months.

5. REGISTRATION OF CHARGES

Charges made by a company on its assets whether in connection with an issue of debentures or not, must be registered,

(a) in the company's own register; and
(b) with the Registrar of Companies.

(a) Registration in Company's own register

By s.100 every limited company must keep a register of (a) all charges specifically affecting the property of the company, and (b) all floating charges on the undertaking or any property of the company giving,

(i) a short description of the property charged;
(ii) the amount of the charge;
(iii) the names of the persons entitled thereto, except in the case of bearer securities.

Any officer of the company wilfully or knowingly omitting to comply with these provisions is liable to a fine of Rs. 500/-. The charge however, is not affected and remains valid.

The above requirements extend to charges on property in Sri Lanka which are created and to charges on property in Sri Lanka acquired, after the 2nd July, 1982, by a company (whether a company within the meaning of the Act or not) incorporated outside this country but having an established place of business here: s.102.

Copies of instruments creating charges

By s.99 every company must keep a copy of every instrument creating a charge requiring registration under ss.91, 93. In the case of a series of uniform debentures a copy of one debenture of the series is sufficient.

Inspection

The Company's register of charges and the copies of instrument creating the charges must be open for inspection without fee, to any creditor or member for at least 2 hours each day during business hours. Any other person may, however, inspect the Register of charges on

payment of such a fee as the company specifies. If inspection is refused, fines will be imposed and the court may order inspection: s.101.

(b) Registration with the Registrar of Companies

By s.91 the following charges created by a company together with any instrument creating the charge must be sent to the Registrar of Companies within 21 days of creation (it is now sufficient if a **copy** of the instrument creating the charge certified by a Notary Public is delivered to the Registrar within 21 days in addition to the prescribed particulars.):

1. charge securing an issue of debentures;
2. charge on uncalled share capital;
3. charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale;
4. charge on land or any interest therein;
5. charge on book debts of the company;
6. floating charge on the undertaking or property of the company;
7. charge on calls made but not paid;
8. charge on a ship or aircraft or any share thereof;
9. charge on goodwill, or a patent or a copyright or a licence under a copyright.

By s.93, when a company acquires any property subject to a charge (which would require registration under the Act) the company must, within 21 days of acquisition of the property, deposit the necessary documents for the registration of the charge with the Registrar. The same requirements apply, on the acquisition of property outside Sri Lanka subject to a charge requiring registration, with the proviso that the documents for registration of the charge must be **despatched so that in the due course of post** the documents would reach the Registrar within 21 days.

The register of the Registrar of Companies must contain the following particulars:

(i) In the case of a **series of debentures** containing, or giving by reference to another instrument, a charge to the benefit of which the debenture holders are entitled *pari passu*, it is sufficient if the following particulars are registered –

(a) the total amount secured by the series;
(b) the dates of the resolutions authorising the issue of the series and the date of any covering deed, if any, by which the security is created;
(c) a general description of the property charged;
(d) the names of the trustees, if any, for the debenture holders, together with the deed containing the charge or, if there is no deed, one of the debentures of the series: s.91 (8).

Particulars of the amount or per cent of the commission, discount or allowance on an issue of debentures must be registered: s.91(9).

(ii) In **other cases** –
(a) the date of the creation of the charge;
(b) the amount secured by the charge;
(c) short particulars of the property charged;
(d) the persons entitled to the charge: s.94(1) (b).

It is the duty of the company to register the particulars required by s.91, but any person interested in the charge may register and recover the registration fees from the company: s.92.

On registration, the Registrar gives a certificate of registration, which is conclusive evidence that the requirements of the Act as to registration have been complied with s.94(2).

A copy of the certificate of registration must be endorsed on every debenture or debenture stock certificate issued by the company and the payment of which is secured by the charge so registered. The penalty for default is a fine not exceeding of Rs.1000/-: s.95.

When the debt for which any registered charge was given is paid or satisfied or when any part of property or undertaking charged has been released from the charge, the company must send a statement to the Registrar to that effect. The Registrar would then enter on the register a **memorandum of satisfaction:** s.96. The register is open to public inspection on payment of the precribed fee: s.94(3).

The court is empowered, on the application of the company or any person interested, to extend the time for registration and to rectify an error in the register if the omission or error is accidental, or due to inadvertence or some other sufficient cause, or not of a nature to prejudice the position of creditors or shareholders, or on other grounds that are just and equitable to grant relief: s.97.

When a charge is created in Sri Lanka comprising property overseas, the instrument creating or purporting to create the charge can

be sent for registration even though further proceedings may be required to make the charge valid in the country where the property is situate: 91(4).

When a charge is created overseas comprising property overseas and a copy of the instrument creating the charge is sent to the Registrar 21 days from the date on which the copy could in due course of post has been received in Sri Lanka, it has the same effect as the receipt of the instrument itself: s.91(3), (5).

When a negotiable instrument, given to secure any book debts of a company is deposited as security for an advance, it is not a charge on the book debts: s.91(6).

The holding of debentures with a charge on land is not considered an interest in land: s.91(7).

6. EFFECT OF NON-REGISTRATION

If a charge requiring registration under s.91 is not registered the effect is as follows:

1. The charge is void against the liquidator and any creditor of the company, but without prejudice to any contract or obligation for repayment of the money secured, which becomes repayable immediately. s.91(1).

2. The company, every director, manager, secretary or other person, who knowingly is a party to the default is liable to a fine of Rs. 500/- s.92.

7. ISSUE OF DEBENTURES

The issue of debentures must be in accordance with the provisions of the articles.[14]

The procedure on an issue of debentures differs to the procedure on an issue of shares. In an issue of debentures,

(a) the borrowing powers must not be exceeded;
(b) the charge must be registered before the debenture or debenture stock certificate is issued;
(c) the debenture or debenture stock certificate must bear a copy of the Registrar's certificate;
(d) the provisions as to minimum subscription and as to the receipt of applicant's money[15] must be complied with;

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[14] Table A provides for the issue of debentures (art. 80).
[15] See B 9.

(e) debentures may be issued at a discount without special authority and formality.[16]

The procedure on an issue of debentures is similar to the procedure on an issue of shares in the following aspects,

(a) The provisions as to prospectuses and offers for sale, and the restrictions imposed by s.50 on allotment apply to the issue of debentures as well.
(b) By s.80 debenture or debenture stock certificates must as in the case of share certificates be issued within 2 months after allotment or after the lodgement of a valid transfer.

A contract to take up debentures may be enforced by specific performance: s.89.

8. RE-ISSUE OF REDEEMED DEBENTURES

By s.88 redeemed debentures may be re-issued again unless,

(i) the articles or a contract (e.g. with existing debenture holders) forbids the re-issue; or
(ii) the company has by resolution or otherwise shown an intention to cancel the debentures.

The holders of the re-issued debentures have the same rights and priorities as if the debentures had never been redeemed.

For the purpose of stamp duty the re-issued debentures are treated as new debentures.

9. TRANSFER OF DEBENTURES

(a) **Bearer debentures**[17] are negotiable instruments and transferable by delivery; a *bona fide* transferee for value takes them free from any defects in the title of a prior holder.

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[16] S. 91(9).

[17] Bearer debentures are in the same form as registered debentures except that it is also stated that they are payable to bearer and coupons for the interest payable thereon are attached.

A secretary pilfered bearer debentures of company B from a safe and deposited them with the bank as security for loans taken by him. Held, the bank was entitled to the debentures as they are negotiable instruments transferable by delivery: Bechuanaland Exploration Co. v. London Trading Bank (1898) 2 Q. B. 658.

Bearer debentures may **not** be issued without the permission of the Central Bank: s.12, Exchange Control Act No. 24 of 1953.

Stamp Duty is not payable on the transfer of bearer debentures.

(b) **Registered Debentures** are usually transferable in the same manner as shares unless the articles or any endorsed conditions provide otherwise. A 'proper instrument of transfer' must be delivered to the company before a valid transfer can be registered: s.75. The company must have debenture or debenture stock certificates ready for delivery within 2 months of the lodging of the instrument of transfer unless the conditions of issue provide otherwise: s.80. If registration of a transfer is refused, notice of refusal must be given to the transferee within 2 months; in case of default, the company and every officer who is in default is liable to a default fine: s.78.

10. REGISTER OF DEBENTURE HOLDERS

The Act requires the company to keep a register of debenture holders or debenture stock holders. The register must comply with s.85, the provisions of which are as follows:

Debenture holders and shareholders may without paying any fee, and any other person, on payment of a fee of Rs.10/- or less, may inspect the register of debenture holders subject to such reasonable restrictions as the company may in general meeting approve, so that at least two hours each day is available for inspection, and demand copies on payment of one rupee for every 100 words. The register may not be closed for more than 30 days in the year. A debenture holder may require a copy of any trust deed securing the issue of debentures on payment of not more than 10 rupees in the case of a printed trust deed or one rupee per 100 words in other cases. Refusal to allow inspection

or to supply a copy exposes the company and every officer in default to a fine of not exceeding Rs. 250/- and in addition a fine of Rs. 20/- for every day the default continues. The court may also, by order, compel inspection of the register or direct copies to be supplied.

11. REMEDIES OF DEBENTURE HOLDERS

If the debentures give **no charge** (i.e. the debenture holder is an ordinary **unsecured** creditor):

(a) sue on the covenant for principal and interest, and after judgement levy execution against the company, or
(b) petition for the winding-up by court and prove in the winding-up as an unsecured creditor.

If the debentures **give a charge** :
(a) sue for principal and interest,
(b) present a petition for the winding-up of the company,
(c) exercise any powers given by the debenture or trust deed e.g. for appointing a receiver,
(d) in the absence of any power conferred by the debenture or trust deed, apply to court for –
(i) the appointment of a receiver or manager
(ii) an order for sale or for closure.

12. TRUST DEED

As there usually are many debenture or debenture stock holders, trustees are often appointed to represent them and act on their behalf. Without trustees the debenture and debenture stock holders would have great difficulty in co-operating to protect their interests, as generally they are numerous, scattered and unknown to each other. The Colombo Stock Exchange requires, in the case of quoted companies, at least two trustees to be appointed, unless the sole trustee appointed is a company or corporation approved by the Committee of the Colombo Stock Exchange.[18] A trust deed is a contract between the trustees and the company setting out the terms under which the debentures are issued.

[18] See Section 6 Re Trust Deeds and Debentures in "Rules and Regulations" of the Colombo Stock Exchange.

The **contents** of a trust deed usually are:

1. An undertaking by the company to pay the principal monies and interest to the debenture holders.
2. Particulars of the charges made on the company's assets and undertaking as security.
3. The events upon which the security becomes enforceable, e.g., default in the payment of interest or principal or the commencement of winding-up.
4. The powers of the trustees.
5. Covenants by the company to maintain a register of debenture holders, and to keep in good condition and insure the property charged, and may have provisions to build up a sinking fund for the amortization (i.e. redemption) of the debentures.
6. Provisions for the holding of meetings of debenture holders.

A common provision in a trust deed is that the debenture holders' rights against the company or any assets charged by the deed, may be modified or compromised by an extraordinary resolution of the debenture holders.[19]

A director cannot act as trustee for debenture holders of the company. Directors who were trustees before the Act became operative may continue till the termination of their appointments: s.86.

13. RECEIVERS AND MANAGERS

A receiver or manager[20] is appointed on behalf of the debenture holders or other creditors to safeguard their rights and interests. A receiver takes possession of the assets charged and sells them or carries on the business for the benefit of the debenture holders and creditors.

An official receiver is appointed in a winding-up by court.

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[19] The following provision of the English Companies Act (1948) is not found in the Act: "Any provision in a trust deed exempting a trustee from negligence or breach of trust is void, unless the deed provides that a resolution of three-fourths in value of the debenture holders authorise him to be excused after a liability has arisen, or on his death or ceasing to act".

[20] **A manager is usually appointed to carry on the business with the intention of selling it as a going concern.**

The court may, however, appoint an official receiver to be the receiver on behalf of the debenture holders or other creditors in a winding-up, if application is made: s.381.

A receiver is not a liquidator. A liquidator is appointed to wind up the company; a receiver after settling the claims of the debenture holders and/or creditors terminates his office and the company will resume business as before.

14. APPOINTMENT

A receiver may be appointed by,

(1) provision contained in the debenture or trust deed;
(2) an order of the court.

The court may appoint a receiver when,

i. the principal or interest is in arrear;[21]
ii. the company is being wound up;[22]
iii. the security is in jeopardy – if there is a risk of the security being seized and taken to settle claims that are not prior to the debenture holders' claim, the security is in jeopardy, e.g., where there was a proposal to distribute the only asset amongst the shareholders a receiver was appointed.[23]

15. RESTRICTIONS ON APPOINTMENT

1. A body corporate or director or secretary of the company may not be appointed as receiver: s.379[24]
2. An uncertified insolvent or undischarged bankrupt may not be a receiver or manager unless, he is appointed by the court or the appointment under which he acts and the insolvency or bankruptcy were both made before the appointed date: s.380.

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[21] Bissill v. Bradford Tramways (1891) W.N. 51.
[22] Wallace v. Universal Automatic Machines Co. (1894) 2 Ch. 547 (C.A.)
[23] Re Tilt Cove Copper Co. (1913) 2 Ch. 588.
[24] If a body corporate becomes a receiver, it is liable to a fine not exceeding rupees one thousand.

16. EFFECT OF APPOINTMENT

1. The company cannot deal with the asset charged without the receiver's consent; floating charges crystallize and become fixed.[25]
2. The directors' power of controlling the company's affairs are suspended, if a receiver of the undertaking is appointed. This does not, however, bar a director from suing on the company's behalf if the debenture holders' interest are not threatened.[26] Directors cannot claim their remuneration unless the receiver employs them, but they can claim from the company the remuneration they were entitled to receive.[27]
3. The company's servants are automatically dismissed if the appointment of the receiver is by court. However, the employees may claim for breach of contract even though the receiver may employ them.[28]

   If the debenture holders or creditors appoint the receiver depending on the circumstances, the employees may be considered dismissed: in Re Foster Clark Ltd.'s Indenture Trusts (1960), 1 W.L.R. 125, when the company's business was sold by the receiver, that it was, in effect, a dismissal of the employees.

4. Every invoice, order for goods, or business letter which is issued by or on behalf of the company or the receiver or manager or liquidator and on which the company's name appears must contain a statement that a receiver or manager has been appointed. Where default is made in complying with the requirements, the company and every officer, liquidator, receiver or manager who knowingly and wilfully authorizes or permits the default will be liable to a fine of Rs. 250/-: s.383.

5. The receiver must forthwith give notice of the appointment to the company, if he is a receiver of the whole or substantially the whole of the company's property,

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[25] R. A. Cripps & Son Ltd. v. Wickenden (1973) 1 W.L.R. 944.
[26] Newhart Developments v. Co-operative Commercial Bank (1978) 2 All E.R. 896.
[27] Re South Western of Venezuela etc. Railway, (1902) 1 Ch. 701.
[28] Reid v. Explosives Co. Ltd. (1887) 19 Q.B.D. 264 (C.A.)

appointed on behalf of the holders of debentures secured by a floating charge: s.385.

6. Within a period of, usually, 14 days after the receiver gives the company notice of his appointment as required by section 385 above, a statement of the company's affairs must be submitted to him, giving particulars of the assets, debts and liabilities, the names and addresses of the creditors, the securities they hold, the dates when they were given and such other information as may be prescribed. The statement must usually be submitted by, and verified by affidavit of, one of the directors and the secretary or, if the receiver is appointed out of court, verified by statutory declaration of the same persons. In certain circumstances the receiver may require past or present officers, persons who have taken part in the formation of the company or past or present employees, to submit and verify the statement: s.386.
7. Within two months after the receipt of the above statement, the receiver must send to the Registrar, and to the court if he was appointed by the court, a copy of the statement and of his comments thereon. He must also send to the Registrar a **summary** of the statement and of his comments thereon. He must send to the company a copy of these comments or a notice that he does not see fit to make any comments. To the trustees for debenture holders and to all the debenture holders he must send a copy of the summary: s.385.
8. Abstracts of the receipts and payments of the receiver or manager must be sent, in the prescribed form, to the Registrar, company and debenture holders within the periods specified in ss.385 and 387.
9. If a receiver or manager fails to furnish the accounts, documents, returns, or receipts and payments within 14 days of service of a notice requiring him to do so the court may, on the application of any member, creditor, the Registrar or liquidator, direct that the default be corrected within a specified time: s.388.

17. POSITION OF RECEIVERS

The receiver is an officer of the court, if appointed by court, and no action can be brought against him without court permission: L.P.

Arthur (Insurance) Ltd. v. Sisson (1966).[29] A receiver appointed by a debenture or trust deed usually states that he is an agent of the company, and hence the debenture holders are not liable for his acts.

A receiver appointed not by court can nevertheless apply to court for directions in any particular matter arising in connection with the performance of his functions: s.382.

A receiver or manager appointed under s.381 (see M 13) is not personally liable on any contract entered into by him in the performance of functions, unless his contract provides otherwise, in which case he can claim indemnity out of the assets to the same extent as if he had been appointed by court: s.382.

A receiver is entitled to be indemnified out of the company's assets[30] to the extent they are sufficient; Boehm v. Goodall (1911).[31]

A receiver appointed under a power in any instrument is in the same position as one appointed by court.

18. RECEIVER'S DUTIES AS TO ACCOUNTS AND RETURNS

A receiver or manager appointed on behalf of holders of any debentures of the company secured by a **floating charge** must,

(a) within two months, or such longer period as the court may allow, after the expiration of 12 months from the date of his appointment; and
(b) every subsequent 12 months; and
(c) within 2 months after he ceases to act as receiver or manager,

send to the Registrar, to any trustees for the debenture holders on whose behalf he was appointed to the company and to all other debenture holders so far as he is aware of their addresses, a **statement showing his receipts and payments** during the 12 month period or,

[29] 1 W.L.R. 1384.
[30] Re Glasdir Mines (1906) 1 Ch. 365.
[31] 1 Ch. 155.

where he has ceased to act, during the period from the end of the period to which the last statement related up to the date of his ceasing to act, and the aggregate amounts of his receipts or payments during the preceding periods since his appointments: s.385. Similar provisions have been included in s.387 where a receiver or manager is appointed under the powers contained in any instrument.

A receiver or manager not complying with these provisions is liable to a fine not exceeding Rs. 250/- for every day during which the default continues.

The court may order the receiver or manager to make any returns or give any notice which he is by law required to make or give, on the application of any member, creditor, the Registrar of Companies or liquidator. s.388.

If the receiver is appointed as the agent of the company as well, he must keep more detailed accounts and present them to the company; as he is managing the company on the directors' behalf he is answerable to the company: Smith Ltd. v. Middleton (1979) 3 All E.R. 842.

19. REMUNERATION OF RECEIVER

On the application of the liquidator, the court may by order fix the remuneration of a receiver or manager appointed under powers contained in any instrument. The court may amend or vary such order periodically on the application of the liquidator, receiver or manager. Where no previous order has been made the court can fix the remuneration for periods before making of the order or application.

The court can fix the remuneration even though the receiver or manager has died or has ceased to act before the order or application was made.

If the receiver or a manager has been paid before the order a sum in excess of the order, he must account for the excess: s.384.

CHAPTER N

MINORITY PROTECTION – OPPRESSION AND MISMANAGEMENT – INVESTIGATION

1. MINORITY PROTECTION

By general law and by statute minority shareholders have sometimes protection against majority action. "A proper balance of the rights of the majority and minority shareholders is essential for the smooth functioning of the company. Since the passing of the Joint Stock Companies Act 1856, most Acts have extended the protection of the minority. The Companies Act 1948 to 1981, and the relevant case law, attempt to maintain that balance by admitting on principle, the rule of the majority but limiting it, at the same time, by a number of well-defined minority rights".[1]

Under the general law the majority cannot commit fraud on the minority but must act *bona fide* for the benefit of the company as a whole. In Peters' America Delicacy Co., Ltd. v. Heath[2] it was held that any alteration to the articles must be *bona fide* for the benefit of the company as a whole. In Re Holders Investment Trust Ltd.[3], preference shareholders sanctioning a modification of the special rights of their class must act *bona fide* for the benefit of the class as a whole.[4]

The Companies Act provides protection for the minority under certain sections. For example s.7 empowers dissentient holders of 15 percent of issued shares to object to any alteration of the objects clause; s.73 empowers, where class rights are attempted to be altered in accordance with a clause in the articles, dissentient holders of 15 percent of the issued shares of the class who did not vote in favour of the variation to apply for cancellation of the variation: see H 9.

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[1] Palmers "Company Law" (23rd ed.) p. 597.
[2] (1939) 61 C.L.R. 457.
[3] (1971) 1 W.L.R. 583.
[4] Numerous other cases establish this rule: Greenhalgh v. Arderne Cinemas Ltd. (1951) Ch. 286 (C.A.), Shuttleworth v. Cox Bros. Ltd. (1927) 2 K.B. 9 (C.A.), Australian Fixed Trusts Pty. Ltd. v. Clyde Industries (1959) S.R. (N.S.W.) 33.

The most effective types of protection available to the minority are,

1. under ss.210 and 211 to petition court for a winding-up or such other order for relief because of oppression or mismanagement;

2. under s.161 to apply to the Registrar for an investigation into the affairs of the company;

3. the control of insider trading (see chapter O) which protects the minority shareholders as well as outsiders dealing with the company or its shares.

2. OPPRESSION AND MISMANAGEMENT

Under s.255 of the Act a company may be wound up compulsorily by Court if it is just and equitable[5] to do so, and under that principle a company may be ordered to be wound up, where there is oppression of a minority or mismanagement. In Loch v. John Blackwood Ltd. (1924) A.C. 783, the Courts held that there being mismanagement and oppression of a minority the company should be wound up.

Sometimes, however, it may not be advantageous for the minority to wind up as, for instance, when the break-up value of the company is small the minority may get little or no return. Sections 210 and 211 provide for such a situation by stating that where there is oppression of a minority or mismanagement, the Court may on application of certain members or member, provide for the control or regulation of the company's affairs or of any matter connected with the company for which the court thinks it is just and equitable that provision should be made.

The court may make any order it thinks fit under 210 and 211 if,

(i) the affairs of the company are being conducted in a manner oppressive to any member or members and to wind up the company would unfairly **prejudice such member or members** ; or if

[5] See R 5.

(ii) (a) **the affairs of the company are being conducted in a manner prejudicial to the interests of the company; or (b) a material change has occurred** in the management or control (e.g., by an alteration in the board of directors, agents, secretary, constitution, or ownership) that would result in the affairs of the company being conducted in a manner **prejudicial to the interests of the company**.

The following member or members of a company have the right to apply under sections 210 and 211:

(a) In the case of a company having a share capital not less than five percent of the total number of its members or the holders of not less than the aggregate of five percent of the nominal value of the company's issued share capital; person on whom shares have devolved through death of a member and the executor or administrator of a deceased member may also be included in determining the five percent requirement.

(b) In the case of a company not having a share capital, not less than twenty percent of the company's members; (joint holders are counted as one member).

If on conclusion of the inquiry the court holds that the application has been made vexatiously or without reason or probable cause the court may, apart from the award of costs against persons making such application, direct that such persons –

(a) be disqualified from holding the office of director, secretary, manager or agent for a period not exceeding five years; or

(b) shall not have the right to convene or requisition a meeting of the company or be present in person or by proxy at any meeting of a company or to vote thereat.

Application for relief under s.210 and s.211 may be made after the commencement of winding-up: s.215.

3. POWERS OF COURT

S.210 and 211 gives the court general powers and without prejudice to such powers, s.216 provides for –

(a) the regulation of the conduct of the company's affairs in future;

(b) the purchase of the shares or interests of any member of the company by other members thereof or by the company;

(c) in the case of a purchase of shares by the company, as aforesaid, the consequent reduction of its share capital;

(d) the termination, setting aside or modification of an agreement, howsoever arrived at, between the company on the one hand, and any of the following persons on the other, namely:–

(i) the managing director,

(ii) any other director,

(iii) the board of directors,

(iv) the agent or secretary, or

(v) the manager,

upon such terms and conditions as may, in the opinion of the court, be just and equitable in all the circumstances of the case;

(e) the termination, setting aside or modification of any agreement between the company and any person not referred to in paragraph (d) but always so that no such agreement shall be terminated, set aside or modified except after due notice to the party concerned and after obtaining his consent;

(f) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by

or against the company within three months before the date of the application, or the commencement of winding-up proceedings, as the case may be, which would if made or done by or against an individual, be deemed in a case of his insolvency to be a fraudulent preference; and

(g) any other matter for which in the opinion of the court it is just and equitable that provision should be made.

An interim order regulating the company's affairs, may be made by court, on the application of any party to the proceedings, pending the making of a final order under ss.210 or 211: s.213.

4. EFFECT OF ORDER

Memorandum and Articles of Association

No alteration whatsoever may be made in the Memorandum and Articles which is inconsistent with the order without leave of the court. The alterations made by the order shall in all respects have the same effect as if they had been made by the company in accordance with the provisions of the Act. A certified copy of every order altering or giving leave to alter the company's memorandum or articles shall within 15 days after the making thereof, be filed by the company with the Registrar of Companies for registration: s.217.

Agreements

Where an order of a court made under ss.210 or 211 terminates, sets aside, or modifies an agreement such as is referred to in paragraphs (d) or (e) of s.216,

(i) the order shall not give rise to any claim whatsoever against the company by any person for damages or for compensation for loss of office or in any other respect, either in pursuance of the agreement or otherwise: s.219(1)(a);

(ii) no managing director or other director, agent, secretary or manager whose agreement is so terminated or set aside and no person who, at the date of the order terminating or setting aside the agreement was, or subsequently becomes an associate of such agent or secretary shall, for a period of five years from the date of the order terminating the agreement, without the leave of the court, be appointed, or act, as the managing director or other director, agent, secretary or manager of the company: s.219(1)(b).

INVESTIGATION

5. INSPECTION OR INVESTIGATION

Occasions may arise which make it desirable for a thorough investigation to be made of a company. The Act gives wide powers to the Registrar to investigate,

(i) the affairs of a company,

(ii) ownership of a company,

(iii) share dealings,

(iv) the company's books and documents.

6. (i) INVESTIGATION OF THE COMPANY'S AFFAIRS

The Registrar **may** appoint competent inspectors to investigate the affairs of a company on an application made –

(a) in a company limited by shares, by more than fifty members or members who among them hold one-fifth of the issued capital of the company: s.161(a),

(b) in a company not limited by shares, by one-fifth of the members: s.161(b).

The Registrar **must** appoint such inspectors when –

(a) the company passes a special resolution:[6] s.162(a)(i),

(b) there is an order of court: s. 162(a)(ii).

The Registrar[7] may in his own right appoint an inspector to investigate and report to him. The circumstances in which the Registrar may appoint an inspector are as follows:

(i) its business is being conducted with intent to defraud its creditors or the creditors of any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive of any part of its members or that it was formed for any fraudulent or unlawful purpose; or

(ii) persons concerned with its formation or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards its members; or

(iii) its members have not been given all the information with respect to its affairs which they might reasonably expect: s.162(b).

The application must be supported by evidence that the applicants have good reasons for requiring the investigation and are not actuated by malicious motives.

The costs of the investigation must be borne by the applicants. Before commencement of investigations the Registrar may require an amount not exceeding rupees two thousand five hundred to be deposited as security to meet costs of investigation. The Registrar may from time to time ask for additional payments to meet costs of investigation and **failure to provide such amounts** may result in the **security being forfeited** and **investigation terminated.**

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[6] When a company by special resolution appoints inspectors, such inspectors have the same powers and duties as inspectors appointed by the Registrar of Companies except that they must report in such manner and to such persons as the company in general meeting directs. The position is the same as in the case of inspectors appointed by the Registrar of Companies.

[7] s.432 also empowers the Registrar to carry on an investigation or inquiry into the affairs of a company.

Minority Protéction - Oppression and Mismanagement - Investigation

If an inspector conducting an investigation feels that it is necessary to also investigate the affairs of **another body corporate** which is either its holding company, its subsidiary or a subsidiary of its holding company, he may with the written approval of the Registrar proceed to do so: s.163.

The inspectors may **examine** all books and documents of the company and **examine on oath** the officers and agents of the company both past and present. When an inspector has no power to examine a person on oath, he may apply to the court which would, if it sees fit, examine the person on oath. This provision would apply to persons such as attorneys-at-law, bankers, auditors and agents of the company. If inspection of documents etc., is refused or any questions are unanswered, the inspectors may inform the court and the court may enquire into the case. The offender would be treated as if guilty of contempt of court: s.164.

It is the duty of all directors, officers and agents of the company and all directors, officers and agents of **another body corporate** whose affairs are being investigated pursuant to section 163 of the Act, to co-operate with the inspector in conducting the investigations. Failure to do so may, after court inquiry, result in the offender being punished as if he were guilty of contempt of court: s.164(3).

A **final report** must be made on the investigation and sent to the Registrar of Companies, and interim reports if so directed by the Registrar. A final report if authenticated by the seal of the company shall, by s.168 be admissible as evidence of the inspector's opinion, in any legal proceedings. The Registrar must send copies of the report to the Registered Office of the company, any member, creditor or company affected (on payment of a prescribed fee), applicants for the investigation (if the investigation is proposed by them) and to court (if the investigation is ordered by court): s.165.

On receiving the inspector's report, the Registrar may,

(1) if it appears to the Registrar that any person is guilty of a criminal offence, refer the matter to the Attorney-General to prosecute: s.166(1),

(2) petition court for a winding-up if the court thinks it is just and equitable: s.166(3).

(3) himself institute proceedings, in the name of the company, for the recovery of damages for fraud, misfeasance or other misconduct in connection with the promotion, formation, management of the company's affairs or for the recovery of any property of the company misapplied or wrongfully retained by another: s.166(4).

6. (ii) INVESTIGATION INTO THE OWNERSHIP OF A COMPANY

By s.169, where it appears to the Registrar that there is good reason so to do, he may appoint one or more inspectors to investigate and report on the **membership of any company** and otherwise with respect to the company **for the purpose of determining the true persons who are, or have been, financially interested in the success or failure (real or apparent) of the company or able to control or materially to influence the policy of the company.**

The instrument of appointment of an inspector under the provisions of subsection (1) may define the scope of his investigation, whether as respects the matters or the period to which it is to extend or otherwise, and in particular may limit the investigation to matters connected with particular shares or debentures.

Where an application for an investigation under the provisions of this section with respect to particular shares or debentures of a company is made to the Registrar by **members of the company**, and the number of applicants or the amount of the shares held by them is not less than that required for an application for the appointment of an inspector under the provisions of s.161, the Registrar shall appoint an inspector to conduct the investigation unless he is satisfied that the application is **vexatious**, and any matter which the application seeks to include in such investigation, other than those matters which the Registrar is satisfied is **unreasonable** to be investigated, shall be included within the scope of such investigation.

Subject to terms of appointment of an inspector, his powers shall extend to the **investigation of any circumstances** suggesting the existence of an arrangement or understanding which, though not

legally binding, is or was observed or likely to be observed in practice and which is relevant to the purposes of his investigation.

For the purposes of any investigation under s.169, the provisions of ss.163, 164 and 165 shall apply with the necessary modifications of references to the affairs of the company or to those of any other body corporate, so however that –

> the said sections shall apply in relation to all persons who are or have been, or whom the inspector has reasonable cause to believe to be or have been, **financially interested in the success or failure or the apparent success or failure of the company** or any other body corporate whose membership is investigated with that of the company, or **able to control or materially to influence the policy thereof,** including persons concerned only on behalf of others, as they apply in relation to officers and agents of the company or of the other body corporate, as the case may be; and
>
> the Registrar is required to furnish the company with a **copy** of any **report** by an inspector appointed under the provisions of this section, provided that the company in turn is required to make available such report to a shareholder on application.

The **expenses** of any investigation made under the provisions of this section shall be **defrayed by the Registrar** out of moneys provided by Parliament for the purpose.

Savoy Hotel Investigations

Large quantities of Savoy Hotel stock were being purchased through nominees on the Stock Exchange in 1953. The beneficial owners of the stock were not known but the obvious intention was to gain control of Savoy Hotel Ltd. and develop its assets .

The boards of the Savoy Company and its subsidiary Berkeley Hotel Co. Ltd., both of which had substantially the same directors, were aware that turning Berkeley Hotel into an office complex would enable substantial profits to be made quickly.

Minority Protection - Oppression and Mismanagement - Investigation

On an application made by members of the company, the Board of Trade initiated an investigation of shareholders which revealed that twenty nine percent of the voting stock had been purchased by two buyers acting through companies under their control.

The Savoy Hotel directors, who felt that they may lose control of the company, formed another company – Worcestor Buildings Co. Ltd. – and sold Berkeley Hotel to the Worcester Company and the consideration was satisfied by the issue to the Berkeley Company of preference shares in the Worcester Company. Thereafter, the Worcester Company gave Berkeley Hotel on lease to the Berkeley Company for 50 years with the stipulation that without the consent of the Worcester Company, the **property should only be used as a hotel.**

The control of the Worcester Company was by shares of a small nominal amount which were issued for cash to the trustees of the Savoy Company's benevolent fund, the cash having been transferred to the trustees from the fund.

Shareholders entitled in number to appeal applied to the Board of Trade which appointed Mr. E. Milner Holland, Q.C. to investigate the affairs of the Savoy Hotel. His report[1] stated that, on the analogy of Piercy v. Mills Co.,[2] the transaction was an invalid use of the powers of management of the Savoy directors, even though they thought they were acting for the benefit of the company and their shareholders, and even though they had legal advice that they could act as they did. The purpose of the transaction was to deny to the majority holding voting control of the Savoy Company the power, by the exercise of that control, to cause the Berkeley Hotel to be used otherwise than as a hotel.

6. (iii) INVESTIGATION OF SHAREHOLDINGS

By s.170 when it appears to the Registrar that there is good reason to investigate the ownership of any shares in, or debentures of, a company and that it is unnecessary to appoint an inspector for the purpose, the Registrar may require any person whom he has reasonable cause to believe –

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[1] Dated June 14, 1954 and published by H.M.S.O.

[2] (1920) 1 Ch. 77.

(a) to be or to have been interested in those shares or debentures; or

(b) to act, or to have acted, as the attorney or agent of any person interested therein,

to give the Registrar any information which he has or can reasonably be expected to obtain as to the present and past interests in those shares or debentures and the names and addresses of the persons interested and of any persons who act or have acted on their behalf.

For the purposes of this section, a person shall be deemed to have an interest in a share or debenture if he has any right to acquire or dispose of the share or debenture or any interest therein or to vote in respect thereof, or if his consent is necessary for the exercise of any of the rights of other persons interested therein, or if other persons interested therein can be required or are accustomed to exercise their rights in accordance with his instructions.

Any person who fails to give information or who in giving any such information makes any statement which he knows to be false in a material particular, or recklessly makes any statement which is false in a material particular, is guilty of an offence and liable to a fine not exceeding five thousand rupees or to imprisonment of either description for a term not exceeding six months or to both.

6. (iv) INSPECTION OF THE COMPANY'S BOOKS AND DOCUMENTS

The books of account must be open to inspection by the Registrar at all times: s.143.

The Registrar has the power to verify the assets and liabilities of the company: s.173.

The Registrar may, by written notice direct the company to furnish before a specified date any form of information, explanation,

declaration, return, document, book or register regarding any matter concerning the company, as he may require for any purpose: s.431.

7. EFFECT OF NON-CO-OPERATION WITH REGISTRAR IN AN INVESTIGATION INTO THE OWNERSHIP OR SHARE-DEALING OF A COMPANY

By s.171:

(1) Where in connection with an investigation under the provisions of section 169 or section 170, it appears to the Registrar that there is difficulty in finding out the relevant facts about any shares (whether issued or to be issued), and that the difficulty is due wholly or mainly to the unwillingness of the persons concerned or any of them to assist the investigation as required by the Registrar, the Registrar may by order direct that the **shares** shall until further order, be **subject to the restrictions** imposed by the provisions of this section.

(2) So long as any shares are directed to be subject to the restrictions imposed by the provisions of this section –

(a) any transfer of those shares, or in the case of **unissued shares any transfer of the right to be issued** therewith and any issue thereof, shall be **void;**

(b) no **voting rights** shall be exercisable in respect of those shares;

(c) **no further shares shall be issued** in right of those shares or in pursuance of any offer made to the holder thereof;

(d) except in a liquidation, **no payment** shall be made on any sums due from the company on those shares, whether in respect of capital or otherwise.

(3) Where the Registrar makes an order directing that shares shall be subject to the restrictions specified in subsection (2) or refuses to make an order directing that shares shall cease to be subject thereto,

any person aggrieved by such order **may appeal to the court** against such order and the court may, if it sees fit, direct that the shares cease to be subject to such restrictions.

(4) Any order, whether of the Registrar or court directing that shares shall cease to be subject to the said restrictions, which is expressed to be made with a view to permitting a transfer of those shares may continue the restrictions specified in paragraphs (c) and (d) of subsection (2) either in whole or in part, so far as they relate to any right acquired or offer made before the transfer.

(5) Any person who –

(a) exercises or purports to exercise any right to dispose of any shares which, to his knowledge, are for the time being subject to the restrictions specified in subsection (2) or of any right to be issued with any such shares; or

(b) votes in respect of any such shares, whether as holder or proxy or appoints a proxy to vote in respect thereof; or

(c) being the holder of any such shares, fails to notify of their being subject to the restrictions specified in subsection (2) any person whom he does not know to be aware of that fact but does know to be entitled, apart from such restrictions, to vote in respect of those shares whether as holder or proxy,

is guilty of an offence and will be liable to a fine not exceeding five thousand rupees or to imprisonment of either description for a term not exceeding six months or to both such fine and imprisonment.

(6) Where shares in any company are issued in contravention of the restrictions specified in subsection (2), the company and every officer of the company who is in default shall be guilty of an offence and shall be liable to a fine not exceeding five thousand rupees.

(7) A prosecution shall not be instituted under the provisions of this section except by or with the consent of the Registrar.

(8) The provisions of this section shall apply in relation to debentures as it applies in relation to shares.

By s.172, **nothing** in the preceding provisions of this Part shall **require disclosure** to the Registrar or to an inspector appointed by the Registrar –

(a) by an **attorney-at-law,** of any privileged communication made to him in that capacity, except as respects the name and address of his client; or

(b) by a **company's bankers,** of any information as to the affairs of any of their customers other than the company.

CHAPTER O

INSIDER TRADING

1. INTRODUCTION

'Insider Trading' or 'Insider Dealing' occurs when persons in privileged positions having access to 'Inside Information', which is not available to the general public, make use of that information to deal in the company's securities for their own gain or for the gain of family members or persons under their control. Such insiders may attempt to make a profit by buying before the market rises or to avoid making a loss by selling before it falls.

Insider trading occurs **only** when listed companies are transacted in a recognized security or stock exchange. Other private transactions are excluded, and are hence exempted from legislation governing 'Insider Dealing'.[1]

2. OBJECTIONS : ETHICAL & LEGAL

The use of inside information prejudices the position of **outsiders** who deal with the insider. It has been said that the situation is equivalent to a cheat at cards, as the insider has a secret advantage which is beneficial to him at the other party's expense. For instance, a director knowing that a substantial gain is accruing to the company or a bonus issue is underway, may purchase large quantities of his company's shares before members of the public who are unaware of the situation, do so.

From the **company's** point of view, the need to regulate insider activities is that the insider is in a potential 'conflict-of-interest' position because of his access to confidential information, which is unpublished and price sensitive.[2] He may be able to withhold public disclosure of vital information or even guide certain decisions so that the outcome would be beneficial to himself at the company's expense.

[1] Ss. 34, 55 Securities Council Act, No. 36 of 1987 as amended by Act No. 26 of 1991.
[2] Vide O 6.

Self-interest may override the best interests of the company; a director is under duty to act *bona fide* in the best interests of the company.[3]

Insider trading tends to bring the **securities market** into disrepute and thus affect the orderly conduct of the market. Investors would tend to lose confidence in the market with the possibility of an adverse effect on investment.[4]

3. COMMON LAW CONTROLS

The Common Law imposes no specific prohibition on the use of inside information in share dealings, unless some special relationship exists when there is a legal duty to disclose all relevant information;[5] it has been said that this attitude stems largely from the decision in Percival v. Wright[6] where it was held that directors' duty was only to the company and there was no duty to disclose to individual shareholders as there was no fiduciary relationship between the directors and shareholders.

4. STATUTORY CONTROLS

The prohibition of insider dealing was first introduced in Sri Lanka by Part V ss. 220 to 223 of the Companies Act No. 17 of 1982; however, in practice this was not brought into operation. The Securities Council Act No. 36 of 1987 repealed these provisions of the Companies Act, 1982.

Part IV (ss.32 to 34) of the Securities Council Act No. 36 of 1987 as amended by the Securities Council (Amendment) Act No. 26 of 1991 (ss. 24, 25) are the provisions affecting insider dealing.[7]

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[3] Hutton v. W. Cork Ry. (1883) 23 Ch.D. 654 C.A; Re Lee Beherens & Co. (1932) Ch. 46; Evans v. Brunner Mond & Co. (1962).

[4] Differing views are emerging - see Manne 'In Defense of Insider Trading', 44 Harvard Business Review H3, and Rider & Liegh French: The Regulation of Insider Trading (MacMillan, 1979). The forefront of the attack against the control of Insider Trading has been in the United States. See also O 8.

[5] Allen v. Hyatt (1914) 30 T.L.R. 444.

[6] (1902) 2 Ch. 421.

[7] In England, by the Companies Act 1980, insider trading became a criminal offence. Prior to that, the Companies Act 1967 only stipulated that a Register of Directors and their families' shareholdings be maintained and be made available for inspection by any interested persons. The Company Securities (insider dealing) Act 1985, repealed the provisions of the Companies Act 1980. This Act, as amended by the Financial Service Act 1986, consolidates the provisions first introduced by ss. 68-73 of the Companies Act 1980.

5. DEFINITION OF 'INSIDERS' & THE RESTRICTIONS IMPOSED ON THEM

The Colombo Stock Exchange Rules describe insiders as follows:

"All persons who come into possession of material inside information, before its public release are considered insiders for the purpose of the Exchange's disclosure policies. Such persons include controlling shareholders, directors, officers, and employees, and frequently also include outside attorneys, accountants, investment bankers, public relations advisers, advertising agencies, consultants, and other independent contractors. The husbands, wives, immediate families and those under the control of insiders may also be regarded as insiders. Where acquisition or other negotiations are concerned, the above relationships apply to the other parties to the negotiations as well. Finally, for the purpose of the Exchange's disclosure policy, insiders include 'tippees'[8] who come into possession of material inside information."

S.32 of the Securities Council Act, 1987 (as amended by the 1991 Act) states:–

(1) An individual who is, or has been at any time during the six months immediately prior to the receipt of information connected with a company shall **not** trade in listed securities of –

i. **that company** if he has information which,

(a) he holds by virtue of being connected with the company;

(b) it would be reasonable to expect a person so connected and in the position by virtue of which he is so connected, not to disclose except for the proper performance of the function attaching to that position;

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[8] Any persons, sometimes referred to as 'tippees', who receive information, directly or indirectly, from another who is or was connected with the company within the period of six months prior to the **receipt of the information** is now caught by the dealing prohibition. The recipient or 'tippee' must be shown either to know or to have reasonable cause to believe that the imparter of the information held it by virtue of being connected with the company and that because of the latter's position it would be reasonable to expect him not to disclose it: Charlsworth, 13th Edition.

(c) he can reasonably be expected to know is unpublished price sensitive information in relation to those securities.

ii. **any other company**[9] if he has information which,

(a) he holds by virtue of being connected with the **first** mentioned company;

(b) same as i (b) above;

(c) same as i (c) above;

(d) relates to any transaction whether actual or contemplated, involving both the first mentioned company and that other company, or involving one of them and securities of the other or to the fact that any such transaction is no longer contemplated.

(2) An individual has obtained on reasonable cause and believes he obtained, directly or indirectly from another who is connected with a particular company, or was at any time in the 6 months immediately preceding the date of obtaining the information so connected, and who the former knows or has reasonable cause to believe, held the information by virtue of being so connected, and that it would be reasonable to expect the latter not to disclose the information except for the proper function attaching to that position, shall not himself, trade in listed securities in,

i. **that company** if he can reasonably be expected to know that the information is unpublished price sensitive information in relation to those securities,

ii. **any other company,** if he can reasonably be expected to know that the information is unpublished price sensitive information in relation to those securities, and it relates to any transaction whether actual or contemplated, involving the first mentioned company and the other company, or involving one

[9] That is, any related company meaning a subsidiary, associate, or holding company, or a subsidiary of that company's holding company.

of them and securities of the other or to the fact that any such transaction is no longer contemplated.

(3) An individual who is contemplating a **take-over** offer for a company, shall **not** trade in listed securities of that company, in another capacity if he can reasonably be expected to know that the information that the offer is contemplated or not, is unpublished price sensitive information in relation to those securities; another obtaining the same information from the aforesaid individual is also prohibited from trading in those securities.

The above persons cannot counsel nor communicate that information to any other person whom they have reasonable cause to believe will make use of such information and trade in such listed securities.

The above restrictions do **not prohibit** an individual by reason of his having any information from,

(a) doing anything otherwise than for making a profit or avoiding a loss for himself or another, by making use of that information (8)(a);

(b) entering into a transaction as a liquidator, receiver or trustee in bankruptcy (8)(b);

(c) doing anything particular if the information was obtained by him in the ordinary course of business of a stockbroker or dealer (8)(c);

(d) doing anything to facilitate the completion or the carrying out of a transaction by an individual who has information relating only to that transaction (9).

Trustees and Legal Representatives are not prohibited from making use of information to trade in the securities, nor to counsel or procure any other person to trade in them, under certain circumstances: s.32(10).

Where any **public servant or former public servant** has any information in relation to listed securities of a company, which is held by him by virtue of his position or former position and which it would be reasonable to expect him not to disclose except for the proper performance of the functions attaching that position and which he knows is unpublished price sensitive information, that public servant or former public servant shall not trade on those securities on the Stock Exchange, nor shall he counsel or procure any other person to deal in such securities knowing or having reasonable cause to believe that that person would deal in them on the Stock Exchange or communicate such information to any person if he knows or has reasonable cause to believe that that or some other person will make use of the information for the purpose of dealing or counselling or procuring any other person to deal in them on the Stock Exchange.

The provisions of this section also apply to any individual who knowingly obtained any such information (whether directly or indirectly) from a public servant or former public servant who that individual knows or has reasonable cause to believe, held the information by virtue of his position or former position as a public servant: s.33.

6. UNPUBLISHED PRICE SENSITIVE INFORMATION

"Unpublished price sensitive information" relates to specific matters (i.e., not of a general nature) relating or of concern, directly or indirectly to that company and is not generally known to those persons who would be dealing in those listed securities but which would if it were known be likely to affect substantially the price of those securities: s.34.

7. STATUTORY PENALTIES

Any person contravening the provisions of the Act is guilty of an offence and where no penalty is expressly provided, shall be liable on conviction after summary trial by a Magistrate to imprisonment for a period not exceeding 5 years or to a fine not exceeding ten million rupees or to both: s.51.

8. IMPLEMENTATION OF THE STATUTORY PROVISIONS

No prosecutions have been brought under the Acts,[10] because prosecutors[11] have to prove that a criminal offence has been committed with all the consequent problems of *mens rea*. It is also difficult to identify insiders who may be operating in the market at any given time.[12] The statutory provisions may, however, act as a mild deterrent and thus be effective to some extent. The transaction remains unaffected although it may be an 'insider deal'. No civil remedies are available to compensate shareholders who have dealt with the insider and suffered loss as a result.

9. COMPOUNDING OF OFFENCES

By s. 51A, which was introduced in the amending Act, the Commission was given power to compound offences under the Act, having regard to the circumstances in which they were committed, for a sum not exceeding one-third of the maximum fine imposable for such offences. All money received by the Commission on the compounding of offences must be credited to the Compensation Fund established under s.38.

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[10] In England, there has been a paucity of prosecutions.

[11] The Securities Council would usually prosecute.

[12] Regulation of insider dealing creates many problems. Whilst discouragement of 'insider activities' is necessary so as not to undermine investor confidence resulting from unconscionably high profits being made by those with inside information, too strict an approach might adversely affect genuine bargaining in the securities market thereby weakening the underlying principle on which the market is based.

CHAPTER P

COMPROMISE OR ARRANGEMENTS – RECONSTRUCTIONS AND AMALGAMATIONS

The terms 'reconstructions, amalgamations and arrangements' are terms commonly used somewhat loosely, and have no definite legal meaning.

Reconstruction is where a new company takes over the assets of an old one, but the persons carrying on the business are substantially the same.

Amalgamation[1] is where two or more companies join together to form a new company, or where one company absorbs another.

Arrangements or compromises, may arise between the company and members or any class of them, or between the company and creditors or any class of them and may be in connection with a reconstruction or an amalgamation.

1. COMPROMISE OR ARRANGEMENTS

Compromises or arrangements with members and creditors under s.206(1): This section declares that where any compromise or arrangement is proposed between a company and its members or any class of them, or between the company and its creditors or any class of them, the court may, on the application of the company, or any creditor or member of the company or the liquidator, order a meeting of the members or class of members, or of the creditors or class of creditors, as the case may be, to be called; and if a majority in number representing three-fourths in value of members or class of members, the creditors or class of creditors, present either in person or by proxy agree to the compromise or arrangement and it is also sanctioned by the court, it will be binding on the company and on all the members or class of members, or on the creditors or class of creditors, as the case may be, and on the liquidator and the contributories of the company, if the company is in liquidation.

[1] A"take-over" i.e., the acquisition of shares in one company by another is often a contested form of amalgamation.

The order becomes effective only on registration with the Registrar of Companies. A copy of such order must be annexed to every copy of the memorandum.

A scheme under this section sanctioned by court cannot be varied nor departed from with the mere consent of the members or creditors: Devi v. People's Bank*, (1938) 4 All E.R. 337.

Compromises or arrangements with creditors: Without going into liquidation a company can effect compromises or arrangements with its creditors under s.206(2) as that section applies to companies not in the course of winding up, as well as to companies in the course of winding-up.

In a voluntary winding-up such a composition with creditors may be effected either under s.206 or s.336[2] and compromises and arrangements with individual creditors (or persons claiming to be such) may at any time be effected by a liquidator in accordance with the powers conferred on him by s.333(1)(a) and s.277(1)(e) with the sanction of an extraordinary resolution of the company in the case of a members' voluntary winding-up, or with the sanction of either the court or the committee of inspection in the case of creditors' winding-up.

Under s.336 an extraordinary resolution of the company and the assent of three-fourths in number and value of the creditors are necessary to sanction the arrangement, which will then bind all the creditors. There is, however, a right to appeal to the court within three weeks of the completion of the arrangement.

In the case of reconstruction of a company, if the creditors of the old company are to be paid in full at once, their consent need not be asked to a reconstruction, but if they are to accept a composition, or to take shares or debentures in the new company in settlement of their claims, or to accept deferred payment, their acquiescence must be given to a scheme of composition.

* Foreign Case.

[2] See R 42.

When creditors and members are summoned for a meeting under the provisions of s.206, a **statement** must be attached to the notice or advertisement, explaining –

(i) the effect of the compromise or arrangement,

(ii) the material interest of the directors whether as directors, members, creditors or otherwise,

(iii) the effect on the directors' interest if different from the effect on the like interests of other persons,

(iv) if the debenture holders' rights are affected, the effect on the trustee (as in the case of directors' interests above) of any deed securing the debentures.

It is the duty of directors and any trustee for debenture holders to give notice to the company of particulars regarding themselves: s. 207(5).

2. RECONSTRUCTION OR AMALGAMATION

Reconstruction or amalgamation can take place under either s.208 or s.317 of the Act. Under s.208 the transferee must be a company within the meaning of the Act. i.e., a company formed and registered under the Act or an existing company: s.449. Under s.317 the transferee company need not be a company within the meaning of the Act. Further under s.208 reconstruction can take place at any time during the company's existence or during winding-up, unlike under s.317 when a company must be or proposed to be in the course of winding up.

Reconstruction under section 208

This section provides that where an application is made to the court under s.206 (see P 1) for the sanctioning of a compromise or arrangement as therein mentioned[3] and it is shown to the court that the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies, or the amalgamation of two or more companies, and that

[3] The proper procedure under this section is, therefore, first to obtain an order under s.206 sanctioning the scheme, with liberty to apply to court.

under the scheme the whole or part of the undertaking or undertaking of any company concerned in the scheme is to be transferred to another company, i.e., the transferee company, the court may, either by the order sanctioning the compromise or arrangement, or by any subsequent order, make provision for all or any of the following matters:

(a) the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company;

(b) the allotting or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the compromise or arrangements are to be allotted or appropriated by that company to or for any person;

(c) the continuation by or against any transferee company of any legal proceedings pending by or against any transferor company;

(d) the dissolution, without winding up of any transferor company;

(e) the provision to be made for any persons who, within such time and in such manner as the court directs, dissent from the compromise or arrangement;

(f) such incidental, consequential, and supplemental matters as are necessary to secure that the construction or amalgamation shall be fully and effectively carried out: s.208(1).

S.208(2) stipulates that where an order under the section provides for the transfer of property or liabilities, that property shall, by virtue of the order, be transferred to and vest in, and those liabilities shall, by virtue of the order, be transferred to and become the liabilities of the transferee company, and in the case of any property, if the order

so directs be freed from any charge which is by virtue of the compromise or arrangement is to cease to have effect.

The expression 'property' includes property, rights and powers of every description, and the expression 'liabilities' includes duties: s.208(4)[4], but not a duty to serve under a contract of personal service.

Where an order is made under the section, every company in relation to which the order is made must cause a certified copy thereof to be delivered to the Registrar for registration within 14 days after the making of the order. Default in compliance exposes the company, and every officer of the company who is in default, to a default fine: s.208(3).

Reconstruction under section 317[5]

When a company is proposed to be wound up or in the course of winding-up under a members' or creditors' voluntary winding-up, it may be proposed that the whole or part of its business or property be transferred or sold to another company. In which case, the liquidator of the transferor company, **after obtaining the sanction of a special resolution**, is empowered to,

(i) **receive compensation or part compensation** for the transfer or sale of shares, policies, or other such interests in the transferee company for distribution among the members of the transferor company, or

(ii) **enter into an arrangement** whereby the members of the transferor company would share in the profits or other benefits of the transferee company.

The resolution may confer either a general authority or an authority for a particular arrangement. It may be passed either before, concurrent with or after the resolution for voluntary winding-up; but if

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[4] Nokes v. Doncaster Amalgamated Colleries (1904) A.C. 1014.

[5] By s.328, the provisions of s.317 apply to a creditors' voluntary winding-up as in a members' voluntary winding-up, except that the powers of the liquidator can be exercised only with the sanction of the court or the committee of inspection.

the winding up becomes, within one year, a winding-up by court or supervision of court, the **sanction of the court** is necessary.

Any member of the transferor company who did not vote in favour of the resolution may **dissent in writing within seven days** of the resolution, requiring the liquidator to (a) abstain from effecting the scheme, or (b) buy his interest, at a price to be determined by agreement or by court.[6] If the liquidator decides on the latter course, the purchase money **must be paid before the company is dissolved, and be raised in the manner determined by a special resolution.**

It must be observed that section 317 only authorises a sale to a company already in existence or formed for the purpose of purchasing the assets of the old company. Hence, a sale to an individual cannot be carried out under this section: Bird v. Bird's Patent Sewage Co., (1874) L.R. 9 Ch. App. 358. However, an agreement may be made with an individual acting as agent or trustee for a company about to be formed and not purchasing to make a profit for himself : Re Hester & Co., (1881) 44 L.T.N.S. 757.

3. DISSENSION FROM RECONSTRUCTION

In the event of dissension among shareholders on reference to arbitration, the dissentient has to prove the value of his interest, but he will not be allowed to examine the directors under s.299[7] to obtain evidence for this purpose: British Building Stone Co., (1908) 2 Ch. 450.[7A] If a person who ought to be, but is not, on the Register of Members gives notice of dissent the court may, on making an order for rectifying the Register declare that it shall relate back, so as to render the notice of dissent effective: Re Sussex Brick Co., (1904) 1 Ch. 598.

If the dissentients take proceedings to set aside the sale to another company, **after the agreement for sale has been executed,** if the method of distributing the purchase consideration can be severed

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[6] Application must be made to court by the member or the liquidator in the manner provided by s.317.

[7] See R 19.

[7A] The statute in force during that period would have had a provision similar to s.299.

from the provisions for sale, the sale may stand good leaving the proper distribution of the shares to be made according to the rights of the members of the vendor company: Wall v. London and Northern Assets Corporation, (1898) 2 Ch. 469.

Power to acquire shares of dissenting members under s.209

This section applies to a scheme or contract for the transfer of shares from one company to another company (whether a company within the meaning of the Act or not) which has, within four months from the making of the offer by the transferee company, been approved by a majority of not less than nine-tenths in value of the shares affected.[8] In such case the transferee company may, at any time within two months after the expiration of such four months, give notice to a dissenting shareholder[9] that it desires to acquire his shares, and thereupon, unless the court on an application made by the dissenting shareholder within one month after such notice was given, thinks fit to order otherwise, the transferee company will be entitled and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company.

Generally, the court will order otherwise, preventing the transferee company from acquiring the shares of dissentient shareholders, **only** if it is satisfied that the scheme is unfair to the general body of shareholders of the transferor company. The dissentients have a heavy proof of burden,[10] as the scheme has been approved by nine-tenths of the shareholders and thus appears, *prima facie*, to be a fair one.[11]. The test being, is it fair to the body of shareholders, it not being enough only to prove that the scheme is criticisable or capable of improvement.[12]

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[8] Other than shares already held at the date of the offer by or by a nominee for the transferee company or is subsidiary: 209 (1).

[9] For this section, 'dissenting shareholder' includes a shareholder who has not assented to the scheme or contract, and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract.

[10] Re Sussex Brick Co. Ltd. (1961) Ch. 289; Nidditch v. The Calico Printers' Association Ltd. (1961) S.L.T. 282.

[11] Re Hellenic General Trust Ltd. (1976) 1 W.L.R. 123.

[12] Re Grierson, Oldham & Adams Ltd. (1968) Ch.17.

The directors of the transferor company are under duty to their shareholders to be honest and not mislead them. If as a result of a breach of duty by such directors, a minority is being wrongfully subjected to the power of compulsory purchase, they can object.[13]

S.209 does not apply when one company acquires shares in another by purchase on the Colombo Stock Exchange.

In Seneviratne v. Seneviratne (1982) it was found that no order could be made under s.153 of the Ordinance (corresponding to s.209 of the Act) because of oppression of a minority; there being only 3 shareholders no order that the first respondent purchase shares of the other two shareholders could he made without violating prohibitions regarding minimum members, prescribed by s.27 of the Ordinance, (corresponding s.33 of the Act) – See R 5 for details of the case.

When one–tenth of the shares are already held by transferee

S.209 does not apply when, at the date of the offer, more than one-tenth in value of the shares or class of shares whose transfer is involved are held by, or by a nominee for the transferee company or it's subsidiary, unless,

(1) the transferee company offers the same terms to all the holders of the shares or each class of shares whose transfer is involved; and

(2) the holders who approve the scheme or contract, besides holding at least nine-tenths in value of the shares whose transfer is involved, are also not less than three-fourths in number of the holders of such shares: s.209(1).

To ascertain whether approving shareholders amount to three-fourths of the total, the date at which a count must be calculated must normally be by reference to the total number of shareholders on the register at the offer date: Re Simo Securities Trust Ltd. (1971).[14]

When transferee acquires nine-tenths of shares

S.209(2) provides that if the shares transferred under the scheme or contract, together with the shares held by, or by a nominee for, the

[13] Gething v. Kilner (1972) 1 W.L.R. 337.
[14] 1 W.L.R. 1455.

transferee company or its subsidiary at the date of the transfer, amount to nine-tenths in value of the shares in the transferor company or of any class of such shares, the transferee company must, within a month after the transfer, give notice of that fact to the holders of the remaining shares, or of the remaining shares of the class, who have not assented to the scheme. Thereupon any such holder may, within three months after the notice, require the transferee company to acquire the shares in question on the terms on which, under the scheme, the shares of the approving shareholders were transferred, or on such terms as may be agreed, or fixed by the court on the application of either the transferee company or the shareholder.

S.209(3) provides that where a notice has been given by the transferee company to the dissentient shareholders and the court has not, on an application made by them, made an order to the contrary, the transferee company must, on the expiration of one month from the date on which the notice has been given, or, if an application to the court by the dissentient shareholders is then pending, one month from the date on which that application has been disposed of, transmit a copy of the notice to the transferor company together with an instrument of transfer executed on behalf of the shareholder by any person appointed by the transferee company and on its behalf by the transferee company, and pay or transfer to the transferor company the amount of other consideration representing the price payable by the transferee company for the shares which that company is entitled to acquire, and the transferor company must thereupon register the transferee company as the holder of those shares (provided that an instrument of transfer is not required for any share for which a share warrant is for the time being outstanding).

Any sums so received by the transferor company must be paid into a separate bank account, and such sums and any other consideration are to be held by that company on trust for the several persons entitled to the shares in respect of which the consideration was received: s.209(4).

CHAPTER Q

PRIVATE, HOLDING, SUBSIDIARY, OVERSEAS, GUARANTEE AND UNLIMITED COMPANIES

1. PRIVATE COMPANIES

A private company is a company which by its articles,

(a) restricts the right to transfer its shares;
(b) limits the number of its members to fifty, exclusive of present employees who are, and past employees who were whilst employed members and have continued to be members;
(c) prohibits any invitation to the public to subscribe for its shares or debentures.*

Where two or more persons hold shares jointly they are treated as a single member: s.30.

Private companies can adopt Part II of Table A.

2. PRIVILEGES AND DUTIES OF A PRIVATE COMPANY

(i) It need have only **two members.**
(ii) **Must have at least** one director: s.174.
(iii) **No statutory report** need be filled nor **statutory meeting** need be held: s.126(10).
(iv) There is **no minimum subscription,** and it need not file a prospectus or statement in lieu of prospectus before allotting shares.
(v) It does **not need** a **certificate to commence business** before it can enter into a binding contract, and may commence trading soon after incorporation.
(vi) **It must file accounts** with its annual return, but the right to inspect is limited.

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* In England the restrictions (a) and (b) above have been removed by the Companies Act, 1985.

It must however,

(i) observe the restrictions in its articles as to (a) maximum number of members, (b) offer of shares and debentures, and (c) restrictions on transfers of shares;
(ii) file with its annual return,
  (a) a certificate that the company has not since the last return offered its shares or debentures to the public,
  (b) if the members exceed fifty, a certificate that the excess consists of persons not to be counted, i.e., joint-holders other than the first, employees and ex-employees.

3. LOSS OF PRIVILEGES AND CONVERSION OF A PRIVATE COMPANY

By s.32–

(a) If a company alters its articles by removing the provisions of s.30 constituting it a private company, then, it ceases on that day to be a private company and must within 14 days file with the Registrar of Companies a prospectus or a statement in lieu of prospectus in accordance with the 2nd Schedule of the Act. A statement in lieu of a prospectus need not be delivered if, within the said 14 days a prospectus complying with the 3rd Schedule is delivered to the Registrar.
(b) If a company fails to comply with the restrictions imposed by s.30 (whilst such restrictions are in the articles) then, it loses the right to continue with fewer than seven members and if it so continues, the remaining members become subject to unlimited liability after six months and the company may be wound up by court. However, the Court, if satisfied that the failure was accidental or due to some other sufficient cause, may grant relief.

To convert a public company into a private company, it is only necessary to alter the articles (by special resolution) by inserting the necessary restrictions and by removing any inconsistent provisions, such as a power to issue share warrants. The number of members must not, of course, exceed the statutory limits – See Q1 above.

Private, Holding, Subsidiary, Overseas, Guarantee and Unlimited Companies

4. WHEN PRIVATE COMPANIES MUST BECOME PUBLIC COMPANIES

By s.224 private companies must become public companies under certain circumstances – See B 11.

5. HOLDING AND SUBSIDIARY COMPANIES*

By s.150(4), a company is a **holding** company of another if that other is its subsidiary.

By s.150(1), (2), (3), a company is a subsidiary of another if,

(A) the latter is a member of it and **controls the composition of the board of directors;** the composition of a company's board of directors shall be deemed to be controlled by another company if, and only if, that other company by the exercise of any power exercisable by it without the consent or concurrence of any other person can appoint or remove the holders of all or a majority of the directorships; but for the purposes of these provisions that other company shall be deemed to have power to appoint to a directorship with respect to which any of the following conditions is satisfied, that is to say –

(a) that a person cannot be appointed to a directorship without the exercise in his favour by that other company of a power to so appoint; or
(b) that a person's appointment to a directorship follows necessarily from his appointment as director of that other company; or
(c) that the directorship is held by that other company itself or by a subsidiary of it.

(B) **the latter holds more than half in nominal value of its equity share capital;** "equity share capital" in relation to a company means its issued share capital excluding any part thereof which, neither as respects dividends nor as respects

* See K 2 for group accounts' of holding and subsidiary companies.

capital, carries any right to participate beyond a specified amount in a distribution.

(C) the first mentioned company **is a subsidiary of any company which is that other company's subsidiary;** in determining whether one company is a subsidiary of another,

(a) any shares held or power exercisable by that other in a fiduciary capacity is treated as not held or exercisable by it;

(b) subject to the provisions of paragraphs (c) and (d), any shares held or power exercisable –

(i) by any person as a nominee for that other (except where that other is concerned only in a fiduciary capacity); or

(ii) by, or by a nominee for, a subsidiary of that other, not being a subsidiary which is concerned only in a fiduciary capacity,

is treated as held or exercisably by that other;

(c) any shares held or power exercisable by any person by virtue of the provisions of any debentures of the first-mentioned company or of a trust deed for securing any issue of such debentures is disregarded;

(d) any shares held or power exercisable by, or by a nominee for, that other or its subsidiary (not being held or exercisable as referred to in paragraph (c)) are treated as not held or exercisable by that other if the ordinary business of that other or its subsidiary, as the case may be, includes the lending of money and the shares are held or power is exercisable as aforesaid by way of security only for the purposes of a transaction entered into in the ordinary course of that business.

6. OVERSEAS COMPANIES

Companies incorporated outsid Sri Lanka and carrying on business within Sri Lanka would in common law be entitled to trade or raise capital in this country. If there were no restrictions in the Act or other statutes, it would have been possible for foreigners or even Sri Lankans to form companies abroad and operate here without being subject to controls that apply to Sri Lankan companies. However, the Act contains provisions controlling all companies formed abroad and having places of business in Sri Lanka.

Private, Holding, Subsidiary, Overseas, Guarantee and Unlimited Companies

The provisions of Part XIII of the Act and the stipulations of Companies (Special Provisions) Law of 1974 apply to overseas companies.

By ss. 395 to 404 of the Act, companies incorporated outside Sri Lanka which establish a place of business within Sri Lanka must within one month[1] file with the Registrar of Companies:

(1) A certified copy of the instrument defining the constitution of the company together with a certified translation if not in English.
(2) A list of directors with particulars as required by the Act to be kept of directors in the register of directors of a company.
(3) The name and address of at least one person resident in Sri Lanka, authorised to accept service of notice on behalf of the company.
(4) The full address of the registered or principal office or the principal place of business of the company within Sri Lanka.
(5) A recently certified copy of the Certificate of Incorporation.
(6) Any alteration in the above particulars must be filed.
(7) The company's name[2] and country of incorporation (and, if the liability of members is limited, a statement of that fact) must be stated on every place of business, every prospectus, and on all letter-heads, notices and official publications of the company in Sri Lanka.
(8) Every company must, in every calendar year, make out a balance sheet and profit and loss account, and in the case of a holding company, group accounts, in the same way as would any other company incorporated under this Act, (subject in certain circumstances to prescribed exceptions). These accounts must be laid before a general meeting and a certified copy registered with the Registrar. If any such document is not in the official language, a translation thereof must be annexed, in a language specified by the Registrar.

A company incorporated outside Sri Lanka which has complied with provisions 1 to 5 has the same power as companies incorporated in Sri Lanka under the Act, to hold lands in Sri Lanka: s.396.

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[1] The Registrar may, upon sufficient cause being shown by the defaulting company, extend the period of one month.

[2] If the liability of member is limited it must be stated on all company documents and place of business.

A document is deemed served on the company if it is addressed to any person whose name has been delivered to the Registrar of Companies (see (3) above) and left or sent by post to that address.

When an oversea company ceases to have a place business in Sri Lanka, it must inform the Registrar of Companies.

The failure to comply with any of the provisions of the Act is an offence and the company and every officer or agent of the company, who knowingly and wilfully authorises or permits such default will be liable to a fine not exceeding five hundred rupees, or in the case of continuing offence two hundred and fifty rupees for every day during which the default continues. Any company defaulting, fails to make good the default within 14 days from the date of service of a notice, the court may, on an application made to the court by the Registrar or by any creditor or by any other person who may appear to the court to be interested, make an order directing the company and any officer thereof to make good the default within such times as it may specify.

7. COMPANIES LIMITED BY GUARANTEE

A registered company in which the liability of members is limited to such amount as they respectively undertake to contribute to the assets of the company in the event of its being wound up[3], is a company limited by guarantee: s.2. The memorandum of such a company, in addition to containing the clauses normally contained in a memorandum,[4] must state that each member undertakes to contribute to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for payment of its debts contracted before he ceases to be a member, and of the costs of winding-up and for adjustment of the rights of the contributories, such sum as may be required, not exceeding a specified amount: s.3(3). The sum specified in Table C (a model form of memorandum and articles for a company limited by guarantee and not having a share capital set out in the First Schedule) is Rs.100/-. A draftsman of such articles, provided he follows the general form of Table C is free to add, subtract or vary as required: Gaimann v.

[3] The amounts which the members have agreed to contribute in a winding-up cannot be mortgaged or charged by the company whilst it is a going concern, as they are not assets of the Company whilst it is a going concern: Re Irish Club (1906) W. 127.

[4] See E 2.

National Association for Mental Health.[5]

A company limited by guarantee may be formed either with or without a share capital.

Whether it has a share capital or not, every company limited by guarantee must register articles of association with the memorandum: s.8. If the company has no share capital, the memorandum and articles must be in the form set out in Table C, or as near thereto as circumstances admit. If the company has a share capital, the memorandum and articles must be in the form set out in Table D, or as near thereto as circumstances admit: s.13.

The articles of a company limited by guarantee must state the number of members with which the company proposes to be registered: s.9(2). Table C, art. 2 provides:

> "The number of members with which the company proposes to be registered is 500, but the directors may from time to time register an increase of members".

Any increase beyond the registered number must be notified to the Registrar within fifteen days: s.9(3).

Most companies limited by guarantee are formed to incorporate clubs or professional, trade, educational and research associations. Many companies limited by guarantee take advantage of s.21.[6]

In the case of a company limited by guarantee and not having a share capital, the memorandum or articles or any resolution of the company, cannot give any person a right to participate in the divisible profits of the company otherwise than as a member; and every provision in the memorandum or articles or in any resolution purporting to divide the undertaking of the company into shares or interests is treated as a provision for share capital, notwithstanding that the nominal amount or number of the shares or interests is not specified: s.23.

If the company has a share capital it must make the annual return required by s.120.[7] If it has no share capital, it must in terms of s.121, make an annual return stating –

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[5] (1971) Ch. 317.
[6] See E 9.
[7] See G 12.

(a) the address of the registered office,
(b) the particulars of the directors which are required to be kept in the register of directors,[8]

and annexed thereto must be,

(c) a statement containing particulars of the total amount of the company's indebtedness in respect of all mortgages and charges required to be registered with the Registrar.[9]

If the company has no share capital, a requisition for calling an extraordinary general meeting of the company can be made by the members having at least one-tenth of the voting rights: s.128.

Apart from what has been said, most other provisions applying to companies limited by shares, apply to companies limited by guarantee.

8. UNLIMITED COMPANIES

A company may be registered as an unlimited company, in which case there is no limitation of the members' liability to contribute to the assets for payment of the debts of the company: s.2.

The memorandum and articles of an unlimited company with a share capital must be in the form set out in Table E, or as near thereto as circumstances admit: s.13. The company must register articles with the memorandum: s.8. The articles must state the number of members with which the company proposes to be registered and, if the company has a share capital, the amount of the share capital: s.9. The word "limited" will not of course be included in the name and no limitation of liability clause will be given in the memorandum.

An unlimited company with a share capital must make the annual return required by s.120. To an unlimited company with no share capital, the provisions of ss.121 & 128 apply, (vide Q 7).

An unlimited company may register as a limited company under s.18. The rights, liabilities, obligations, or contracts entered into by the company before the date of registration, however, remain unaffected.

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[8] See L 9.
[9] See M 5.

Private, Holding, Subsidiary, Overseas, Guarantee and Unlimited Companies

If the memorandum and articles authorise, it appears that an unlimited company which has a share capital may reduce its capital without the consent of the court, and if the articles permit, capital may be returned to members, and they may even cease to be members on such terms as may be agreed upon: Re Borough Commercial and Building Society (1893), 2 Ch. 242.

An unlimited company is exceptional in that it's members may be associated on the terms that they may withdraw in the manner specified in the memorandum and articles; and it appears that such a company may validly provide by its memorandum and articles for a return of capital to it's members, i.e. without the consent of the Court; it may purchase it's own shares if it's constitution authorises it to do so: Nelson Mitchell v. City of Glasgow Bank (1879) 6 R (H.L.) 66.[10]

[10] In England since the Companies Act (1981) all companies may include this power in their constitution.

CHAPTER R

WINDING-UP

1. DISSOLUTION

A company may be dissolved by –

(1) **Cancellation of registration** where registration has been improperly granted. Such a dissolution is very unusual, but was resorted to in a case where a company with unlawful objects was inadvertently registered.

(2) **Removal of name** of defunct company from the register.

(3) **Order of Court without winding up** as part of a scheme of arrangement sanctioned by the court; (see P 1, 2).

(4) **Winding-up.**

2. REMOVAL OF NAME OF DEFUNCT COMPANY FROM THE REGISTER

By s.373 if the Registrar of Companies has reasonable cause to believe,

(a) that a company is not carrying on business or is not in operation, or

(b) that in the case where a company is being wound up, either no liquidator is acting or that the affairs of the company are fully wound up, and the returns required to be made by the liquidator have not been made for a period of six consecutive months,

the Registrar of Companies may, after carrying out a specified procedure, strike the company's name off the register, after which it is dissolved and s.374 applies.[1] The specified procedure by s.373(1) to

[1] See R 57.

(4) is as follows – (i) to (iv) in the case of (a) and (iii) and (iv) in the case of (b) –

(i) Send to the company by post a letter asking whether the company is carrying on business.

(ii) If no answer is received within one month, send within the next fourteen days a registered letter, stating that if no reply is received within one month, a notice will be published in the Gazette with a view to striking the company's name off the register.

(iii) If no satisfactory reply is received, send to the company by post and publish in the Gazette a notice, stating that unless cause is shown to the contrary the company will be struck off after three months.

(iv) If cause is not shown to the contrary, strike the company off and publish notice thereof in the Gazette, whereupon the company is dissolved.

Striking the company's name off the register does not affect the liability of any director or member of the company, and the company may still be wound up by the court. s.373(5).

If the company, or any member or creditor thereof, feels aggrieved by the striking off from the register, it or he may, within ten years, apply to the court which, if satisfied that it is just that the company be revived, may order that the name of the company be restored to the register. Upon a certified copy of the order being delivered to the Registrar the company is deemed to have continued in existence as if its name had not been struck off. The court may, by the order, give directions for placing the company and all other persons in the same position as nearly as may be as if the company had not been struck off: s.373(6).

3. WINDING-UP

May be –

(1) **Compulsory**, i.e., by order of the court;

(2) **Under supervision of the court;**

(3) **Voluntary:** s.247.

A voluntary winding-up may be either,

(a) a members' voluntary winding-up, or

(b) a creditors' voluntary winding-up, according to whether the company is solvent or insolvent.

In a winding-up, a liquidator is appointed who takes possession of the company's assets. He collects the assets, pays the costs of the winding-up and the creditors (settling first the preferential creditors, e.g., employees' wages, and then the secured creditors before the unsecured creditors), and distributes any surplus amongst the members according to their rights as defined in the memorandum and articles. The company is then dissolved. Until it is so dissolved its corporate state continues. **The powers of the directors, however, cease** as soon as the winding-up commences.

The procedure in the various methods of winding-up generally differs, except in some matters such as the collection and distribution of the assets.[2]

COMPULSORY WINDING-UP

4. HOW INITIATED

Winding-up by the court is initiated by a petition presented to the appropriate court. The appropriate court is by s.254, the District Court of the district in which the registered office is situated. For the purposes of this section, "registered office" means the place which has longest been the registered office of the company during the six months immediately preceding the presentation of the petition for winding-up.

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[2] These matters are accordingly dealt with together at a later stage under the title of 'provisions applicable to every mode of winding-up' — see R 45 to 57.

5. GROUNDS FOR COMPULSORY WINDING-UP

A company may be wound up by the court if,

(1) the company has by special resolution resolved that the company be wound up by the court;

(2) default is made in delivering the statutory report to the Registrar or in holding the statutory meeting;[3]

(3) the company does not commence its business within a year from its incorporation or suspends its business for a whole year;

(4) the number of members is reduced, in the case of a private company, below two, or, in the case of any other company, below seven;[4]

(5) the company is unable to pay its debts;

(6) the court is of opinion that it is just and equitable that the company should be wound up: s.255.

In Seneviratne v. Seneviratne & another (1982) 2 421 S.L.L.R. a winding-up was pursued on the ground that it was just and equitable. The petitioner, first respondent and second respondent were brothers and shareholders in a company called "Kadirana Mills Ltd." duly incorporated under the Companies Ordinance. The first respondent was sole Managing Director while the second respondent was a Director and Secretary. The petitioner made an application in terms of section 162(6) of the Ordinance corresponding to s.255(6) of the Act to wind up the company.

The District Judge found that there was no mismanagement or oppression but there was disharmony among the brothers who were the

[3] See I 2.
[4] See B 10, Q 2.

shareholders and as a result there was a complete deadlock; the directors could not function and business had come to a complete standstill. On these findings, the District Judge ordered a winding-up, declining to make an order that the shares of the petitioner and the second respondent be purchased by the first respondent. On appeal by the first respondent the Court of Appeal reversed the order of the District Judge. The petitioner appealed to the Supreme Court seeking restoration of the District Judge's order.

Held, that as the business of the company could not be carried on and was not being carried on at the time material to the proceedings, a winding-up order would not be prejudicial to the interest of any one member or members.

The court's power to order a winding-up of a company on the ground that it is **just and equitable** has been exercised where –

(a) The main object of the company had been completely achieved: Pirie v. Stewart (1904) 6 F 847.

(b) The pursuance of the main object of the company had become impossible: Re German Date Coffee Company (1882), 20 Ch.D 169; Re Bleriot Aircraft Co., (1916), 32 T.L.R. 253.

(c) The main object of the company is fraudulent: Re Brinsmead & Sons (1897), 1 Ch. 45 406 (C.A.).

(d) The company is in substance a partnership and there are grounds for dissolving a partnership, e.g., deadlock in the management: Re Yenidje Tobacco Co. Ltd., (1916), 2 Ch. 426, 435. Similarly, when rights of the members are not exhaustively classified in the articles and where the members entered into membership on the basis of mutual understanding and confidence, and the understanding or

confidence is not maintained. Re Westborne Galleries Ltd. (1973) A.C. 360.

(e) The company is a "bubble", i.e., if it never had any business or assets: Re London and County Coal Co. (1866), L.R. 3 Eq. 355.

(f) A preponderance of voting power was permanently vested in a board in whom the minority shareholders had justifiably no confidence: Loch v. John Blackwood, (1924) A.C. 783 (P.C.). S.210 may now provide an alternative in cases of oppression of a minority.[5]

In **Ceylon Textiles Ltd. v. Sir Chittampalam Gardiner** (1952) 54 N.L.R. 313, it was held that,

(a) conflicts between directors which may bring the business to a standstill or may cause irreparable damage to the shareholders are insufficient grounds for winding up under deadlock;

(b) internal questions arising in the working of a company are matters for discussion and settlement in a domestic forum and should be settled by the company itself;

(c) though the language of s.255(f) is wide on the face of it, the courts have acted under this subsection only in the following cases:

(i) where majority shareholders having controlling interest used such power perversely;

(ii) where the substratum has disappeared;

[5] See I 25, N 1 and 2.

(iii) where the deadlock is such that no remedy is obtainable by recourse to the courts.

Further, L. M. D. de Silva, J. said "A shareholder puts his money into a company on certain conditions. The first of them is that the business in which he invests shall be limited to certain definite objects. The second is that it shall be carried on by certain persons elected in a specified way. And the third is that the business shall be conducted in accordance with certain principles of commercial administration defined in the statute, which provide some guarantee of commercial probity and efficiency. If shareholders find that these conditions or some of them are deliberately and consistently violated and set aside by the action of a member and official of the company who wields an overwhelming voting power, and if the result of that is that, for the extrication of their rights as shareholders, they are deprived of the ordinary facilities which compliance with the Companies Acts would provide them with, then there does arise, in my opinion a situation in which it may be just and equitable for the court to wind up the company".

6. INABILITY TO PAY DEBTS

A company is deemed to be unable to pay it's debts when –

(1) a creditor, to whom the company owes a debt of more than Rs. 500/- **has served on the company** a demand for payment, and the **company has for three weeks** thereafter **neglected** to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor; or

(2) **an execution or other process** issued on a judgement, decree or order of any court in favour of a creditor **remains unsatisfied** in whole or in part; or

(3) it is **proved to the satisfaction of the court** that the **company cannot pay its debts;** contingent and prospective liabilities must be taken into account: s.256.

7. WHO MAY PETITION

The petition may be presented by –

1. The **company** itself.

2. Any **creditor** or creditors.

3. Any **contributory** or contributories; or by all or any of the above.

4. **The Official Receiver,** or any of the above, where the company is already being wound up voluntarily and it is shown that such winding-up cannot continue with due regard to the interests of creditors or contributories: s.257(1).

A contributory can present a winding-up petition only if,

(a) the number of members is reduced below the statutory minimum – in the case of a private company below two, in the case of any other company below seven or in the case of a people's company below fifty*; or

(b) all or some of the shares in respect of which he is a contributory were originally allotted to him or have devolved upon him through the death of a former holder, or have been held by him for at least **six** months out of the previous **eighteen** months: s.257(1)(a).

* It would be inequitable to forbid him this right, since it may be his only way of avoiding personal liability under s.33.

A petition for winding up a company on the ground of default in filing the statutory report or in holding the statutory meeting cannot be presented by any person except a **shareholder,** nor before the expiration of fourteen days after the last day on which the meeting ought to have been held: s. 257(1)(b).

In the case of creditors, the court will not give a hearing to a winding-up petition presented by a contingent or prospective creditor until such security, as the court thinks reasonable, for costs has been given and until a *prima facie* case for winding-up has been established to the court's satisfaction: s.257(1)(c).

The Registrar may present a winding-up petition if the company is being investigated under s.166 (vide N 6): s.257(1)(d).

8. POWERS OF COURT ON HEARING PETITION

On hearing a winding-up petition the court may dismiss it, adjourn the hearing (conditionally or unconditionally), make any interim order, or any other order that it thinks fit. The court cannot, however, refuse to make a winding-up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets, or that the company has no assets: s.258(1).

Where a winding-up petition is presented by members of the company as contributories on the ground that it is just and equitable that the company should be wound up, the court shall, where it is of opinion that –

(a) the petitioners are entitled to relief either by winding up the company or by some other means; and

(b) in the absence of any other remedy it would be just and equitable that the company should be wound up,

make a winding-up order, unless it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy: s.258(2).

Where the petition is presented on the ground of default in delivering the statutory report to the Registrar or in holding the statutory meeting, the court, may,

(a) instead of making a winding-up order, direct that the statutory report shall be delivered or that a meeting shall be held, and

(b) order the costs to be paid by any persons who, in the opinion of the court are responsible for the default: s.258(3).

Although the court will usually make an order if a case had been made out (e.g., a creditor for over Rs. 500/- cannot get payment), it may refuse to do so if the majority of the creditors oppose the winding-up e.g., are prepared to accept a composition. The court may also order the petition to stand over for a time if the debt is disputed or the shareholders are taking steps to make the company solvent.

The court may, before making a winding-up order, appoint a provisional liquidator where it is necessary to preserve the assets.

9. POWER OF COURT BEFORE THE WINDING-UP ORDER

After the presentation of the winding-up petition, but before the winding-up order is made, on the application of the company or a creditor or a contributory, the court may grant a stay or restraint of proceedings when any action against the company is pending: s.259.[6] The court would not, however, order a stay of proceedings if it is not just and beneficial to the parties concerned: Vanguard Insurance Co., Ltd. v. Ruhunu Transit Co., Ltd. (1962) 65 N.L.R. 60.

10. COMMENCEMENT OF WINDING-UP

If an order to wind-up is made, the winding-up dates back to the presentation of the petition, unless the company was already being wound up voluntarily, when it dates back to the passing of the resolution to wind up: s.262.

11. CONSEQUENCES OF WINDING-UP ORDER

Upon the making of the order,

(a) a copy of the order must be forwarded to the Registrar of Companies: s.263;

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[6] See R 43.

(b) the order operates in favour of all the creditors and all the contributories of the company as if made on the joint petition of a creditor and of a contributory: s.265;

(c) or on a provisional liquidator being appointed, no action can be proceeded with or commenced against the company except by leave of the court: s.264;

(d) any disposition of the property of the company, and any transfer of shares or alteration in the status of the members, after the commencement of the winding-up, is void unless the court otherwise orders: s.260;

(e) any attachment, sequestration, distress or execution put in force against the estate or effects of the company after the commencement of the winding-up is void: s.261;

(f) the Official Receiver by virtue of his office becomes provisional liquidator, and he continues to act until he or another becomes liquidator: s.272(a);

(g) on the appointment of a liquidator the powers of the directors cease: Fowler v. Broad's Night Light Co. (1893), 1 Ch. 724;

(h) the servants of the company are *ipso facto* dismissed: Chapman's Case (1886) L.R. 1 E;

(i) the company's property and things in action are taken into the provisional liquidator's or liquidator's custody: s.275.

PROCEEDINGS AFTER WINDING-UP ORDER BY COURT

12. OFFICIAL RECEIVER AND HIS DUTIES

The official receiver is any officer attached to the court for insolvency purposes or such person appointed by the Court as Official Receiver for the winding-up concerned: ss.266, 267.

His duties are:

(1) To receive the **statement of affairs:** s.268.

(2) To **summon separate meetings** of **creditors and contributories:** s.272(b).

(3) To **report** to the court of the company's affairs: s.269.

STATEMENT OF AFFAIRS

By s.268, within 14 days after the appointment of a provisional liquidator or after the winding-up order, a **statement of the affairs of the company** must be delivered to the official receiver, unless the court orders otherwise. This statement must be in the prescribed form, verified by affidavit, and must show particulars of the assets, debts and liabilities of the company, the names, residences and occupations of its creditors, the securities held by them and the dates when they were given, and such other information as may be required.

The statement must be made by one or more of the directors and by the secretary or other chief officer or if the official receiver so requires, by other persons, e.g., present or past officers of the company.

The statement is open to the inspection of anyone stating himself in writing to be a creditor or contributory.

13. REPORT OF OFFICIAL RECEIVER

By s.269 where a winding-up order is made, as soon as practicable after he has received the statement of affairs, the official receiver must submit a **preliminary report** to the court,

(a) as to the amount of capital issued, subscribed and paid up and the estimated amount of assets and liabilities;

(b) if the company has failed, as to the cause of the failure; and

(c) whether further inquiry is desirable as to any matter relating to the promotion, formation or failure of the company or the conduct of its business.

If he thinks fraud has been committed in the promotion or since the formation of the company, the official receiver may make a **further report** to the court, and a public examination may be ordered under ss.299 and 300 (see R 19, 20).

14. FIRST MEETINGS OF CREDITORS AND CONTRIBUTORIES

The official receiver must summon the first (separate) meetings of the creditors and contributories of the company for the purpose of determining whether or not application is to be made to the court,

(i) for the appointment of a **liquidator** in place of the official receiver; and

(ii) for the appointment of a **committee of inspection** to act with the liquidator, and who are to be the members of the committee, if appointed: ss.272, 284.

15. LIQUIDATOR

Appointment

The liquidator may be appointed by the court, on application being made after the meetings of the creditors and contributories have been held. If the two meetings do not agree on the person to be appointed, the court will decide the difference and make such order as it thinks fit. If a liquidator is not appointed by the court, the official receiver is the liquidator: ss.270, 272.

A person other than the official receiver who is appointed liquidator cannot act until he has given notice of his appointment to the Registrar of Companies and given security in the prescribed manner to the satisfaction of the Registrar: s.273.

Provisional Liquidator

At any time after the presentation of the winding-up petition and before the making of the winding-up order, a provisional liquidator

(who may be the official receiver) may be appointed by court which may also restrict his powers: s.271.

Powers

S.277 provides that :

(1) The liquidator in a winding-up by the court has power, **with the sanction of the court or of the committee of inspection to –**

(a) Bring and defend actions and legal proceedings in the name and on behalf of the company.

(b) Carry on the business of the company so far as may be necessary for the beneficial winding-up.

When a liquidator carries on the business of the company, he does so as the company's agent and is not personally liable on contracts which he enters into as liquidator: Stead, Hazel & Cooper (1933), 1 K.B. 840.

(c) Appoint an Attorney-at-Law to assist him in his duties.[7]

(d) Pay any classes of creditors in full.

(e) Make a compromise or arrangement with creditors.

(f) Compromise, secure and discharge all calls, claims, debts and liabilities of the company.

(If there is no committee of inspection, the Court may, on the liquidator's application, give authorization required to be given by the committee: s.286.)

(2) On his own responsibility and without obtaining any sanction, the liquidator can –

(a) Sell the property of the company.

[7] Provided that where the liquidator is an attorney-at-law he shall not appoint his partner unless the latter agrees to act without remuneration.

(b) Do all acts and execute, in the name and on behalf of the company, all deeds and documents, and use the company's seal therefor.

(c) Prove in the insolvency of a contributory, or take out letters of administration to the estate of a deceased contributory.[8]

(d) Draw, accept, make and endorse bills of exchange in the name and on behalf of the company.

(e) Raise money on the security of the company's assets.

(f) Appoint an agent to do business which he cannot do himself.

(g) Do all such other things as are necessary for winding up the affairs of the company and distributing its assets.

Further, by s.303[9] the following powers of the court may be delegated to the liquidator subject to court control:

(1) the holding and conducting of meetings to ascertain the wishes of creditors and contributories;

(2) the settling of lists of contributories and the rectifying of the register of members (with court sanction) where required, and the collecting and applying of assets;

(3) the paying, delivery, conveyance, surrender and transfer of money, property, books or papers to the liquidator;

(4) the making of calls (with the sanction of the court or committee of inspection);

(5) the fixing of a time within which debts and claims must be proved.

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[8] The rights and duties of the Public Trustee cannot be affected.

[9] The Minister is empowered by this section to make rules for carrying out the provisions in the section.

The liquidator cannot, as stated, rectify the register of members nor make any call without the sanction of the court or the committee of inspection.

Control of Liquidator's Powers

The liquidator (subject to the provisions of the other sections) must in the administration of the assets of the company and in the settlement of the creditors, have regard to any directions that may be given by resolution of the creditors or contributories at any general meeting, or by the committee of inspection. The directions given by the former shall override that of the latter: s.278(1).

If any person is aggrieved by any act or decision of the liquidator, that person may appeal to the court which may confirm, reverse, or modify the act or decision complained of: s.278(6).

If the liquidator does not faithfully perform his duties or if any complaint is made, the Registrar of Companies must enquire into the matter and take action and if necessary report to the court: s. 282.

Liability of Liquidator

In Latif v. Fernando (1978) 79 2 N.L.R. p-89 it was held, that a liquidator of a company which is being wound up, **cannot be personally liable** for the obligations of the company and no award under the Industrial Disputes Act could have been made against him by the Arbitrator.

Per Sharvananda, J. (referring to the Ordinance),

"According to section 218, a voluntary winding up shall be deemed to commence at the time of passing of the resolution for voluntary winding up; and section 219 provides that, in the case of a voluntary winding-up, the company shall, from the commencement of the winding-up, cease to carry on its business, except so far as may be required for the beneficial winding-up thereof, provided that the **corporate state and corporate powers of the Company shall, notwithstanding anything to the contrary in its articles, continue until it is dissolved.** There is no change of personality. Section 232(2) provides that in the case of a creditor's voluntary winding-up, all the powers of the directors cease on the appointment of a liquidator, except so far as the

committee of inspection, or if there is no such committee, the creditors sanction the continuance thereof. The liquidator assumes all the functions of the directors, but in the performance thereof he is charged with certain special statutory duties of collecting and realising the Company's assets and discharging its debts and liabilities. He is given wide powers for the purpose of winding up the Company's affairs and distributing its assets. The property of the company does not vest in him; the company continues in existence and he administers the affairs of the company on behalf of the company. Before a resolution to wind up voluntarily is passed, the management of the company is in the hands of the officers, the directors; after such a resolution, it is in the hands of its agent, the liquidator and the Company, acting by its agent, the liquidator, carries out its obligations towards its employees."

Books and Accounts of Liquidator

The liquidator must keep books (a) recording the minutes of meetings and (b) other prescribed matters.[10] Such books may be inspected by a creditor, contributory or their agent subject to court control: s.279.

All money received must be paid into the Company's Liquidation Account, unless upon the recommendations of the committee of inspection, leave is given by the court for the sake of convenience, to open an account with another bank. The liquidator may not retain a sum exceeding Rs. 500/-[11] for more than 10 days without court permission, and may not pay sums received by him as liquidator into his private account: s.280.

The liquidator must at least twice a year file an account of his receipts and payments which shall be audited, printed and copies sent to all creditors and contributories by the Registrar of Companies: s.281.

Remuneration of Liquidator

In the matter of the winding-up of the Travancore National and Quilon Bank, Ltd. (1939) N.L.R. 428, it was held –

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[10] Any further matter which the court may require to be recorded in the liquidator's books.

[11] Unless he explains the retention to the satisfaction of the court, he must pay interest on the amount retained in excess at the rate of 20% per annum, and is liable to disallowance of all or part of his remuneration and is open to removal from his office by court; he is also liable to pay all expenses caused by his default: s.280(2).

"The court has power to fix the remuneration of the liquidator of a company, by way of salary or on a percentage basis, after notice to the creditors. The court has also power to make such interim payment as may be prudently made in accordance with the English practice. Any payment so made will be subject to the condition that the whole or part of such amount may have to be repaid if it is found to be irregular at a later stage on an audit of the liquidator's accounts."

The court may, if necessary, require the liquidator to enter into a bond for securing the repayment of any sum that may ultimately be found to be an overpayment.

Section 274(2) has provided for the remuneration of liquidators.

'Where a person other than the official receiver is appointed liquidator, he shall receive such salary or remuneration by way of percentage or otherwise as the court may direct, and, where more such persons than one are appointed liquidators, their remuneration shall be distributed among them in such proportions as the court directs.'

Vacation of Office of Liquidator

The liquidator vacates his office,

(a) on resignation; or

(b) on removal by the court if there is sufficient cause: s.274(1),

(c) on being released.[12]

A release may be granted when he has realised all the property of the company or so much thereof as can be realised, without needlessly protracting the liquidation and has distributed the final dividend, if any, to the creditors and contributories, or has resigned or been removed from his office. The court then requests a report on the accounts to be prepared and on his complying with all the requirements of

[12] An order of court releasing the liquidator discharges him from all liabilities and any default whilst acting as a liquidator; but such order may be revoked if fraud, suppression or concealment is proved: s.283(3).

the court and after consideration of any objection from any interested party, the court may grant release: s.283.

A vacancy in the office of the liquidator is filled up by the court.

16. COMMITTEE OF INSPECTION

The committee of inspection is appointed by the court in the same way as the liquidator: s.284.

The committee consists of a small number of creditors and contributories (or their attorneys). Its function is to assist the liquidator and to inspect and certify the accounts. In certain matters he must obtain their consent. The committee meets at least once a month; the liquidator or any member of the committee may summon a meeting and the quorum is a majority of the members. If a committee member becomes insolvent or absents himself from 5 consecutive meetings without leave, he vacates office. A committee member may be removed by an ordinary resolution of creditors if he represents creditors, or of members if he represents members: s.285(1 to 6).

If there is a vacancy, the liquidator must summon a meeting of the creditors or contributories to fill in the vacancy. However,

"where the liquidator, having regard to the state of the winding up is of the opinion that it is unnecessary for the vacancy to be filled he may make an application to court for an order that the vacancy shall not be filled and the court may make such an order, or an order that such vacancy shall not be filled except in such circumstances as may be specified in the order": s.285(7).

If there is no committee of inspection, the court acts: s.286.

GENERAL POWERS OF COURT IN A COMPULSORY WINDING-UP

17. STAY OF WINDING-UP

On the application of the liquidator, official receiver, creditor or contributory, the court may at any time after the commencement of the

winding-up, if it is satisfied that the winding-up be stayed, order a stay of the proceedings. The official receiver may be required to furnish a report.

A copy of every order made shall forthwith be forwarded by the company, or otherwise as may be prescribed, to the Registrar, who shall forthwith make a minute of the order in his books relating to the company: s.287.

18. CONTRIBUTORIES

Settlement of list of contributories: The court must settle the list of contributories as soon as possible after making the winding-up order. The court may rectify the register of members when rectification is required: s.288.

Extent to which set off is allowed: When computing the amount payable by contributories, if the company owes a contributory some amount, the extent to which the two debts are allowed to be set off is as follows:

(1) If all creditors are not paid in full, in the case of (a) **an unlimited company,** debts due to the contributory not in the capacity of a member of the company, are allowed to be set off; (b) **a limited company** debts due to any director or manager, whose liability is unlimited, a similar set off is allowed.

(2) If all creditors are settled, any money due to a contributory from the company is allowed as a set-off against any subsequent call: s.290.

Creditors excluded from distribution: If a time is fixed for the proving of debts and claims of creditors, any creditor not proving before such time may be excluded from any distribution made before such debts are proved: s.295.

Calls: At any time after the winding-up order the court may make calls on any or all of the contributories for the settlement of the

liabilities of the company and the costs of winding-up, and for the adjustment of the rights of the contributories among themselves. In making a call the court may take into consideration the probability that some of the contributories may partly or wholly fail to pay the call: s.291.

The arresting of absconding contributories: At any time before or after the winding-up order on proof of probable cause for believing that a contributory is leaving Sri Lanka or otherwise to abscond, or to remove or conceal any of his property for the evading of payment of calls, or of avoiding examination, the court may cause the contributory to be arrested and his books, papers and movable property to be seized: s.301.

19. PRIVATE EXAMINATIONS

After the appointment of a provisional liquidator or the making up of a winding-up order, the court may examine on oath any officer of the company or person known or suspected to have in his possession any property of the company or supposed to be indebted to the company, or any person deemed capable of giving information as to the company or its property or affairs. The court may require the answers in writing and require them to be signed. The court may request the production of any books and papers relating to the company in the custody of the person being examined. If a person summoned for examination does not appear, the court may cause him to be apprehended and brought before the court for examination: s.299.

The application for the order for a private examination is generally made by a liquidator or contributory.

20. PUBLIC EXAMINATION

In a winding-up by court, if the official receiver has made a further report[13] stating that in his opinion a fraud has been committed by a promoter, director or official of the company, the court may order

[13] See R 13.

a public examination of such person(s) on an appointed date.[14] The official receiver must take part in the examination and may employ an attorney-at-law. The liquidator and any creditor or contributory may take part in the examination either personally or by an attorney-at-law. A person ordered to be examined must be provided with a copy of the official receiver's further report, and may be represented by an attorney-at-law. Evidence is given on oath and taken down in writing and signed by the person examined: s.300.

21. RESTRAINT OF PERSONS CONVICTED OF CERTAIN OFFENCES FROM MANAGING COMPANIES

In a winding-up by the court, if the official receiver has made a further report[15] stating that in his opinion a fraud has been committed by a promoter, director or officer of the company, on the application of the official receiver, the court may order that that person, director or officer shall not without leave of the court, be a director of or in any way directly or indirectly be concerned in, or take part in the management of a company for a period not exceeding five years. Contravention of such an order results in a fine not exceeding Rs. 5000/- or imprisonment for a period not exceeding 6 months. The person intending to make an application must give at least 10 days notice of his intention to apply for the court order, to the person charged with the fraud: s.186.

22. SPECIAL MANAGER

The court may appoint a special manager[16] of the estate or business of the company on the application of the official receiver when he becomes a liquidator of the company. The special manager must give security and account in the manner the court directs; he will receive such remuneration as fixed by the court: s.294.

[14] The report must make out a *prima facie* case of fraud though the charge need not be such as will support civil or criminal proceedings: Tejani v. Official Receiver (1963) I.W.L.R. 59.

[15] See R 13.

[16] Other than the official manager.

23. DISSOLUTION IN COMPULSORY WINDING-UP

When the affairs of the company have been completely wound up the court shall on the application of the liquidator make a **Dissolution Order.** The company is dissolved from the date of the order. Within 14 days of making of the Order the liquidator must notify the Registrar of Companies: s.304. (A defaulting liquidator is liable to a fine of two hundred and fifty rupees for every day during which the default continues.)

24. SUMMARY OF PROCEDURE ON COMPULSORY WINDING-UP

(1) Presentation of petition.

The appointment of a provisional liquidator (if any).

The staying of legal proceedings by court, if necessary.

Unless the court directs otherwise, the stopping of all transfers of property or shares and the alteration in the status of members.

The stopping of any attachment, sequestration, distress or execution.

(2) Making of the winding-up order.

Official receiver becomes provisional liquidator.

Action stopped, except with the leave of court.

Directors' powers cease.

Dismissal of officers and employees.

(3) Statement of affairs prepared within 14 days of order.

(4) Official Receiver reports to court, as soon as practicable.

(5) Within one month of order first meetings of creditors and contributories held.

(6) Liquidator and committee of inspection appointed.

(7) List of contributories settled.

(8) Assets collected.

(9) Proof of debts settled.

(10) Creditors paid off.

(11) Any surplus returned to contributories.

(12) Company dissolved by order.

VOLUNTARY WINDING-UP

A voluntary winding-up is deemed to **commence** at the **time of passing of the resolution** for voluntary winding-up: s.310.

25. WHEN A COMPANY MAY BE WOUND UP VOLUNTARILY

(1) If the articles provide for the dissolving of the company after a specified period or on the occurrence of a specified event, and such period has lapsed or such event has occurred and the company has resolved in general meeting to wind up in which case an ordinary resolution suffices.

(2) If the company resolves by special resolution.

(3) If the company cannot pay its debts and resolves by extra-ordinary resolution that the company be wound up (i.e., a creditor's voluntary winding-up): s.308.

Notice of winding-up resolution must be given in the Gazette within 14 days of passing of the resolution: s.309.

26. EFFECT OF VOLUNTARY WINDING-UP

On the commencement of the winding-up:

(1) The company **ceases to carry on its business** except for the beneficial winding-up thereof: s.311.

(2) **All transfers of shares are void** unless sanctioned by the liquidator: s.312.

(3) **Any alteration in the status of members** is void: s.312.

(4) **Floating charge**s created within 6 to 12 months preceding the winding-up resolution becomes void, except as to any cash or interest paid (at the legal rate) at the time or subsequently, unless the company was solvent immediately after the creation of the charge: s.350.

On the appointment of the liquidator :

(1) All the powers of the directors cease, but the company in general meeting or the liquidators in the case of a members voluntary winding-up and the committee of inspection or creditors in the case of a creditors' winding-up may sanction the continuance of certain powers: ss.315(2), 326(2).

The corporate state and corporate powers of the company continue until dissolution (notwithstanding contrary provisions in the articles).

27. TYPES OF VOLUNTARY WINDING-UP

Voluntary winding-up may be

(1) a **members'** voluntary winding-up;

(2) a **creditors'** voluntary winding-up.

A voluntary winding-up becomes a members' voluntary winding-up when a declaration of solvency is made, and a creditors' voluntary winding-up when such a declaration is not made.

28. DECLARATION OF SOLVENCY

Such a declaration is made by the directors or a majority of them at a meeting. The statutory declaration must state to the effect that the directors[17] having made a full inquiry into the affairs of the company are of the opinion that the company will be able to pay its **debts in full within** a period not exceeding **12 months** from the commencement of the winding-up; the declaration takes effect only on registration with the Registrar of Companies. The statutory declaration must be made and filed within the 5 weeks preceding the meeting at which the winding-up resolution is passed and must embody a statement of the assets and liabilities: s.313.[18]

MEMBERS' VOLUNTARY WINDING-UP

29. APPOINTMENT AND REMUNERATION OF LIQUIDATOR

Appointment of one or more liquidators are made by the members in general meeting at which the **remuneration** of the liquidators may be determined. If a **vacancy** occurs by death, resignation or otherwise of a liquidator, the company in general meeting may fill the vacancy subject to any arrangement with the creditors (for this purpose a general meeting may be convened by any contributory or the remaining liquidators, if any): ss.315, 316.

30. GENERAL MEETINGS SUMMONED BY THE LIQUIDATOR AT THE END OF EACH YEAR

If a winding-up continues for more than a year, the liquidator **must** summon a **general meeting** of the company at the **end of the first year,** and **each succeeding year,** or at the first convenient date within 3 months from the end of the year at such longer period as the Registrar may allow and lay before the meeting an **account** of his acts and dealings and of the conduct of the winding-up during the year: s.319.

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[17] i.e., the majority of them: s.313(1).

[18] The provisions of s.313 do not apply to a winding-up which commenced before the passing of the Act, in which case the provisions of the Ordinance applies: s. 313(4).

31. FINAL MEETING AND DISSOLUTION

As soon as the affairs of the company are fully wound up the liquidator must present an account of the winding-up showing how the winding-up has been conducted and the property disposed of, at a general meeting of the company. Such meeting must be called by advertisement in the Gazette giving at least one month's notice, specifying the time, place and object of the meeting. Within one week after the meeting, the liquidator[19] must send to the Registrar of Companies (a) the **account** and (b) a **return of the meeting.** On the **expiration of 3 months from the registration of the return**, the company is deemed to be **dissolved**: s.320.[20]

32. DEFERRING DATE OF DISSOLUTION

The liquidator or any other person interested may apply to court to defer the date of dissolution for such time as the court thinks fit. If the court makes an order, the applicants must file a copy of such order with the Registrar of Companies within 7 days of making of the order: s.320.[20]

33. THE OUTLINE OF PROCEDURE IN A MEMBERS' VOLUNTARY WINDING-UP

(1) Statutory declaration of solvency is made and filed.

(2) Notices are issued by the board of directors of an extraordinary general meeting to pass a winding-up resolution (usually a special resolution).

(3) The meeting passes resolution (i) to wind up (ii) to appoint a liquidator (an ordinary resolution suffices).
Company ceases to carry on business except for purposes of winding-up. Corporate existence continues.
No transfer of shares without liquidator's consent.
Powers of directors cease.

(4) Resolution filed with Registrar: s.139. Gazetted within 14 days: s.309.

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[19] A defaulting liquidator is liable to a fine not exceeding three hundred and fifty rupees per day for each day that the default continues.

[20] In a members' voluntary winding-up if the liquidator finds that the company cannot pay its debts fully within the specified period, the winding-up must be conducted as in a creditors' voluntary winding-up: s.321.

Notice of liquidator's appointment gazetted and registered within 14 days: s.335.

(5) (a) The liquidator assumes control.

List of contributories made; assets collected; proof of debts finalised; creditors paid off; residue, if any, returned to contributories.

(b) If the winding-up is for purposes of amalgamation or reconstruction, the liquidator will be authorised by special resolution to sell all or part of the company's business or property for shares in another company, such shares being distributed to the members according to their holdings.

(6) If the winding-up continues for **more than one year**, the liquidator must,

(i) summon general meetings at the end of or soon after the first and each succeeding year, and lay before it an account of his acts and dealings and of the conduct of the winding-up: s.319,

(ii) send to the Registrar of Companies at prescribed intervals the prescribed particulars of the proceedings and position of the liquidation: s.368.[21]

(7) As soon as the winding-up is completed, the liquidator calls a **final meeting** of the company by one month's notice in the Gazette, and submits his final account (showing the conduct of the winding-up and disposal of the property). Within **one week** after the meeting the liquidator must file with the Registrar a copy of the account and a return of the meeting. Three months after registration of the return the company is automatically **dissolved**: s.320.

CREDITORS' VOLUNTARY WINDING-UP

34. MEETING OF CREDITORS

In a creditors' voluntary winding-up the directors must summon a meeting of the creditors to be held on the day or the day after the

[21] Defaulting liquidator is liable to a fine of rupees five hundred for each day during which the default continues.

members' meeting at which the winding-up resolution is to be passed. The notices of the two meetings must be sent simultaneously. The notices of the creditors' meeting must be advertised in the Gazette and at least in two newspapers circulating in the district where the registered office or principal place of business of the company is situate. At the meeting one of the directors must preside, and a statement disclosing fully the company's affairs, the list of creditors and their claims must be laid before the meeting: s.323.

35. APPOINTMENT AND REMUNERATION OF LIQUIDATOR

At the two meetings referred to above, the members and creditors may appoint their liquidator. If the members and creditors appoint different persons the creditors' nominee will be the liquidator. If no person is appointed by the creditors, the members' nominee would be the liquidator. However, within 7 days of different persons being nominated, any director, member, creditor or the company may apply to court for an order either directing that the person nominated as liquidator by the company shall be liquidator instead of or jointly with the person nominated by the creditors, or appointing some other person to be liquidator instead of the person appointed by the creditors: s.324. The creditors may fill any vacancy in the office of a liquidator, except in the case of a liquidator appointed by court: s.327.

The liquidator's remuneration is fixed by the committee of inspection or if there is no such committee, by the creditors: s.326.[22]

36. COMMITTEE OF INSPECTION

At the creditors' meeting, or at a subsequent meeting, the creditors **may** appoint a **committee of inspection** of **not more than 5 persons.** The members may also appoint 5 persons at their meeting or at a subsequent meeting, but the creditors are entitled to object to such appointments, in which case such persons may not act on the committee unless sanctioned by court; the court may, instead, appoint others. The proceedings of the committee of inspection under a creditors' winding-up are the same as under winding-up by court, and the provisions of s.285(2) to (7) apply: s.325.

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[22] See R 16.

37. MEETINGS AND DISSOLUTION

If the winding-up continues for more than a year, the liquidator **must** summon a **general meeting of the company** and a **meeting of the creditors** at the end of the **first year,** and **each succeeding year,** or at the frst convenient date within 3 months from the end of the year or such longer period as the Registrar may allow, and lay before the meeting an **account** of his acts and dealings and of the conduct of the winding-up during the year: s.329.

The provisions are the same as in a members' voluntary winding-up, except that both creditors' and members' **final meetings** must be held **separately** and **within one week** of the later meeting must **file the account and return** with the Registrar of Companies:[23] s.330.

38. THE OUTLINE OF PROCEDURE IN A CREDITORS' VOLUNTARY WINDING-UP

(1) Notices are issued by the board of directors simultaneously for,

   (a) an **extraordinary general meeting** of the company to pass a resolution (usually an extraordinary resolution) for the winding-up of the company,
   (b) a **meeting of creditors** to be held on the same day as the above meeting or on the following day.

(2) **Resolution** to wind-up is passed at the company meeting. The meeting may nominate the liquidator and persons to be members of the committee of inspection.

(3) **Directors' statement of affairs** and the **list of creditors** together with their respective claims are received by the creditors' meeting. The liquidator and members of the Committee of inspection are nominated.

(4) **Liquidator** is appointed and **committee of inspection** appointed subject to court orders.

Other proceedings are the same as 4 to 7 in a members' voluntary winding-up (R 33), except in addition, meeting of creditors are summoned along with the meetings of the company, and except in the case of 5 (b) consent of the court or committee of inspection is also required.

[23] Default in filing accounts and return with Registrar makes the liquidator liable to a fine not exceeding rupees two hundred and fifty for every day during which the default continues: s.330(3).

PROVISIONS APPLICABLE TO EVERY MODE OF VOLUNTARY WINDING-UP

39. LIQUIDATOR

The court has power to appoint a liquidator where there is no liquidator, and to remove a liquidator if cause is shown for such removal: s.334. The liquidator must within 14[24] days of appointment publish in the Gazette and deliver to the Registrar for registration a notice of his appointment; in the case of default, the liquidator is liable to a fine of Rs. 350/- per day for every day during which the default continues: s.335.

Powers and Duties

By s.333 –

The liquidator **may,**

(a) in the case of a **members' voluntary winding-up** with the sanction of an **extraordinary resolution of the company,** and in case of a **creditors' voluntary winding-up** with the sanction of either the **court or committee of inspection** or if there is no such committee a meeting of creditors, exercise any of the powers given in (d), (e) and (f) of s. 277(1) to a liquidator in a winding-up by Court;[25]
(b) without sanction exercise any of the other powers of a liquidator under a winding-up by court;[26]
(c) settle the list of contributories;[27]
(d) make calls;
(e) summon general meetings of the company.[28]

The liquidator **must,**

(a) pay the debts of the company;
(b) adjust the rights of the contributories among themselves;

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[24] The Ordinance required 21 days.
[25] See R 15.
[26] See R 15.
[27] In a voluntary winding-up the liquidator's list of contributories is *prima facie* evidence of the liability of the person named therein as contributories: s.333. (C).
[28] For the purpose of obtaining the sanction of the company by special or extraordinary resolution or for any other purposes.

When several liquidators are appointed powers may be exercised by such one or more of them as may be determined at the time of their appointment, or, in default of such determination by any number not less than two.

40. COSTS AND DISTRIBUTIONS OF ASSETS

All costs, charges and expenses including the remuneration of the liquidator incurred in a winding-up must be paid out of the assets before settlement of all other claims: s.338.

Preferential payments must be settled first, then the liabilities being treated *pari passu* (i.e., ranking equally) and unless the articles provide otherwise the balance distributed among the members in accordance with their rights and interests in the company: s.332.

41. ARRANGEMENTS UNDER A RECONSTRUCTION OR AMALGAMATION

Under a scheme of reconstruction or amalgamation the liquidator is empowered to enter into binding arrangements with the purchasing or transferee company with the sanction of a special resolution:[29] s.317. The same applies in a creditors' voluntary winding-up as in a members' voluntary winding-up except that the liquidator can act only with the sanction of the Court or the committee of inspection: s.328.

42. ARRANGEMENTS BINDING ON CREDITORS

Any arrangement entered into between the company about to be or in the course of winding-up and its creditors is binding,

(a) on the company if sanctioned by an extraordinary resolution; and
(b) on the creditors if agreed to by three-fourths in number and value of the creditors.

Any creditor or contributory may, however, appeal to the court against it within three weeks of the completion of the arrangements: s.336.

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[29] See P 1, 2.

43. POWER TO APPLY TO COURT

The liquidator, a contributory or a creditor can apply to the court to,

(a) determine any question arising in the winding-up;
(b) exercise on any matter the powers the court has under a compulsory winding-up by court.[30]

A copy of an order made staying the proceedings in the winding up shall forthwith be forwarded by the company or otherwise as may be prescribed to the Registrar who must make a minute of the order in his books relating to the company: s.337.

At any time during a voluntary winding-up a creditor or contributory can petition court for a compulsory winding-up. In the case of a contributory, however, it must be proved that the rights of contributories will be prejudiced by the voluntary winding-up: s.339.

WINDING-UP SUBJECT TO SUPERVISION OF COURT

44. PROVISIONS AND EFFECTS

When a company has passed a resolution for voluntary winding-up, the court may order that the voluntary winding-up shall continue subject to such supervision of the court, and with such liberty for creditors, contributories or others to apply to the court, and generally on such terms and conditions as the court thinks just: s.340.[31]

The date of the resolution for voluntary winding-up is the commencement of the winding-up subject to the supervision of the court.

Supervision orders are rare[32] and of little importance because in a voluntary winding-up if creditors and contributories are dissatisfied they can,

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[30] e.g. , (a) The enforcing of calls and (b) the application of s.259 (See R 9) as decided in Vanguard Insurance Co. Ltd. v. Ruhunu Transit: v. Co. Ltd. (1962) 65 N.L.R. 60.

[31] It has been held that the court has an absolute discretion as to the granting of a supervision order and that a creditor is not entitled to such an order as a right: Crawford v. Cowper (1902) 4 Fra. 849.

[32] Only about 2 companies were wound up under supervision of court from 1960 to 1969 (recent statistics are not readily available).

(a) petition for a compulsory winding-up; or

(b) by the powers granted by s.337[33] they can apply to court to determine questions and exercise powers which the court could exercise in a compulsory winding-up.

The main advantage of the supervision order is that no proceedings can be commenced or continued against the company without leave of the court. A petition for the continuance of a voluntary winding-up subject to supervision, is for the purposes of giving the court jurisdiction over actions, deemed to be a petition for winding-up by the court: s.341. Consequently, the court has the s.259[34] power to stay proceedings against the company and under s.264[35] actions are stayed when the supervision order is made. For the purposes of ss.260 and 261[36] winding-up subject to supervision is deemed to be a winding-up by court: s.342.

Another advantage is that where such an order is made, the court may appoint an additional liquidator; the liquidator so appointed is in the same position as if he had been appointed in a voluntary winding-up: s.343.

Effect of a Supervision Order

The liquidator is allowed to wind up the company as in a voluntary winding-up, subject only to any restrictions imposed by the court. The liquidator can exercise all the powers of a liquidator in a voluntary winding-up, but in those cases in which he requires sanction in a voluntary winding-up he requires the sanction of the court (instead of the sanction of an extraordinary resolution of the company), or where before the order the winding-up was a creditors' voluntary winding-up the sanction of the court or committee of inspection or where there is no such committee, a meeting of creditors. The various sections set out in the Eight Schedule which are applicable to a compulsory liquidation are not applicable to a winding-up under supervision. Subject however, to those exceptions, a supervision order is for all purposes deemed to be an order for winding-up by the court: s.344.

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[33] See R 43.
[34] See R 9.
[35] See R 11.
[36] See R 11.

PROVISIONS APPLICABLE TO EVERY MODE OF WINDING-UP

45. CONTRIBUTORIES

In the event of a winding-up of a limited company every past and present member is liable to contribute to the assets of the company to an amount sufficient for the payment of its debts and liabilities, the costs charges and expenses of the winding-up and for the adjustment of the rights of the contributories among themselves s.248(1).

A past member, however, is not liable,

(1) if he ceased to be a member for one year or more before the commencement of the winding-up;
(2) for the debts contracted after he ceased to be a member;
(3) unless it appears to the court that present members are unable to pay the contributions requested of them: s.248(1)(a)(b)(c).

In the case of a company limited by shares, members present and past are **liable only if they own or transferred partly paid shares and only to the extent remaining unpaid on the shares:** s.248(1)(d).[37]

In the case of a company limited by guarantee, a member is liable only to the amount undertaken to be contributed by him in the event of winding-up: s.248(1)(e). In a company limited by guarantee with a share capital, in addition to the above, a member is liable to contribute any sum remaining unpaid on his shares: s.248(3).

Debts due to members as members, e.g., dividends, cannot be paid till all creditors are satisfied, but they can be taken into account in the adjustment of the rights of the contributories among themselves: s.248(1)(g).

In the event of the death or bankruptcy of a contributory his estate would be liable to contribute: ss.251, 252.

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[37] Insurance policies or contracts whereby the liability of individual members' on the policy or contract is restricted, or whereby the company's funds are alone made liable in respect of the policy or contract are valid: s.248(f) .

46. DIRECTORS AND MANAGERS WITH UNLIMITED LIABILITY

In a winding-up of a limited company, they are liable to contribute,

(a) to amounts remaining unpaid on any share held by them;
(b) as if they were the members of an unlimited company at the commencement of the winding-up, unless
  (i) they ceased to hold office for one year prior to the commencement of the winding-up,
  (ii) liabilities were contracted after they ceased to hold office,
  (iii) the court directs: s.248(2).

47. PROOF AND RANKING OF CLAIMS

In **every winding-up** all debts payable on a contingency and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages are admissible as evidence against the company: s.345.

If the company is **insolvent** the bankruptcy rules apply with regard to (1) the respective rights of secured and unsecured creditors (2) debts provable, and (3) the valuation of annuities and future and contingent liabilities: s.346.

48. DISTRIBUTION OF ASSETS

In a winding-up the assets of the company are applicable in the following order –

(1) Secured creditors with fixed charges may settle their claims out of their security, being unsecured creditors for any balance.
(2) All costs, charges and expenses properly incurred in the winding-up, including the remuneration of the liquidator: ss.338, 298.
(3) Preferential debts: s.347 (vide R 49).
(4) Creditors with floating charges.
(5) Unsecured creditors.
(6) Debts due to members as members, e.g., calls paid up in advance and unclaimed dividends.

(7) Repayment of paid up capital.
(8) Surplus to members.

In the two latter instances regard being paid to any priorities to which classes of shareholders are entitled.

49. PREFERENTIAL DEBTS

The following preferential creditors must, by s.347, be paid in priority to all other unsecured creditors:

(a) Income tax and business turnover tax charged or chargeable for one complete year prior to the date of the commencement of winding-up (such year to be selected by the Commissioner General of Inland Revenue in accordance with the Inland Revenue Act, No: 28 of 1979 and Finance Act No: 11 of 1963);
(b) Rates and taxes (other than income tax) due from the company at the date of the commencement of the winding-up and having become due and payable within 12 months next before that date;
(c) Dues to the Government as recurring payments for services rendered;
(d) Wages or salary (whether or not earned wholly or in part by way of commission) of any clerk or servant for services rendered within the preceding 4 months and all wages (whether payable for time-work or for piece-work) of any workman or labourer in respect of services so rendered;
(e) Provident Fund dues, gratuity payments, industrial court awards to any employee or workman;
(f) Compensation payable to workmen under the Workmen's Compensation Ordinance unless such rights to claim from insurers have been already transferred to the workmen or unless the winding-up is merely for purposes of amalgamation or reconstruction;
(g) Accrued holiday payments on the termination of the employment of any employee before or by effect of the winding-up.

The preferential debts rank equally among themselves. If necessary the debts must be paid out of the proceeds of any assets subject to a floating charge.

A person (e.g., a banker) who has advanced money for the payment of salaries or wages to any clerk, servant, workman or labourer employed by the company has the same priority as the persons whose wages are paid out of the money advanced.

50. EFFECT OF WINDING-UP ON TRANSACTIONS

Tittawella, J. in Hire Purchase Co. Ltd. v. Fernando (1978) N.L.R. 79 2 pq 10 at p. 17 –

"As is well known a company comes into existence as a legal personality on its incorporation and ceases to exist as such on its dissolution. Winding up or liquidation is the process whereby the management of the company's affairs is taken out of its directors' hands. A liquidator is appointed to administer the property of the company. He must apply the assets to the payment of the creditors in their proper order. The point to be remembered is that throughout this process of winding-up the company does not cease to exist as a legal entity (*vide* the proviso to section 219 of the Companies Ordinance). "*

* "..... the corporate state and corporate powers of the Company shall, notwithstanding anything to the contrary in the articles continue until it is dissolved" s.219 (Ordinance), s.311 (Act).

(a) On Contracts

The commencement of a winding-up does not put an end to a contract to which the company is a party: Tolhurst v. Associated Portland Cement Manufacturers 1900, (1902) 2 K.B. 660 at 678; Halsbury 3rd ed., vol. 8, p.201.[38]

(b) Fraudulent Preference

A Fraudulent Preference is void.

A Fraudulent Preference is a transaction done,

[38] It was held in Hire Purchase Co. Ltd. & Another v. P. A. C. N. Fernando N.L.R. 79-2-p.15 that a company being in liquidation did not deprive a Labour Tribunal of jurisdiction and making an award against the company's property. The same was decided in Hire Purchase Co. Ltd. v. Tancho (1979) 15 Part I p.15 and in Latiff v. Fernando (1979) II Part I p. 89.

(1) with the intention of preferring one creditor over another;[39]
(2) voluntarily by the company and not under pressure;[40]
(3) whilst unable to meet its debts.

Further,

(4) any conveyance, mortgage, delivery of goods, payment, execution, or other act relating to property which if made or done by or against an individual is deemed in his insolvency a fraudulent preference, if made or done by or against the company is deemed in the event of its being wound up, a fraudulent preference of its creditors: s.348(1),
(5) any conveyance or assignment by a company of all its property to trustees for the benefit of all the creditors is a fraudulent preference: s.348(3).

The sole directors and shareholders of the company were K and his wife. K had guaranteed the company's overdraft. On May 12 the directors were informed that the company was insolvent. Between May 12 and 21 the overdraft was paid up and on May 23 a winding-up resolution was passed. Trade creditors were not paid between the 10 and 23. Held, a fraudulent preference: Re Kushler, Ltd. (1943), Ch.248.

(c) Floating Charges

In a winding-up a floating charge is invalid if –

(1) Not registered within 21 days of its creation: s.91.[41]
(2) Created within 12 months of the commencement of the winding-up (except as to any cash paid to the company upon or after the creation of the charge and in consideration therefor, with interest at the legal rate), unless it is proved that the company was solvent immediately after the creation of the charge. In relation to a charge created more than six months before the appointed date, the provisions of this section shall have

[39] Peat v. Gresham Trust Ltd. (1934) A.C. 252.
[40] Sharp v. Jackson (1899) A.C. 419.
[41] See M 4, 5, 6.

effect with the substitution, for the words "twelve months", of the words "six months.": s.350.

(3) If given as fraudulent preference of its creditors: s.348.

The following claims have a precedence to the floating charge and must be paid out of the proceeds of the assets which are subject to the floating charge,

(i) fixed charges on the same assets.
(ii) preferential creditors.

(d) **Disclaimer of Onerous Property**

When a company is being wound up if any part of its property consists of,

(1) land burdened with onerous covenants; or
(2) unprofitable contracts; or
(3) stocks and shares in companies and property that is unsaleable or not readily saleable because it binds the possessor to the performance of an onerous act or to the payment of money, the liquidator **may**[42] with the **leave of the court** disclaim the property; the disclaimer must be,

(i) in writing, signed by the liquidator; and
(ii) made within 12 months after the commencement of the winding-up or such extension of time as the court may grant, or if the liquidator was not aware of the property within one month after the commencement of the winding-up, within 12 months after his becoming aware of it or such extended period the court may allow: s.351(1).

Operation of Disclaimer:

A disclaimer operates to determine the rights, interest and liabilities of the company in respect of property disclaimed but does not, except for the purpose of releasing the company from liability, affect the

[42] The liquidator may disclaim property, notwithstanding that he has endeavoured to sell or has taken possesion of the property or has exercised any act of ownership in relation thereto: s.351(1).

rights or liabilities of any other person: s.351(2). A disclaimer which would cause substantial injury to other parties will not be allowed by court : Re Katherine et Cie, Ltd. (1932) 1 Ch. 70.

When disclaimer cannot be used:

The liquidator cannot disclaim any property if notice in writing is served on him by a person interested in the property, requiring him to decide whether he will disclaim or not, and he does not within 28 days or further period allowed by the court, give notice that he intends to apply for leave to disclaim; in the case of a contract, if the liquidator does not disclaim within the same time, the company is deemed to have adopted it: s.351(4).

Position and rights of persons affected by disclaimer:

Any person who is, as against the liquidator, entitled to the benefit or subject to the burden of a contract with the company, may apply for a court order rescinding the contract. The court is empowered to grant rescission if it deems fit on any terms, including the payment of damages for breach of contract. Damages granted by the order may be proved for in the liquidation: s.351(5).

On the application of any person interested in the disclaimed property or is under any liability in respect of the disclaimed property, the court may, if certain specified conditions are satisfied, order for the vesting of the property or the delivery of the property to any person entitled thereto, on such terms the court thinks just: s.351(6).

Any person injured by a disclaimer is deemed a creditor of the company to the amount of the injury and may prove for the amount as a debt in the winding-up: s. 351(7).

(e) Execution Against the Company's Property by a Creditor

When a creditor has issued execution against the property of the company or has attached any debt due to the company, he cannot retain the benefit of the execution or attachment against the liquidator, unless the execution or attachment is completed before the commencement of

the winding-up.[43] A buyer, however, who acquires the company's property on which an execution has been levied under a sale by order of the Court, in good faith, acquires a good title against the liquidator. The rights conferred on the liquidator may be set aside by the court in favour of the creditor to such extent and subject to such terms as the court thinks fit: s.352.

51. OFFENCES[44]

Offences by Officers under ss.354, 355, 356

During winding-up, any person, being a past or present officer of the company found guilty of the following offences would be liable to imprisonment for –

(1) a term not exceeding 5 years if during the 12 months preceding winding-up or during winding-up, if he

(a) has by false representation or other fraud obtained property or credit for the company; or
(b) pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid for unless such act has been done in the ordinary way of the business of the company; (persons who **take** in pawn or pledge, or otherwise receives the property knowing of the fraudulent circumstances is guilty of an offence and are liable to imprisonment for a term not exceeding 7 years).

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[43] The receiving of notice of a meeting at which a resolution for voluntary winding up is to be proposed by a creditor, is considered as the commencement of the winding up for the purpose of this section.

[44] SS.359, 360 are procedural only and do not give any new cause for action against officers. S.359 empowers court to examine the persons charged with offences and order repayment or restoration with interest, where necessary. S.360 deals with the manner of prosecution of persons criminally liable: in the case of a winding-up by court, the court may direct the liquidator to prosecute or refer the matter to the Attorney-General; in a voluntary winding-up if the liquidator reports to the Attorney-General, the Attorney-General may take proceedings himself or refer the matter to the Registrar of Companies for investigation, or permit the liquidator, with court sanction, to take proceedings, (the court may on its own motion or on the application of any person interested direct the liquidator to make such report).

(2) a term not exceeding 2 years if during the 12 months preceding winding-up or during winding-up, he
   (a) does not fully disclose or deliver to the liquidator property, books, documents, debts, etc., of the company; or
   (b) conceals, destroys, mutilates, falsifies, alters makes an omission in any book, document or paper or is privy to such act; under certain circumstances, however, the accused has a good defence if proved that he had no intention to defraud, to conceal the state of affairs of the company or to defeat the law: s.354.

S.355 provides a term of imprisonment not exceeding 2 years for the wilful falsification of books, papers, accounts, securities etc.

S.356 provides a term of imprisonment not exceeding 2 years to officers who have fraudulently obtained credit for the company, or who have acted with intention to defraud creditors.

Default in Keeping Accounts

If in a winding-up it is found that proper books of account have not been kept throughout the preceding 2 years or the period between the incorporation of the company and the date of commencement of the winding-up, whichever is the shorter, every officer who is in default is liable on conviction to imprisonment for a term not exceeding one year. They can escape liability if they can show they acted honestly, or that the default was inevitable in view of the circumstances in which the business of the company was carried on: s.357.

Fraudulent Trading

If in the winding-up of a company it appears that business has been carried on with intent to defraud creditors, or others or for any fraudulent purpose, the court, on the application of the official receiver, the liquidator or any person creditor or contributory, may order that any persons who were knowing parties to the fraudulent trading shall be made personally liable for the company's debts and other liabilities without any limitation of liability. Such persons are also liable to imprisonment for a term not exceeding 2 years and/or a fine not exceeding Rs. 5,000/- s.358.

Fraudulent trading occurs when to the knowledge of the directors the company is unable to make payment, but the company carries on business and incurs debts: Re Leitch (William C.) Bros. Ltd., (1932), 2 Ch. 71.

It is not fraudulent trading for a holding company to give false promises of support to a subsidiary. To establish liability the fraudulent trading must be committed by someone carrying on the business i.e., the subsidiary – the fraud of the parent company cannot be linked to the subsidiary: Re Augustus Barnett & Son Ltd. (1986) B. C. L. C. 170.

To be responsible for fraudulent trading and be "parties to " it, as required by s.358, involves some positive steps. Thus the omission by the secretary to advise that the company should not trade as it is insolvent, is not being a party to carrying on business in a fraudulent manner: Re Maidstone Buildings Provisions Ltd. (1971) 1 W.L.R. 1085. However, another creditor who being aware of the situation accepts amounts fraudulently received by the company may be liable to repay even though he did not actually participate in the fraudulent trading itself: Re Gerald Cooper Chemicals Ltd (1978) Ch. 262.

It does not amount to fraudulent trading to prefer one creditor to another, even though all creditors could not be fully settled: Re Sarflax Ltd. (1979) Ch. 592; nor to sell defective goods with the knowledge that liability for such defects cannot be settled: Norcross Ltd. v. Amos (1981) 131 N.L.J. 1213.

52. NOTIFICATION OF LIQUIDATION

During winding-up every invoice, order for goods or business letters containing the company's name issued by the company, liquidator, receiver or manager must **state that the company is being wound-up.** In case of default persons knowingly and wilfully at fault are liable to a fine of Rs. 250/-: s.364.

53. LIQUIDATOR

A body corporate or any director or secretary of the company cannot be a liquidator: s.361.

Any person who gives or agrees or offers to give to any member or creditor any valuable consideration with a view to securing his own appointment or nomination, or to securing or preventing the appointment or nomination of some person other than himself, as the company's liquidator shall be guilty of an offence and shall be liable on conviction to a fine not exceeding Rs. 2,000/- s.362.

If a liquidator defaults in filing, delivering or making any return, account or other document or fails to give any statutory notice within 14 days of service of a notice requiring him to do so, any contributory, creditor or the Registrar of Companies may apply to court for an order enforcing the liquidator to make good the default: s.363.

If the winding-up continues for more than one year after its commencement the liquidator must file with the Registrar of Companies at prescribed intervals, statements containing prescribed particulars with respect to the proceedings and position of liquidation. A defaulting liquidator is liable to a fine not exceeding Rs. 500/- for each day during which the default continues: s.368.

54. DISPOSAL OF BOOKS AND PAPERS

When a company is wound up and is about to be dissolved, the books and papers of the company are disposed of as follows:

(a) In a compulsory winding-up by court – as the court directs:
(b) In a members' voluntary winding-up – as the company by an extraordinary resolution directs;
(c) In a creditors' voluntary winding-up – as the committee of inspection directs or if there is no such committee, as the creditors may direct.

After 5 years from the dissolution of the company there is no responsibility on the company, the liquidator, or any custodian for the books and papers in their charge: s.367.

55. SUPPLEMENTARY POWERS OF COURT

In a winding-up if there is sufficient evidence, the court may have regard to the wishes of the creditors or contributories and may direct meetings to be held to ascertain such wishes: s.371.

56. UNCLAIMED ASSETS AND THE COMPANIES LIQUIDATION ACCOUNT

Money representing assets unclaimed or undistributed for 6 months from the date of their receipt or money such as unclaimed dividends must be paid to the Company's Liquidation Account by the liquidator: s.369(1).

The Registrar is empowered to pursue the collection of such amounts: s.369(2).

Claims may be settled by the Registrar from this fund and dissatisfied claimants may appeal to court: s.369(3), (4).

After fifteen years, unclaimed amounts in the Account will be transferred to the Consolidated Fund. Claims may be settled from the Fund with the sanction of the Minister in charge of Finance: s. 369(5).

57. DISSOLUTION

In a members' or creditors' voluntary winding-up, dissolution occurs automatically 3 months after the liquidator has filed his final account and the return of the holding of the final meeting(s).

In compulsory and supervision winding-up, dissolution takes immediate effect on the making of the Dissolution Order.

Any interested person may, within the 2 years after dissolution, apply to court to declare the dissolution void. If dissolution is declared void any proceedings may be taken as if the company had not been dissolved: s.372. If the company has been struck off the register as defunct the corresponding period is 10[45] years: s.373. When making the

[45] The Ordinance required 20 years.

order for restoration the court may make any order that it thinks fit ; in one case the court directed that debts which had become statute-barred in the meantime after dissolution should rank for payment.[46]

Property of dissolved company to rest in the State

When a company is dissolved all property and rights vested in or held on trust for the company immediately before the dissolution (including leasehold property but excluding property held by the company on trust for others) vests in and is at the disposal of the State, unless an order is made by court, under the provision of ss.372 and 373 (i.e. when dissolution is declared void and in the case of a defunct company): s.374.

[46] Re Kenyon (Donald) Ltd. (1956) W.L.R. 1397.

CHAPTER S

REGISTRAR – SOME OTHER PROVISIONS OF THE COMPANIES ACT

1. REGISTRAR

The Registrar of Companies is the key figure around whom, company law and its application revolves.The duties and powers imposed on the Registrar by statute are wide and of great importance.[1]

The Registrar by s.390, may make a seal or seals for the authentication of documents required for the registration of companies.

Documents, copies of them etc., required by the Act to be delivered or notified to the Registrar may be accepted, registered, recorded or filed by him; he may refuse to do so if he is not satisfied that the provisions of the Act are not fully complied with: s. 391. Fees are payable to the Registrar for registering documents etc. or for recording of any fact required by the Act to be recorded: s.392.

Any person may inspect[2] the documents kept by the Registrar or require copies or extracts of such documents or a certificate of incorporation of any company, on payment of a prescribed fee; documents kept by the Registrar are admissible as evidence as of equal validity with the original document: s.427.

If any document with the Registrar[3] is damaged or becomes illegible the Registrar may request that a further certified copy of such document be sent to him: s.424.

Past and present employees of the Department of the Registrar are prohibited from communicating any information regarding any company, obtained whilst in service, to an unauthorised person. If

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[1] The various duties and powers of the Registrar are referred to in the relevant chapters.

[2] **Only** members and creditors of **private companies** (unless subsidiaries of a public company) may inspect or obtain copies or extracts of any document annexed to an annual return referred to in sections 123 and 124 - See G 12.

[3] S.293 of the Ordinance permits the Registrar to dispose of documents in the prescribed manner, of a company that has been dissolved, after 2 years. The corresponding section in the Act, s.427, makes no such provision. In practice, the Registrar of Companies does **not** dispose of documents in their custody.

found guilty, they would be liable to a fine not exceeding rupees twenty thousand or to imprisonment of not more than one year or to both: s.429.

2. THE FUND

A fund has been created to be administered by the Secretary to the Minister of Trade, in consultation with the Registrar.

Two-thirds of all fees collected by the Registrar must be paid into the fund and one-third into the Consolidated Fund.

Expenses of the Registrar in carrying out his duties under the Act are defrayed from this fund.

The Secretary to the Minister must prepare a report on the Fund's administration and the accounts of the fund must be audited by the Auditor-General: s.425.

3. ADVISORY COMMISSION

By s.422 an Advisory Commission, of not less than five nor more than ten persons may be appointed to advise the Minister on the law relating to companies.

The Registrar is an *ex-officio* member and also functions as the convenor and secretary.

The Commission must,

(i) inquire into and report to the Minister on all matters relating to companies and the law applicable to them as may be referred to it by the Minister;

(ii) periodically review the law relating to companies and make recommendations to the Minister;

(iii) consult trade chambers, professional organisations, monetary institutions, governmental authorities and the general public for their views, where necessary.

The Commission must abide by the Minister's directions: s.422.

4. AUTHENTICATION OF DOCUMENTS AND TRANSLATIONS

A document or record of proceedings requiring authentication by a company must be signed by a director, secretary or an authorised officer. The seal need not be used: s.38 (1).

If any document that is required to be delivered to the Registrar is in a language other than the official language, the Registrar may, if he considers it necessary, request in writing a printed translation in such language as may be decided by the Registrar, duly certified in the prescribed manner to be a correct translation. If the request is not complied with, the Registrar must take no further action on such document: s.38 (2).

5. FALSE STATEMENTS

If any person wilfully, knowing it to be false, makes an untrue statement in any document required by the Act and specified in the Ninth Schedule, he is liable to a fine not exceeding twenty thousand rupees and to imprisonment of not more than one year or to both: s.433.

6. IMPROPER USE OF THE WORD "LIMITED"

Any person or persons, without being incorporated, carries on a business using the word 'Limited' or an abbreviation thereof is liable to a five hundred rupees fine for every day on which the title was used: s.434.

7. SERVICE OF DOCUMENTS ON COMPANY

A document may be served on a company by delivering or posting to,

(a) the registered office of the company;

(b) any director, secretary, manager or other officer of the company;
If for any reason it cannot be served to persons under (b) it may be served in such manner as may be ordered by court: s.442.

For service of documents to companies incorporated outside Sri Lanka and carrying on business within Sri Lanka, see C 5.

The Criminal Procedure Code (Amendment) Act, No. 10 of 1957 s.45 provides –

> "Summons may be served on a corporation by delivery to the secretary or a like officer, or a director, or the person in charge of the principal place of business of the corporation and where it cannot be served in accordance with the preceding provisions of this subsection, may be served on a corporation by delivering it by registered post to the registered office or if there is no registered office, at the principal place of business of such corporation."

In Sirimavo Bandaranaike v. The Times of Ceylon Ltd. (1984) S.L.R. Vol. II Part 9-134, with respect to the service of summons, it was held, that it was the duty of the company to register with the Registrar of Companies the address of its Registered Office.

8. PROVISIONS IN ARTICLES OF ASSOCIATION OR CONTRACTS RELIEVING OFFICERS FROM LIABILITY

Any provision in the articles or any contract exempting or indemnifying any director, manager, officer or auditor of the company from any liability arising from negligence, default, breach of duty or breach of trust is **void**: s.205.

9. SHARES OF NO PAR VALUE

S.3 requires the capital of a company to be divided into shares of a fixed amount, i.e., each share must have a par or nominal value. In some countries such as the U.S.A. and Canada, shares are issued for no par value, i.e., shares are issued for a fixed sum and once the shareholder has paid such sum, his shares represent "proportional rights" in the profits of the company and in its assets on winding-up.

The advantage of no par value shares are –

(a) Re capital: after a company has been in existence for any length of time, the nominal value of the shares rarely bears

any relation to the real value of the shares, and gives no assistance to investors and creditors. For instance, a share issued at Rs.10/- may become worth Rs. 20/- yet its nominal value would remain at Rs. 10/-.

(b) Re dividends: on no par value shares, dividends are stated so much cash per share, whilst in the case of par value shares, dividends are expressed as a percentage of the nominal value of such share, and when the real return is say 6% on the market value of the shares, the dividend will be expressed as 12% of the nominal value, thereby giving rise to a (mistaken) impression that the dividend is high.

(c) Re further issues of shares: in the case of no par value shares further public issues can be made at market value, the cash received being credited to capital account. The prevailing difficulty of marketing a new issue at a discount would greatly disappear.

(d) Re bonus shares: the prevailing system of issuing bonus shares to represent profits ploughed back is often misunderstood and misrepresented, it being usually considered that they are "free" shares. In the case of no par value shares, the shares are merely split or subdivided and it is clear that the splitting merely divides the shareholders' portions into smaller sections, giving rise to no illusions.

CHAPTER T

THE SECURITIES MARKET

1. SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA ACT, (i.e., the Securities Council Act, No. 36 of 1987 as amended by the Securities Council (Amendment) Act No. 26 of 1991), was enacted to,

(i) establish a Securities and Exchange Commission to regulate the securities[1] market;
(ii) grant licences to Stock Exchanges[2], Unit Trusts[3], Stock Brokers[4] and Stock Dealers[5] who trade in securities;
(iii) create a Compensation Fund.

2. THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA[6]

It is a body corporate having perpetual succession, a common seal; it may sue and be sued: s.2.

The members of the Commission are, a Deputy Governor of the Central Bank, the Deputy Secretary to the Treasury, the Registrar of Companies, the President of the Institute of Chartered Accountants and six persons with experience and capability in legal, financial, business or administrative matters appointed by the Minister: s.3. The chief

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[1] "securities" means debentures, stocks, shares, funds, bonds or notes issued, or proposed to be issued, by any Government or of any body, whether corporate or un-incorporate, including any rights, options or interests (whether described as units or otherwise) therein or in respect thereof or any other instruments commonly known as securities, but does not include bills of exchange or promissory notes or certificate of deposits issued by a bank: s. 55 (as amended).

[2] "stock exchange" means a market, exchange or other place at which securities are regularly offered for sale, purchase or exchange, including any services connected with such business: s.55.

[3] "unit trust" is defined in T 11.

[4] "stock broker" means any individual or body corporate engaged in the business of buying or selling of securities on behalf of investors in return for a Commission: s.55.

[5] "stock dealer" means any individual or body corporate engaged in the business of buying or selling of securities or in the dealing or jobbing or trading of securities, or the underwriting or retailing of securities: s.55.

[6] referred to as "the Securities Council" by the The Securities Council Act, No. 36 of 1987.

executive is the Director-General. The members and the chief executive may be removed at anytime by the Minister and such removal is unquestionable in any Court. A member who without leave of the Commission fails to attend three consecutive meetings of the Commission is deemed to have vacated his office; in this event or vacation through death, resignation or removal, the Minister may appoint another to hold office for the unexpired term of office of the vacating member: ss.5, 42 (as amended).

3. OBJECTS OF THE COMMISSION

(a) To create and maintain a market where securities are issued and traded orderly and fairly, and to regulate such market so that professional standards are ensured.
(b) To protect investors' financial interests.
(c) To operate a Compensation Fund to protect investors from financial loss arising from the failure of a licensed stock broker or stock dealer to meet his contractual obligations.

4. POWERS, DUTIES AND FUNCTIONS OF THE COMMISSION

By s.13 (as amended), the Commission is empowered to:

(a) License a body corporate to operate as a stock exchange and give necessary directions periodically, and ensure the proper conduct of its business.

(b) License a body corporate or an individual to operate as a stock broker or dealer and ensure the proper conduct of their business.

(c) License a managing company to operate a unit trust and ensure the proper conduct of the business of such unit trust.

(d) Give directions to a licensed stock exchange, stock broker or dealer, managing company or trustee of a unit trust from time to time.

(e) Grant compensation to any investor who suffers pecuniary loss resulting from the failure of a licensed stock broker or dealer to meet his contractual obligations.

(f) Advise the Government on the development of the securities market and implement the Government's policies and programmes.

(g) Inquire into and conduct regular inspections of the business activities of licensed stock exchanges, stock brokers, stock dealers, unit trusts, and managing companies, to determine whether they are operating in conformity with the provisions of the Act. The Commission must publish findings of malfeasance, and must suspend or cancel the listing of any securities or the trading of any securities for the protection of investors. Suspension of trading must not be for more than three days at a time.

(h) Ensure that annual balance sheets and income statements, certified by qualified auditors are filed by the stock exchanges, stock brokers, stock dealers and managing companies of unit trusts.

(i) Request the Registrar of Companies to call upon a private limited liability company to become a public limited company, under s.227 of the Companies Act, 1982.

All costs of inspection by the Commission must be borne by the stock exchange, stock broker or dealer or managing company of the unit trust.

S. 53 (as amended), in addition, empowers the Commission to formulate the following rules that may be required, from time to time, for ensuring orderly and fair trading in securities and for the protection of investors:

(a) listing of securities in a stock exchange;
(b) disclosure by brokers, and dealers about share transactions and transactions relating to units in a unit trust by persons who acquired or disposed of securities and by a stock exchange about security transactions;
(c) proper maintenance of books, records, accounts, financial statements and audits by stock exchanges, brokers or dealers, or the managing company of a unit trust and the reporting of such particulars to the Commission of their affairs;
(d) regulation of take-overs, or mergers where at least one party is a listed company;
(e) a code of conduct for the trustee and managing company of a unit trust;
(f) matters for which rules are required by the Act to be made.

All rules made must be gazetted; they come into operation on the date of the gazette or such later date as specified therein.

The Seal of the Commission must be affixed to any document only in the presence of one member and the Director-General of the commission, or in the absence of the Director-General in the presence of two members who must sign the document: s.11 (as amended).

5. LICENSING

From the commencement of the Act, no body corporate or an individual can use the words "stock exchange", "stock broker or "stock dealer" or carry on business as a stock exchange, stock broker, stock dealer as the case may be unless such body corporate or individual is authorized to do so by a licence granted under the provisions of this Act. However, any body corporate or an individual who was already carrying on business as a stock exchange, stock broker or stock dealer is entitled to carry on such business without obtaining a licence for a period of three months, or if prior to the expiration of those three months an application is made for a licence, until the licence is granted or finally refused or the application is withdrawn. For contravention of these provisions the liability, after a summary trial before a Magistrate, is a fine not exceeding one million rupees: s.30 (as amended).

SCHEDULE

PART I (Section 16)–as amended

Requirements and conditions to be satisfied for the purpose of granting a **licence as a stock exchange** to a **body corporate are** as follows:-

that the applicant is –

(a) a public limited liability company or an association registered as a company with limited liability under the Companies Act, No 17 of 1982;

(b) having articles of association which do not permit any distribution of profits to members; and which restricts the membership of the stock exchange to brokers and dealers only;

(c) having at least six members who will carry on brokering business in securities independently of and in competition with each other and having at least four members experienced in brokering in securities during the last five years;

(d) engaged solely in the business of operating a stock exchange;

(e) having a Board of Directors and the chief executive consisting of persons of business integrity and consisting of nine members approved by the

commission out of whom not more than five members who are individual stock brokers or stock dealers elected by the general membership and at least four members appointed by the Minister who are recommended by the commission;

(f) by its location and activities to be able to create a more orderly market for securities in Sri Lanka;

(g) financially satisfactory;

(h) having satisfactory provision in its rules for –

(i) admission of members;

(ii) exclusion from membership of persons who are not of good character and not of high business integrity;

(iii) the expulsion, suspension or disciplining of members for conduct inconsistent with just and equitable principles in the transaction of business or for a contravention of or failure to comply with rules of the stock exchange or the provisions of this Act;

(iv) appointment of authorized representatives and clerks;

(v) conditions under which securities may be listed for trading in the market as well as conditions under which the listing of a particular security may be revoked;

(vi) conditions governing dealings in securities by its members;

(vii) timely and accurate disclosure of all material information required for investors to make informed investments decisions;

(viii) the protection of investors in securities from misrepresentation, misleading information, fraud, deceit and other adverse practices in the issue and trading of securities and from the abuse of certain persons of privileged information not yet made available to the general public;

(ix) the prohibition of securities market manipulation of any form including false trading, market rigging etc.;

(x) investigating into trading in securities and financial transactions of stock brokers and stock dealers and for conducting surprise checks on the members;

(xi) suspension of trading of any given security for the protection of investors or for the conduct of orderly and fair trading;

(xii) the conduct of securities trading of stock brokers and stock dealers and the manner in which information relating to such transactions be maintained;

(xiii) ensuring that the customers' funds and securities are segregated from other business of the brokers or dealers;.

(xiv) appointing a disciplinary committee having a majority of members disassociated with any licensed stock broker or dealer;

(i) having in its articles of association, provision for a procedure for removal of stock exchange management officials only by the vote of at least two-thirds of the members.*

* There is a misprint in the Act which states "... two-third of all the men – broker or stock dealer"; officials dealing with these aspects were, therefore, consulted and they confirmed "two-third of members" was correct.

PART II (Section 17)

Terms and conditions to be complied with for the purpose of granting a licence as **a stock broker or stock dealer** to **a body corporate** are –

that the applicant company is a member of a stock exchange licensed under this Act and is incorporated under the Companies Act, No.17 of 1982;

that

(a) the Directors of the applicant company have never been,
  (i) declared bankrupt;
  (ii) themselves, or been directors of a company that has been denied a licence as a stock broker or stock dealer; or
  (iii) themselves or been directors of a company whose licence as a stock broker or stock dealer had been removed by the appropriate authority;

(b) at least one director and at least one employee who will be the chief employee of the applicant company, is certified by a stock exchange licensed under the provisions of this Act, as sufficiently trained in stock exchange operations; and

(e) the applicant company has lodged security in such sum as may be determined by the Minister, having regard to the value of transactions that are likely to be carried on by such applicant or an equivalent in bank guarantee with a stock exchange licensed under the provisions of this Act.

PART III (Section 18)

Terms and conditions to be complied with for the purpose of granting a **licence as a stock broker or a stock dealer to an individual** are that the applicant–

(a) is a citizen of Sri Lanka;
(b) is a fit and proper person and is financially sound;
(c) is a member of a stock exchange licensed under this Act and is certified by such stock exchange as sufficiently trained in stock exchange operations;
(d) has lodged security in such sum as may be determined by the Minister having regard to the value of transactions that are likely to be carried on by such applicant or an equivalent in bank guarantee with a stock exchange licensed under this Act; and
(e) has not been expelled or debarred from membership of any stock exchange licensed under this Act.

No licensed stock broker can be licensed as a stock dealer nor *vice versa*. This restriction also applies to "any holding, subsidiary or an associate company of such licencee or any director of such licencee": s.31.

A licence for a stock exchange is given for five years and to brokers and dealers for one year. Application for **renewal** may be made, together with the prescribed fee, by the former within 6 months

of the expiry of the existing licence, and the latter within 3 months of the expiry of the existing licence. Before granting a renewal of the licence, the Commission must be satisfied that the applicant has at no time contravened any provisions of the Act. s.20 (as amended).

The Council will cancel or suspend the licence granted to a stock broker or dealer if the applicant has:

(a) contravened the provisions of the Act,
(b) ceased to be of good financial standing,
(c) been disqualified,
(d) been guilty of malpractice or irregularity in the management of his affairs.

Before the cancellation or suspension of a licence, the licencee must be given an opportunity to show cause as to why such licence should not be cancelled or suspended. If the applicant's contravention is not of a serious nature the Commission may require the applicant to rectify the condition resulting from such contravention or to comply with the provisions of any relevant statute or to cease from such contravention. The Commission's directions do not affect or prejudice the institution or maintenance of a prosecution against the applicant for an offence under the Act.

If it is subsequently found that the particulars furnished by the stock broker or stock dealer were false, the Commission must suspend for a specified period the license granted requesting the stock broker or stock dealer to supply the correct information within the period of suspension whereupon the suspension may be revoked, otherwise the licence would be cancelled: s.18A (introduced in amending Act).

If the licence is cancelled or suspended the licencee must surrender his licence forthwith to the Commission: s.21 (as amended).

An applicant who has been refused a licence or whose existing licence has been cancelled or suspended, may appeal to the Secretary to the Ministry within 3 months from the date on which the decision was communicated to such person, and thereafter appeal to the Court of Appeal within 14 days. The court is empowered to confirm, revise, modify or set aside the decision of the Secretary: s.22.

6. GENERAL RULES

When a licensed stock broker or dealer ceases to function, the Commission must direct the stock exchange to arrange for another licensed broker or dealer to take over the outstanding contracts relating to the securities of the broker or dealer who has ceased to function: s.23 (as amended).

The management of a licensed stock exchange may be taken over by the Commission from time to time, if it is in the public interest. If so, each period must be Gazetted, as well as any further extension of the period. A copy must be sent to the Registrar. The Commission may appoint a manager, who must take possession of all the assets and administer the stock exchange. During such period all directors and officers cease to function, unless authorised by the Commission. The Commission may request the stock exchange to reconstitute its Board of Directors. After the reconstitution and the expiry of the specified period of management, the Commission must hand over the property taken possession of, to the re-constituted Board: s. 23A (introduced in amending Act).

The **rules** of a licensed stock exchange (in so far as they have been approved by the Commission) must not be amended, varied or rescinded without the **prior** approval of the Commission. Within 21 days of the receipt of the notice to amend the rules, the Commission must give a written notice to the stock exchange stating whether the amendments are allowed or not. Within a further 21 days of the amendment taking effect the Commission may disallow such amendment without prejudice to anything previously done thereunder: s.24 (as amended).

A licensed stock exchange, stock broker or stock dealer is prohibited from changing any particulars that have been furnished in the application or changing its **state** specified in the application without the **prior** approval of the Commission: s.25 (as amended).

A person who contravenes these provisions is liable on conviction after a summary trial before a Magistrate, to a fine not exceeding one million rupees: s.26 (as amended).

A licensed stock broker or dealer cannot lend, borrow or arrange for lending or borrowing on any securities belonging to customers without their written consent: s.27.

Public company shares listed[7] in a licensed stock exchange cannot be sold, bought or gifted except in compliance with the trading procedure adopted by such exchange. A person may, however, gift any share to a relation, (i.e., a parent, spouse, child or spouse of a child) without compliance with such trading procedures if he gives prior notice to the Commission and the stock exchange. On the death of a shareholder, shares of a listed company may be transferred to another **only** with the approval of the Commission. Licensed stock exchange, brokers or dealers are prohibited from misleading or defrauding anyone in the buying and selling of listed securities through the use of devices, actions or statements: s.28 (as amended).

No licensed stock broker or dealer can trade in listed securities outside the licensed stock exchange of which he is a member without the prior approval of the Commission, nor in contravention of the rules of the Commission, in relation to clearance, settlement, payment, transfer and delivery of listed securities; he cannot effect any transaction in a margin account in a manner contrary to the rules of the stock exchange of which he is a member without the prior approval of the Commission, nor deceptively or fraudulently induce the purchase or sale of listed securities; s.29 (as amended).

7. FINANCE

(a) The Fund of the Commission receives its income from:
   (i) monies voted by Parliament, periodically,
   (ii) licence fees paid,
   (iii) donations, gifts, grants, received.

(b) The Compensation Fund grants compensation to any investor who suffers loss due to the failure of a broker or dealer to meet his contractual obligations. The Commission

[7] "listed securities" means securities of any listed public company; "listed public company" means any public company which has its securities listed or quoted on a licensed stock exchange: s.55.

may invest any monies voted by Parliament for this Fund: s.38. A Compensation Committee of three members assess and award compensation. Their decision is final and conclusive: s.39.

An investor suffering loss must apply for compensation within three months: s.40.[8]

8. COLLECTION OF INFORMATION

The Commission or any person authorised by the Commission may request information from any person so as to enable the Commission to exercise, perform and discharge its powers, functions and duties. The request must be in writing and may specify a period during which the returns or information must be furnished. Any person who is so requested must comply unless they are precluded from doing so by another law.

Information obtained by the Commission must not be disclosed to outsiders except with Court permission: s.45.

9. COMMITTEE TO HEAR COMPLAINTS OF SHAREHOLDERS

The Commission is empowered to establish a committee to hear and determine complaints of shareholders of public companies listed in a licensed stock exchange relating to the professional conduct or activities of the stock exchange, its brokers and dealers.

The complaint of a shareholder must be in writing. The committee after considering the case will take such action as it deems expedient in accordance with the provisions of the Act: s.46 (as amended).

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[8] The Committe may require evidence, periodically, and may request the claimant in writing, to attend inquiries. If the claimant fails to comply, the Commission may disallow his claim: s.40 (2) (3).

10. OFFENCES

Anyone contravening the provisions of the Act or furnishes information knowing it to be false, incorrect or misleading or wilfully obstructs a member, officer or servant of the Commission or any person with whom the Commission has entered into an agreement under s. 23A (see T 6) from performing his duties, is liable to a fine of ten million rupees or to imprisonment not exceeding five years or to both. The Commission may, having regard to the circumstances under which the offence was committed, compute the money payable to not more than one-third of the maximum fine imposable for such offence: s.51A (amending Act).

All such fines must be paid into the Compensation Fund (see T 7).

11. UNIT TRUSTS

By s.55 (as amended),

"unit trust" means any arrangement made for the purpose, or of having the effect, of providing for the participation by persons as beneficiaries under a trust, in profits or income and capital gains arising from the acquisition, holding, management or disposal of securities or any other property vested in the trustee of such trust;

"unit holder" in relation to a unit means a person for the time being registered by the trust as the holder of a unit certificate under such unit trust;

"trustee" in relation to a licensed unit trust, means the person appointed as trustee in the instrument creating such unit trust;

"managing company" in relation to a licensed unit trust means a company, incorporated under the law for the time being in force relating to the incorporation of companies or any body corporate established by or under any written law, managing property held by the trustee of such unit trust for the benefit of unit holders of such unit trust;

"connected person" in relation to the trustee or managing company of a unit trust means –

(a) a person owing, directly or indirectly, a prescribed *per centum* or more of the ordinary share capital of the trust company, or managing company, or is able to exercise directly or indirectly a prescribed *per centum* or more of the total votes in the trust company, or managing company;

(b) a company, a prescribed *per centum* or more whose ordinary capital is owned, directly or indirectly, together by the trust company and managing company or a prescribed *per centum* or more of the total votes are exercised directly or indirectly by the trust company and managing company;

(c) a director or officer of the trust company, managing company or a company referred to in paragraph (b).

Part IIIA has been introduced by the amending Act, titled "Grant of Licence to Unit Trust", having ss.31 A to 31 J.

The word 'Unit Trust' or 'licensed unit trust' cannot be used unless permission to operate a unit trust has been obtained from the Commission: s.31 H. No prospectus or advertisement inviting the public to invest in units of a unit trust may be issued without the prior written approval of the Commission: s.31 I.

Granting of licence to operate a unit trust: s.31 B

A managing company intending to operate a unit trust must make an application to the Commission on the prescribed form together with the prescribed fee and prescribed documents: s. 31 A.

By Part IV of the Schedule (which was introduced in the amending Act), for a licence to be granted the following conditions must be fulfilled:

(a) the trustees and managing company of the unit trust in respect of which the application is made, be **separate persons;**

(b) the trustee is **not a connected person** of the managing company;

(c) the **trust deed** creating such trust or the agreement between the trustee and the management company –

(i) sets out the restrictions on the investment of trust property;

(ii) provides that unit holders shall not be required to make any further payment or assume any further liability, except in the circumstances, if any, as are set out in such trust deed;

(iii) sets out the method of calculating the offer and redemption prices of units;

(iv) sets out the circumstances in which the redemption of units can be suspended;

(v) provides for the maintenance of a register of unit holders;

(vi) contains provisions requiring the trustee, the managing company and their connected persons to disclose their interest, whenever any business in which they have a material interest is being discussed at any meeting of the trust;

(vii) provides for the appointment as auditors of the unit trust of persons having the qualifications specified by rules of the Commission and empowers the Commission to require the retirement of such auditors when they cease to possess such qualifications;

(viii) empowers the trustee to dismiss the managing company on the managing company going into liquidation (other than voluntary liquidation) or on the appointment of a receiver in respect of any assets of the managing company or on the trustee being satisfied that a change of managing company is desirable in the interest of unit-holders or on the

holders of at least seventy-five *per centum* of the units issued request the dismissal of the managing company;

(ix) provides for the appointment by the trustee of a successor, immediately on the dismissal of the managing company;

(x) prohibits the trustee from retiring until a new trustee is appointed;

(xi) prohibits the managing company from entering into any under-writing or sub-writing contract on behalf of the trust, except with the approval of the trustee and the Commission;

(xii) prohibits the making or granting of loans out of trust property, except with the consent of the trustee;

(xiii) provides for the approval in writing of the trustee, for any transaction between the managing company or any connected person of the managing company and the trust;

(xiv) does not exempt the managing company from any liability imposed on it by law nor indemnifies it against such liability at the expense of the unit holders;

(xv) provides that the consideration paid duly created units (less any charges that the managing company is entitled to retain) shall become subject to the trust immediately on receipt of such consideration by the trustee;

(xvi) provides that a certificate in respect of units shall be delivered to a third party only on the trustee being satisfied that the consideration paid for such units (less any charges that may be retained by the managing company) has been or will be, vested in the trustee;

(xvii) provides that where any trust property is registered in the name of a lender as security for a loan obtained by the trust the trustee shall be liable for any act or omission of the lender or his agent with respect to such property;

(xviii) prohibits the appointment of a new trustee except with the approval of the Commission;

(xix) specifies the minimum initial investment in units permitted;

(xx) specifies the maximum initial charge which can be levied on the purchase of units;

(xxi) provides for deposit of security by the trustee, guaranteeing against loss due to his misconduct or negligence, where required by the Commission.

Cancellation or suspension of licence: s.31 D

The Commission will cancel or suspend the licence if the trustee or managing company,

(a) has acted in breach of the stipulations of the Act;
(b) has ceased to be of good financial standing;
(c) has been disqualified for the grant of such licence;
(d) is guilty of malpractice or irregularity in the management of their affairs; or
(e) the trustees of a unit trust has dismissed the managing company of the unit trust.

Before the cancellation of the licence, the licencee is entitled to show cause as to why the licence should not be cancelled.

On cancellation the licencee must forthwith surrender the licence to the Commission.

If the contraventions of the trustee or managing company are **not of a serious nature, the Commission may direct,**

i. to rectify or set right the condition resulting from such contravention, or
ii. to comply with the provisions of the Act or to desist from continuing such contravention.

Such a directive by the Commission does not affect or prejudice prosecution against the trustee or managing company for an offence under the Act.

Appeal against a refusal, cancellation or suspension: s.31 E

Any party aggrieved by the Commission for refusing to grant a licence or cancelling or suspending a licence may appeal to the Secretary to the Ministry of the minister against such refusal, cancellation or suspension, within three months from the date on which the decision is communicated to such person.

The Secretary may require the Commission to show cause for its decision and must within three months of the receipt of such appeal, communicate his decision to the applicant.

The applicant may appeal against the Secretary's decision to the Court of Appeal within fourteen days from the date on which the decision is communicated to the applicant.

The Court of Appeal can confirm, revise, modify or set aside the decision of the Secretary and make any order.

Amendments of a trust deed: s.31 F

A trust deed cannot be amended without the prior written approval of the Commission.

On receipt of the proposed amendments, the Commission must within twenty days give a written notice as to whether the amendments are allowed or disallowed, and if disallowed giving the reasons therefor.

Liabilities: s.31 J

Notwithstanding anything in the Trust Ordinance or any other law, a trustee of a licensed unit trust is **not** liable for any breach of trust arising from any act of the managing company of such unit trust if,

(a) such act was done without obtaining the concurrence of such trustee;
(b) such act was done after obtaining the concurrence of such trustee and such concurrence was given, in good faith, on the faith of any written statement or representation made to such trustee by such managing company as to any matter relating to trust property or on the faith of any professional advice obtained by such managing company independently of such trustee.

However, a trustee is liable for a breach of trust which has been occasioned by fraud or negligence.

Inspection by the Commission

In addition to the powers set out in T 4 (above), the Commission can require the managing company of a unit trust to file with the Commission, in respect of every year, at least two reports of the activities of that unit trust for that year. The report must contain the prescribed particulars. The first report must be filed before the 30th September of that year and the second report before the 31st March of the subsequent year: s.14(3).

The Regulations on **insider dealing** in the Securities and Exchange Commission of Sri Lanka Act, are dealt with in Chapter O.

INDEX

The subject titles are followed by references that comprise the chapter letter and topic number. Thus accounts, reference K 1 – 7 are dealt with in topic numbers 1 – 7 inclusive, in chapter K.

Index

WICKREMASINGHE'S

COMPANY LAW OF SRI LANKA

Revised, 2nd Edition

Kimarli Wickremasinghe

Wickremasinghe's **Company Law of Sri Lanka** was the first, and with publication of this second edition, still is the only book available covering the entire law relating to companies in Sri Lanka. This book gives a comprehensive coverage of all statutory provisions as well as a wide spectrum of relevant case law, both in Sri Lanka and in other countries. The statutes include all the legislation on companies from inception to date, e.g. the Companies Ordinance of 1853 and the Companies Act No. 17 of 1982, as well as relevant provisions of other statutes affecting companies – the Finance Act, Exchange Control Act, Banking Act, Inland Revenue Act, Stamp Duty Act and the Penal Code. The Securities Council Acts are studied in great detail in two separate chapters, "Insider Trading" and "Securities Market". The provisions governing overseas companies operating in Sri Lanka, Sri Lankan companies trading overseas, the purchase of securities by foreigners, and other recent developments are included.

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Extracts from the Foreword by Mr. G. F. Sethukavaler, *President's Counsel*
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