CEYLON COMPANY LAW

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CEYLON COMPANY LAW

AYOMA, INDULEKA, WICKREMASINGHE,
A.C.I.S., A.C.C.S.

TO MY MOTHER AND FATHER
WHO HAVE DONE SO MUCH FOR ME

CONTENTS

FOREWORD

THIS book is designed for students of legal and professional examinations and for those in trade, commerce and industry : great detail in case law has been avoided as it would render the subject cumbersome and hence of little practical use to such persons. To those in the legal profession this book would be useful only as a primary reference because of the lack of greater detail and example in case law.

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 resolutions 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 as application and practice of company law is a separate subject commonly referred to as Company Secretarial Practice.*

Mr. Tivanka N. Wickremasinghe, Advocate of the Supreme Court very kindly helped in the compilation and revision. Without his contribution and clarification of many points of law the book would have taken much longer than the three years it took to complete.

The late Mr. H. V. Perera, Q.C., must be remembered with gratitude for the encouragement given and improvements suggested during the early stages of the manuscript. His advice not to overburden the subject matter with too much case law and thus retain the practical value to students and those in trade, commerce and industry, I have endeavoured to follow. I am sorry he is not here to see the book in print.

Mr. J. W. Subasinghe, Advocate of the Supreme Court, must be thanked for making his library available for reference.

Appreciation is due to the Department of the Registrar of Companies for providing the necessary data and statistics, whenever required.

The bulk of the typing was done by Mrs. Therese Jansz, excellently, from almost indecipherable matter.

The dealings with the printers were pleasant. They were efficient and caused the minimum of trouble and delay.

The proof reading was facilitated by my husband, mother and a few others who must be thanked for sacrificing so many hours of their time.

The encouragement given by many, was invaluable.

A. I. W.

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* A book on Company Secretarial Practice should be undertaken by someone dealing with the subject in practice as it would be useful to many.

TABLE OF CASES

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CHAPTER A

HISTORY OF THE REGISTERED COMPANY

Ceylon 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 enacted. 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 existing law 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 every year. The Act required the auditors of public and ordinary

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

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, which is the Act now in force in England abolished the Exempt Private Company and required still greater detailed information in the annual accounts especially in regard to directors.

In **Ceylon,** 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 provisions 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.

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.[3] The penalty on associations of more than 20 persons carrying on business was 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 oversea Companies to carry on business in Ceylon were introduced by Ordinance No. 7 of 1918.

[2] No. 4 of 1861.

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

History of the Registered Company

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 Ordinances, 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 it's 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 as 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 is the law now in force. 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 objection given to certain members and debentures 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 is 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.

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[4] See M 1

[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.

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 it's own money and property, engage workers, borrow and owe money and enter into contracts like an individual. Law regards a registered company as a person just as it regards human beings like Mr. Dharmasena or Mr. Perera.

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 it's 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 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.

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 a company

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

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 9).

2. WHAT IS A 'REGISTERED COMPANY'?

A registered company is one registered under the Companies Ordinance.

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

Ordinances No. 6 of 1939
19 of 1942
54 of 1946

and Acts 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.

Reference in this book to 'Companies Ordinance' or 'Ordinance' is to be taken, therefore, as reference to the Companies Ordinance (Chapter 145) as amended by the Companies (Amendment) Act, No. 15 of 1964.

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).

[2] In the year 1966/67 (the latest figures available up to publication) registration of companies was as follows: public companies with limited liability–42, private companies with limited liability — 248, companies limited by guarantee—4 unlimited companies—nil.

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

The greatest number of companies are registered as limited liability companies.

A registered company may be a public company or a private company. A private company is a registered company which by it's articles contains the restrictions of s. 27,

(a) restricts the right to transfer it's shares; and

(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 determination of that employment to be, members of the company; and

(c) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

4. OBLIGATION TO REGISTER

An association of more than twenty persons and ten in the case of banking business formed to carry on business for the acquisition of gain*, whether by association or by it's members individually must be registered under the Ordinance unless it is otherwise incorporated: ss. 348, 334.

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 the company, association or partnership unregistered;

(c) Unable either individually as members, or collectively as an association, to sue each other or outsiders to enforce a contract or the payment of debts.

[3] If two or more persons hold one or more shares in a company jointly, they are treated as a single member: s. 27(2).

However, money given to a treasurer may be recovered, and a servant found dishonest can be prosecuted to conviction.

*Whether an association is carrying on business for gain depends on the facts and circumstances of each case. Thus, an association trading only with members and distributing it's profits would be trading for gain.

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 whereon a 'Certificate of Incorporation' is issued by the Registrar, and the company comes into existence on the date of the certificate.

(a) The documents required to be filed are:

(1) **Memorandum** of Association.

(2) **Articles** of Association.

(3) **Statement of Nominal Capital,** upon which the capital duty (as per Ninth Schedule) will be assessed.

(4) **A Statutory Declaration** by a proctor of the Supreme Court engaged in the formation of the company, or by a person named in the articles as a director or secretary of the company, of compliance with the requirements of the Ordinance.

and, except in the case of a private company,

(5) **List** of persons who have consented to be directors.

(6) Their **consents** to act as such.

(7) Their **undertakings** to take and pay for their qualification shares, if any, unless they have signed the memorandum as subscribers for a sufficient number.

Further, the following must be filed,

(i) Notice of the situation of the registered office must be filed within 28 days of incorporation or from the day on which the company commences to carry on business, which ever is the earlier: s. 91.

(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. 142.

[4] See K 9.

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

6. 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 Ordinance as to registration, and as to matters precedent and incidental thereto, have been complied with, and that the company is duly registered under the Ordinance. 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. 14, 16.

7. 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. 14.

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

* A public company cannot commence business until the requirement of s. 93 (see B 8) have been complied with.

8. COMMENCEMENT OF BUSINESS

By s. 93,

(a) A company formed as a **private company,** and any company without a share capital, may commence business immediately on receiving it's 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).

A certificate (i.e., a trading certificate) will be issued[5] if,

[5] In the year 1966/67 (the latest statistics available up to publication) the number of certificates issued to commence business was,
(a) where a prospectus was filed—two
and
(b) where a statement in lieu of prospectus was filed—eleven.

(i) Where a prospectus is issued, a **statutory declaration** by a director or a secretary has been filed declaring that:—

(1) Shares payable wholly in cash have been **allotted** to an amount not less than the **minimum subscription**;[6]

(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; and

(ii) Where the company has not issued a prospectus, a **statement in lieu of prospectus** and a **statutory declaration** 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, have been 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. 93 is liable to a fine not exceeding Rs. 500/- for every day during which the contravention continues.

9. MEMBERS - STATUTORY MINIMUM

The ordinance demands a minimum of,

7 members for a public company,
2 members for a private company: s. 2(1)

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. 29. The effect of s. 29, is that limited liability continues for six months. 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. 162.

10. REGISTERED COMPANIES AND PARTNERSHIPS CONTRASTED

	Limited Companies	Partnerships
Creation	By registration of documents with the Registrar and the payment of fees etc.	By agreement, express or implied.

[6] See E 3.

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 being formed.
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 and 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 some 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.
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 Ordinance.	There is very little statutory control, partnerships being practically free from such regulation.

[7] See B 4
[8] See B 1

CHAPTER C

PROMOTERS: CONTRACTS: SEAL

1. PROMOTERS: 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]

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.

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 if a promoting syndicate, if he has personally taken an active part in the promotion.[2]

POSITION OF PROMOTERS

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.

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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
3 Kelner v. Baxter (1866) L.R. 2 C.P. 174
4 Omnium Electric Palaces, Ltd. v. Baines (1914) 1 Ch. 332

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 reselling 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 judgment on the transaction'.[6]

4. DUTY OF DISCLOSURE

Disclosure by 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 (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 Hanely 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] Reynell v. Lewis (1846) M. & W. 517
[6] *Per* Lord Cairns L.C. in Erlanger's case.
[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.

5. REMEDIES FOR BREACH OF DUTY

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

(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 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. 67 which states '. . . . . the directors may pay all expenses incurred in getting up and registering the company . . . ' such articles, however, give no right to promoters to sue for promotion expenses since it confers a discretion on 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: Fourth Schedule.

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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.

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

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. 206, and where a public examination is ordered under s. 207 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. 264.

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: secs. 141A & 208.

CONTRACTS

9. PRE-INCORPORATION OR PRELIMINARY CONTRACTS

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

The general effect of preincorporation contracts are,

(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 preclude 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.

(3) 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 it's 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.

10. PROVISIONAL CONTRACTS

Vide B 8.

11. FORM OF CONTRACTS ENTERED INTO BY A COMPANY

Sec. 30 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 authorized persons*
Contracts by parol	By parol by authorised*person

*Authorization may be express or implied.

12. COMMON SEAL

Every Company must have a common seal on which it's name must be legibly engraved: ss. 14, 92.

The company's articles give the manner in which the seal should be affixed and provides for it's safe custody. Table A, art. 71 states,

"The seal of the company shall not be affixed to any instrument, except by the authority of a resolution of the board of directors, and in the presence of a director and of the secretary or such other person as the directors may appoint for the purpose; and that director and the secretary or other person as aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence".

A company is **not bound** if the seal is affixed without it's authority by a secretary: Ruben 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) may appoint as **attorney** (in writing under it's common seal) to use the attorney's own seal on behalf of the company: sec. 32; 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: sec. 33.

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[13] See D 21

CHAPTER D

MEMORANDUM OF ASSOCIATION: ARTICLES OF ASSOCIATION

1. MEMORANDUM OF ASSOCIATION

The Memorandum of Association is the registered company's charter and defines it's constitution and powers. It informs shareholders, creditors and all persons dealing with the company, what the company's objects are, it's 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 it's internal activities.

The Memorandum must be registered with the Registrar of Companies: s. 13. It must bear a stamp to the value of Rs. 50/-: s. 4.

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 of a company limited by shares or by guarantee.

(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 it's 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 at least one witness;

(b) be stamped to the value of Rs. 50/-: s. 4, 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.

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).

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, the conveyance of passengers and goods in ships or boats between such places as the company may from time to time determine, and the doing all such other things as are incidental or conducive to the attainment of the above object.

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. John Jones of . . . . . .merchant	200
2. John Smith of . . . . .merchant	25
3. Thomas Green of . . . .merchant	30
4. John Thompson of . . . .merchant	40
5. Caleb White of . . . . . .merchant	15
6. Andrew Brown of . . . .merchant	5
7. Ceaser White of . . . . .merchant	10
Total shares taken	325

Dated the ..... day of ....., 19.....

Witness to the above signatures,

A.B., No. 20, Main Street, Colombo.

3. ALTERATION OF THE MEMORANDUM

A company may alter the conditions contained in it's memorandum **only** in the cases, in the mode and to the extent for which express provision is made in the Ordinance: s. 5,

The following alterations are permitted:—

(1) change the objects: s. 6.

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

(3) create reserve liability: s. 50.

and, **if authorised by the articles,** to:

(4) increase, consolidate, sub-divide, cancel or otherwise alter the share capital: s. 51.

(5) reduce the share capital, subject to the confirmation of the court: s. 56.

(6) make the directors' liability unlimited: s. 145.

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. 23.

Other clauses included in the memorandum may be altered by any method set out in the clause—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 G 9.

4. ALTERATION OF OBJECTS

A company is permitted, by s. 6 to alter it's objects to—

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

(b) attain it's main purpose by new or improved means;

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

(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 of persons.

The alteration must be effected by **special resolution,** and subject to the **confirmation of the 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 of any class, 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 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 forthwith give notice 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 it's order, file a copy of the order together with a copy of the memorandum, if altered.

5. THE OBJECTS CLAUSE AND THE MAIN OBJECT

The memorandum must have a clause giving the objects: s. 3

Main Object:

When there are several objects in the objects clause, it may appear that one or some are the main or principal objects and the rest are subsidiary clauses and may be construed as such.

"Where a memorandum of association expresses the objects of the company in a series of paragraphs, and one paragraph or the first two or three paragraphs, appear to embody the 'main object' of the company, all the other paragraphs are treated as merely ancillary to this 'main object' and as limited or controlled thereby. The principal purpose of this rule is for the protection of shareholders so that they may know how the money they invest is to be used."[1]

If the main object fails, the substratum of the company is said to fail and the company may be wound up:

A company's objects clause provided that the main object was to manufacture coffee from dates using a German patent. Subsequently, the company being unable to obtain the German patent functioned on a Swedish patent. Held, the company's substratum had failed and the company must be wound up: Re German Date Coffee Co. (1882) 20 ch. D. 169 (C.A.).

Petition for winding up on the grounds that the substratum had failed may only be presented by a shareholder. Shareholders are, however, **not bound** to petition if the substratum has failed.

When a company has many objects in the objects clause, it may be provided that all objects shall rank equally in importance and that each is to be regarded as the main clause, in which case there is no such thing as the main clause and all clauses rank equally: Cotman v. Brougham (1918) A.C. 514.

[1] *per* Salmon J. in Anglo Overseas Agencies, Ltd. v. Green (1961) 1 Q.B. 1

6. 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 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 to do also 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*".[2] 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.

7. 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".[3]

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".[4]

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

8. NAME

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

(a) If the company is limited, the last word in the name must be "Limited": s. 3, unless the company has a licence as an "association not for profit": s. 19. If the company is not

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2 *per* Lord Selbourne L.C. in Attorney-General v. G. E. Railway Co. (1880) 5 App. Cas. 473.

3 Charlsworth's Company Law, Eighth Edition.

4 York Corpn. v. Henry Leetham & Sons, Ltd. (1924) 1 Ch. 557.

limited it cannot add 'limited' or an abbreviation thereof, to it's name, if not it would be liable to a fine not exceeding Rs. 50/- per day for every day during which such title was used: s. 350.

(b) The company may not be registered by a name which is in the opinion of the registrar of companies undesirable: s. 18.

Apart from the above statutory provisions, if the name is too much like that of a person or firm carrying on a similar business as to deceive, the latter **may** obtain an injunction restraining the registration or preventing the company from using it.

In Ceylon Insurance Co. Ltd. v. United Insurance Co. (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.

9. CHANGE OF NAME [5]

By s. 20,

(a) A company may at any time change it's 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.

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

10. PUBLICATION OF NAME

The company's full name must appear **legibly** and **conspicuously** in the case of (i)

(i) outside every office or place of business;

(ii) on it's seal;

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

in the event of default, the company and officers are liable to default fines and the directors, officers etc., responsible are personally liable on the contracts bills of exchange etc., unless they are duly paid by the company: s. 92.

[5] **From 1960 to 1967 (the latest years for which figures were available up to publication) the names of about 25 companies were changed.**

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

11. ASSOCIATIONS NOT FOR PROFITS

An association not for profit is one formed to promote art, science, charity or other useful object which applies it's income in promoting it's objects, and prohibits the distribution of profits to members: s. 19.

Such an association may obtain the Registrar of Companies' permission to be registered as a limited liability without the addition of the word 'Limited' to it's name: s. 19.[6]

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 it's name and of sending lists of members to the Registrar of Companies (i.e., with the Annual Return): s. 19.

The Registrar of Companies may revoke the licence on giving the company notice and an opportunity to object: s. 19.

12. REGISTERED OFFICE

A company must, as from the day on which it commences business or as from the 28th day after the date of it's incorporation, which ever is earlier, **have** a registered office to which all communications and notices may be addressed: s. 91(1).

Notice of the situation of the registered office, and of any change therein must be given to the Registrar of Companies within twenty-eight days of incorporation or the change as the case may be: s. 91(2).

A company may, by special resolution and the sanction of the Registrar of Companies, **change** the situation of it's registered office, to any district whether or not it is a district specified in the memorandum as the district in which such office is to be situated. Notice of the change must be given to the Registrar within 14 days of the resolution. If the Registrar refuses to sanction, the company may appeal to the Permanent Secretary whose decision shall be final: s. 91(3).

The registered office is of significance from two points of views:—

(a) A document may be served on a company by leaving it or sending it by post to the registered office: s. 357.[7]

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

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[6] From 1960-1967 (the latest year for which figures were available up to publication) the Registrar of Companies allowed about 6 companies to omit 'Limited' from it's name.

[7] see P 2 for other ways of service of documents to the company.

(1) Register of Members: s. 97.
(2) Register of Directors: s. 142.
(3) Register of Charges: s. 87.
(4) The Minute Books of General Meetings: s. 119.

Further, copies of instruments creating charges requiring registration must be kept at the registered office: s. 86.

13. LIABILITY CLAUSE

In compliance with s. 3 a liability clause merely states that the liability of members is limited whether the liability of members is limited by shares or by guarantee.

14. CAPITAL CLAUSE

The nominal or authorised capital is set out and it's division into shares of 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. 51, and reduced by a special resolution with the confirmation of the court under s. 56, and no special provision in the memorandum is necessary.

15. 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.

16. 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: s. 2), 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.

17. THE SUBSCRIPTION

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

The subscribers must take at least one share. Each subscriber must write opposite his name the number of shares he takes and must sign in the presence of at least one witness who must attest his signature: ss. 3, 4.

18. 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 it's constitution, and proceeds 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, dividend, accounts, audit and winding-up.

Articles **may** in the case of a company limited by shares and **must** in case of a company limited by guarantee or unlimited be registered with the memorandum and signed by the subscribers to the memorandum: s. 7.

For articles of unlimited and guarantee companies see P 5, 6.

Articles may adopt all or any of the regulations in Table 'A': s. 9(1). Table 'A' in the First Schedule is a model form of articles for a company limited by shares; private companies may not, however, adopt Table 'A' since the provisions of s. 27, applicable to such companies is not contained in the Table A. Thus a public company limited by shares may—

(1) adopt Table 'A' in full;
(2) adopt Table 'A' subject to modifications; or
(3) register its own articles and exclude Table 'A'.

If a public company limited by shares does not register articles or if articles are registered in so far as they do not modify or exclude Table 'A', Table 'A' will automatically be the Company's articles: s. 9(2).

19. PRINTING ETC. OF ARTICLES

Articles must,

(1) be printed;
(2) be divided into paragraphs numbered consecutively;
(3) bear a ten rupee stamp;
(4) be signed by each subscriber of the memorandum in the presence of at least one witness who must attest the signa-

[13] render v. Lushis. 10.
[14] Wood v. Odessa
[15] Eley v. The Posit
[16] Rayfield v. Hands

Articles of Association must be registered with the ir of Companies: s. 13.

20. ALTERATION OF ARTICLES

Subject to the provisions of the Ordinance and to the conditions of the memorandum, the company may by **special resolution** alter or add to it's articles. Any alteration or addition to the articles, subject to the provision of the Ordinance is as valid as if originally contained therein and is subject in like manner to alteration by special resolution: s. 11. A company cannot deprive itself of the power to alter it's 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 s. 153A and 153B, without leave of the court: s. 153G.

(5) In the case of a private company not remove the restrictions applicable to private companies.

(6) Be made *bona fide* for the benefit of the company as a whole,[9] i.e., each member must act upon what in his honest opinion, is for the benefit of the corporate body.[10]

Further,

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

(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. 23;

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9 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 interfere 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 as a whole, it is immaterial even if it inflicts hardship on the minority: Sidebottom v. Kershaw, Leese & Co. Ltd. (1920) 1 Ch. 154 (C.A.).

10 Greenhalgh v. Arderne Cinemas Ltd. (1951) 1 Ch. 286.

(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. 62.[11]

21. 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. 21. 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 it's members are to be referred to arbitration, the members cannot sue the company regarding any matter concerning them as members.[12]

(2) Although s. 21 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, the member is entitled to such vote[13] and can restrain the company by injunction from acting contrary to the articles.[14] 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.[15]

(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.[16]

(4) Articles do not constitute a contract between the company and the 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

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[11] see G 9.

[12] Hickman v. Kent or Romney Marsh Sheep-Breeders Association (1915) 1 Ch. 881.

[13] Pender v. Lushington (1877) 6 Ch. D. 70

[14] Wood v. Odessa Waterworks Co. (1889) 42 Ch. D. 636.

[15] Eley v. The Positive Life Assurance Co. (1876) 1 Ex. D 20, 88.

[16] Rayfield v. Hands (1958) 2 W.L.R. 851.

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 it's 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 it's 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 and hence reliance on them is not actually made;

(f) reliance is made upon a forged document.[17]

22. 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 prescribed fee: s. 293.

If a member requests, a company must send a copy of the memorandum and articles to such member on payment of a fee of not more than Rs. 1/-: s. 24. Copies sent must embody all alterations: s. 25

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

CHAPTER E

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. 363 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]

Only a public company can issue a prospectus, a private company being unable to offer it's shares or debentures to the public.

1 The English Companies Act, 1948, s. 55 clarifies the position to some extent by providing that an offer to any section of the public, whether selected as members or debenture holders of the company, or as clients of the person making the offer, or otherwise, will be deemed to be an offer to the public unless it is unlikely to result in the shares or debentures becoming available to persons other than those receiving the offer, or it can properly be regarded as a matter of domestic concern to those making and receiving it. The Ordinance contains no such provision.

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

2. DATING, SIGNING AND FILING

A prospectus must be,

(a) **dated**—such date shall be taken as the date of publication unless the contrary is proved: s. 35(1).

(b) **signed**—by every person named therein as a director or proposed director or by his agent authorised in writing: s. 35(2).

(c) **delivered**—to the Registrar of Companies on or before the date of publication: s. 35(2). The prospectus must **state on the face of it** that a copy has been delivered for registration: s. 35(4). If a prospectus is issued without a copy being delivered to the Registrar, the company and every person **knowlingly** a party to the issue, is guilty of an offence and is liable to a fine not exceeding Rs. 50/- per day from the date of issue until a copy is delivered to the Registrar: s. 35(5).

3. 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 nondisclosure 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. A prospectus must state the matters specified in Part 1 of the Fourth Schedule and have attached the reports specified in Part II of the Schedule s. 36(1). The matters specified in Part I are as follows:

1. Contents of the memorandum of association.
2. The number of 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 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. The amount payable on application and allotment on each share. In the case of a second or subsequent offer of shares, the amounts offered on subscription on each previous allotment within the two preceding years and the amounts allotted and paid up on the shares.

7. 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.

8. The names, and addresses of the vendors of any property purchased or to be purchased by the company 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 of which had not been completed at the date of issue of the prospectus, and the amount payable in cash, shares or debentures to each vendor.

A vendor is defined (by Fourth Schedule, Part III) as a person who has entered into any contract for the sale or purchase, or for any option of purchase, of any property to be acquired by the company in any case where—

(a) the purchase money is not fully paid at the date of the issue of the prospectus;

(b) the purchase money is to be paid or satisfied wholly or partly out of the proceeds of the issue for subscription;

(c) the contract depends for its validity or fulfilment on the result of such issue.

9. The amount paid or payable in cash, shares or debentures for such property, specifying the amount payable for good will, if any.

10. 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, or the rate of commission.

11. The amount or estimated amount of preliminary expenses.

12. The amount paid within the two preceding years or intended to be paid to any promoter, and the consideration therefor.

13. The dates of and parties to 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) and a reasonable time and place at which such material contract or a copy thereof may be inspected.
14. The names and addresses of the auditors.
15. 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, and 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 or for services rendered by him in connection with the promotion or formation of the company.
16. Where the prospectus invites the public to subscribe for shares the voting, capital and dividend rights attached to the different classes of shares.
17. If the business of the company or the business of the business to be acquired is carried on for less than 3 years, the length of time during which the business was carried on.

By Part III of the Fourth Schedule the provisions of Part I with respect to the memorandum, directors (i.e., with respect to directors' names, addresses, description, qualification, remuneration and interest) or proposed directors, and the amount or estimated amount of the preliminary expenses **does not apply** in the case of a prospectus issued more than two years after the date at which the company is entitled to commence business.

Reports to be set out in the prospectus

An **auditors' report** giving the profits and dividends paid on the different classes of shares and particulars if dividends were not paid in each of the three financial* years 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 3 years, ending on a date 3 months before the issue of the prospectus.

An **accountants' report** upon the profits 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 3 financial* years immediately preceding the issue of the prospectus. The accountants reporting must be named in the prospectus.

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. 36(2).

It is illegal to issue any form of application for shares or debentures of a company unless the above provisions are complied with: s. 36(3).

* 'Financial Year' is defined in Part III of the Fourth Schedule.

4. EXCEPTIONS FROM STATUTORY REQUIREMENTS

The requirements of the Fourth Schedule need not be complied with when the form of application is issued,

(a) in connection with a *bona fide* invitation to a person to enter into an **underwriting agreement** with respect to the shares or debentures: s. 36(3); or

(b) in relation to shares or debentures which are **not issued to the public:** s. 36(3).

(c) in a offer made to **existing members or debenture holders,** whether or not they have the right to renounce in favour of other persons: s. 36(5).

5. RESTRICTION ON ALTERATION OF TERMS MENTIONED IN PROSPECTUS OR STATEMENT IN LIEU OF PROSPECTUS[3]

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. 37.

6. OFFERS FOR SALE AND PREVENTION OF SHARE HAWKING

Offers for sale: An offer for sale occurs when an issuing house[4] subscribes for an issue of shares or debentures and then invites the public to buy it from them at a higher price.

As it is possible to avoid giving in the issuing house's offer to the public, the particulars required by the Fourth Schedule, as s. 36 and the Fourth Schedule apply only to prospectuses issued "by or on behalf of a company or promoter", s. 39 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 allotee (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. 39.

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[3] See E 9

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

The document forming the offer of the allotees 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 alloted may be inspected.

The provisions of s. 35 apply to an offer for sale as if the offerers were directors, so that the filed copy must be signed by the offerers[5] 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 it's directors etc. as if they were allotees.

Share hawking: s. 332[6] makes it unlawful to have house to house canvassing of any member of the public for the purchase of shares. "House" does not include an office used for business purposes. The section applies to all companies whether incorporated in Ceylon or outside Ceylon.

S. 332(2) provides that it is unlawful to make a written offer to the public (not being a person whose ordinary business or part of whose ordinary business it is to buy and sell shares, whether as principal or agent) of shares for purchase unless the offer is accompanied by a signed statement in writing giving certain particulars of the company and the person making the offer.

The particulars required in the statement, by s. 332(3) (4), must be **only** the following:—

(a) name and address of the principal in Ceylon, if an agent is is making the offer;

(b) date and country of incorporation and address of registered office in Ceylon;

(c) authorised and issued share capital and the classes of shares with their capital, dividend and voting right;

(d) the dividend paid during the year immediately preceding the offer;

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

[6] S. 332 is designed to prevent the "hawking" of shares. The similar section (i.e. s. 356) of the English Companies Act, 1929, ceased to have effect on the 8th August, 1944 (Prevention of Fraud, Investments, Act 1939, s. 25) when ss. 1 and 13 of last mentioned Act came into force (see S.R.& O 1944, No. 864).

(e) debentures issued and outstanding and the rate of interest payable on them;

(f) names and addresses of the directors;

(g) whether the shares offered are fully paid up, if not to what extent they are paid up;

(h) whether permission to deal in any stock exchange in Ceylon or elsewhere has been granted or refused;

(i) if the offer relates to units the names and addresses of persons in whom the units are vested, and an address in Ceylon where the document defining the terms at which the shares are held may be examined.

The above statement need **not** be attached if,

(a) the shares have been granted permission to be dealt with in any recognised stock exchange in Ceylon; or

(b) the shares offered have been allotted with a view to their being offered for sale to the public; or

(c) the shares are being offered only to persons with whom the offerer has been doing regular business in the purchase or sale of shares.

If any person contravenes or incites or causes the contravention of the provisions of s. 332, he is liable to a fine not exceeding Rs. 5,000/- and any contract made as a result of the offer may be declared void by the court: s. 332(5), (6).

7. 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 ordinance (i.e., by s. 36), to be disclosed.

If disclosure as required by the Ordinance 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. 36 if he can prove,

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

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

(c) in the opinion of the court the omission is immaterial or is 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 15 of Part I of the Fourth Schedule he had no knowledge of the matters undisclosed: s. 36(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 a compliance with the provisions of s. 36, the persons responsible are liable to a fine not exceeding Rs. 5,000/- s. 36 (3).

8. EFFECT OF MISREPRESENTATION

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.

(b) **Remedy against the persons responsible for the issue** may be damages for fraud and compensation under s. 38.

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;**

(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.

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 integrum* is impossible.)

(c) third parties' rights acquired after allotment are affected.

Damages for fraud

At common law damages are available only for fraudulent misrepresentation. 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.

For 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. 38.

Compensation under s. 38

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) that—

(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 up to the time of the allotment that the statement was true; and

(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; provided that a person is liable if it is proved that he had no reasonable ground to believe that the person making any such statement, report or valuation was competent to make it; 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.[7]

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.

[7] S. 44 of the English Companies Act, 1948, imposes criminal liability on persons responsible for the issue of the prospectus unless such persons can prove that that statement was immaterial or that they had reasonable grounds to believe that the statements were true. There is no corresponding provision in the Ordinance.

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 it's 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 a **first** allotment of shares or debentures until at least 3 days before a statement in lieu of prospectus has been delivered to the Registrar of Companies: s. 41.

The statement must be in the form set out in the Fifth Schedule,[8] 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. 1,000/- is imposed on the company and on every director who knowingly authorises the contravention.

Statements in lieu of prospectuses 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 alloting 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 of the Third Schedule: s. 28.[9]

An applicant misled by material misrepresentation in the statement in lieu of prospectus cannot obtain compensation under s. 38 as the section refers only to prospectuses. But the remedies of rescission,[10] and of damages for fraud, if fraud is provable, would be available to him.

An allotment made in contravention of s. 41 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. 41 is liable to compensate the company and the allotee for any loss sustained thereby; any action for compensation under the section must be commenced within 2 years from the date of allotment: s. 42.

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8 Contains much the same information as a prospectus with the exception of the minimum subscription.

9 See M 4

10 Re Blair Open Hearth v. Furnace Co. Ltd. (1914) Ch. 390 (C.A.)

10. PROSPECTUS OF OVERSEAS COMPANIES

A company incorporated abroad, (whether or not it has an established place of business in this country), issuing in Ceylon a prospectus offering for subscription it's shares or debentures must, (unless the offer is to a person whose ordinary business is to buy or sell shares or debentures) comply with ss. 330 and 331 which extend to such companies. By sections 330 and 331, 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 it's 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 objects of the company, 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 Ceylon, if any, and subject to necessary modifications the provisions of the Fourth Schedule; the ss. 38 and 39 are deemed to apply to oversea companies.

Any person knowingly responsible for the contravention of the provisions of s. 330 is liable to a fine not exceeding Rs. 5,000/-.

By s. 331 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) he made an honest 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.

UNDERWRITING

11. 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. **A over-riding commission** is a small commission paid to a principal underwriter for procuring such subsidiary contracts.

12. PAYMENT OF UNDERWRITING COMMISSION

By s. 44, no company may apply any of it's 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,[11] unless,

(1) The payment is authorized 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, which ever 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[12] and also in any circular or notice inviting subscriptions for the shares;

(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.[13]

S. 44 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, (s. 45),[14] annual return(s. 106)[15] and in any prospectus or statement in lieu of prospectus issued within 2 years (Fourth Schedule).[16]

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11 S. 44 only refer to shares and not debentures.

12 Such statement must be registered with the Registrar of Companies before the payment of commission.

13 See G 22

14 See J 3

15 See F 12

16 See E 3

13. FINANCIAL ASSISTANCE FOR PURCHASE OF SHARES

A company may not purchase its own shares.[17]

A company being authorised by it's articles to purchase it's own shares, a shareholder sold his shares to the company. The company went into liquidation, and the shareholder claimed to prove in liquidation payment for his shares. Held, the claim failed, as a company has no power to buy its own shares: Trevor v. Whitworth (1887) 12 App. Cas. 409.

S. 46 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,

(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 to enable **trustees** to purchase **fully paid** shares to be held for the benefit of **employees** including salaried directors;

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

The aggregate amount of any outstanding loans made under 1 and 2 must be shown as separate items in every balance sheet of the company: s. 46(2).

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. 46(3).

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[17] **Under s. 153 E a company may be ordered by court to purchase it's own shares where protection from oppression and mismanagement is seeked; the company must, however, reduce it's capital proportionally. See N 4.**

CHAPTER F

MEMBERSHIP

1. MEMBERSHIP

By s. 26 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. 101. The Court has power to rectify the register under s. 99[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 it's own shares. A subsidiary may hold shares in it's holding company.[2]

(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 Women's Property Ordinance No. 18 of 1923. Only her separate estate is liable for calls.

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[1] See F 8

[2] By the English Companies Act, 1948, a subsidiary may not be a member of its holding company.

(d) A **foreigner** may be a member, and although all members are foreigners the company may be Ceylonese. By the Exchange Control Act, 24 of 1953 (Part IV) however, shares may be transferred to foreigners or their nominees only with the consent of the Central bank.

(e) A **bankrupt** may become a member of a company.

(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 the judgment 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 ever had any value.[6]

3. JOINT HOLDERS

Shares may be alloted 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 4, 12, 55 and 105 deal with such matters. 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.

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

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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: Rhode 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.).

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. 4); he has a right to a duplicate on giving an indemnity (art. 5); he has a right to proper notice of calls (art. 11); to appoint a proxy (art. 58), etc.

Statutory rights: the statutory rights given by the Companies Ordinance 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 it's 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 or articles, unless **he consents in writing:** s. 23.

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]

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;**

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[7] See B9

(c) **forfeiture, surrender** or **enforcement of a lien;**

(d) **redemption** of shares;

(e) issue of **share warrants;**

(f) Shares are disclaimed or transferred on a liquidation.

The register is, however, only *prima facie* evidence, s. 101, and by s. 99, application may be made to court for verification of the register.[8]

7. REGISTER OF MEMBERS

By s. 94 the register must state—

(1) The name, address and nationality 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.

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

If the number of members is more than fifty, an index must be kept, unless the register is self indexing— s. 95.

8. RECTIFICATION OF REGISTER OF MEMBERS

If,

(1) 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: s. 99(1). 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. 99(2).

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

[8] See F 8

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 fifty cents. Any person may demand to be supplied with a copy of the register or any part of it on payment of not more than twenty five cents 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. 25/- and a further default fine of Rs. 25/-, and the Court may order inspection or copies to be sent. 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. 97.

10. BRANCH REGISTER

A company having a share capital, if authorised by it's articles may keep a branch register of it's members resident in the United Kingdom, or in any part of Her Majesty's Realms and Territories outside Ceylon, in such territories. The company must notify the Registrar of Companies within one month the situation of the office where the branch register is kept and any change in it's situation and if the register is discontinued of it's discontinuance: s. 102.

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: s. 103. Transfers executed in territories outside Ceylon would be exempt from stamp duty charged in Ceylon: s. 104.

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, or 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. 100, "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 Ceylon". 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.[9]

12. ANNUAL RETURN

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

Company having a share capital

By s. 106 the return must state,

(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;

(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, 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.

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[9] In England, under the Rules of the Supreme Court, a person having equitable interest in shares may protect himself and hold up transfers for eight days, by issuing a notice in lieu of distringas on the company; action, however, must be taken within the eight days, if not the company can register the transfer.

(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. 107 the return must state—

(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.

Accounts in Annual Return

By s. 108, an annual return must contain a balance sheet as required by s. 121[10] certified by a director, the manager or secretary. Private companies are exempted from this provision.

Private Companies

A private company—

(a) need not include balance sheet with the annual return: s. 108;

(b) must attach a certificate signed by a director or the secretary that the company has complied with the provisions of s. 27[11] applicable to private companies: s. 109.

Register of Members—Part containing annual returns

The register of members must have a separate part containing the annual returns; provisions as to inspection and copies of the register of members applies to this section too: s. 108.

Filing of Annual Return

The annual return must be completed each year within 28 days after the first or only general meeting and a copy signed by a director, the manager or secretary, sent forthwith to the Registrar of Companies— s. 108.

The directors of a company failed to forward to the Registrar of Companies the annual return for a certain year. The directors on being charged by the Registrar of Companies 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 otherwise 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.

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[10] See J 1, 3

[11] See M 2

CHAPTER G

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 it's 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 share holders.

Called-up Capital is the total amount paid 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 G 4 below.

2. RESERVE CAPITAL

S. 50 states that a limited company may by special resolution resolve that any uncalled part of it's 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: Bartlett v. 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[1] 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 provides,

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

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[1] During the year 1966/67 (the latest figures available up to publication) the number of shares issued were, Ordinary—37,265,257, Preference—150,000 Redeemable Preference — Nil, Founders — Nil, Employees — Nil, Others 101,700.

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 preference 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 G 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: Fourth 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. There 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[2]

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;

[2] The London Stock Exchange is opposed in principle to voteless equity shares.

(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.

8. REDEEMABLE PREFERENCE SHARES

By s. 47 a company limited by shares, if **authorised by it's articles** may issue redeemable preference shares provided that:

(a) shares shall be **reedemed 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 applied in redeeming the shares must 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;

(d) Any **premium** payable on redemption is **provided out of profits.**

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.

Failure to comply with this section results in the company and every officer guilty liable to a fine not exceeding Rs. 1,000/-.

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. 62. 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 **fifteen percent of** the issued shares of the class, who did not consent or vote in favour, may **within seven 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. 51 a company limited by shares or guarantee may, if **authorised by the articles** and by **resolution in general meeting,** alter it's memorandum to,

(a) **increase** it's 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) **sub-divide** 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. 53. Upon any other alteration, notice must be filed within one month: s. 52.

11. REDUCTION OF CAPITAL

It is a principle of Company Law that capital (i.e., issued capital) cannot be reduced except as allowed by the Ordinance so that,

(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. 56 states that a company may reduce it's share capital provided,

(i) the articles authorise,

(ii) special resolution is passed,

(iii) confirmation of court is obtained.

Reduction may be effected in any way, the following are examples:

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

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3 **Cancellation does not amount to a reduction of share capital, see G 11.**

(b) anulling 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: 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. 61 if any director, secretary or other 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 creditor, or aids, abets, or is privy to any such concealment or misrepresentation he is liable to a fine not exceeding Rs. 1,000/- and or imprisonment for not more than one year.

When the court makes it's 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.

The reduction takes effect on registration of the order and a minute approved by the court with the Registrar of Companies. The Registrar's Certificate is conclusive evidence that all the requirements of the Ordinance with regard to reduction of capital have been complied with: s. 59.

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

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.[4] It carries with it the rights and obligations belonging to it as set out in the Companies Ordinance and in the company's memorandum and articles.

Every share must be distinguished by it's number:[5] s. 63.

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

[5] In English Company Law numbers could be dispensed with if all shares of a particular class are fully paid-up and rank *pari passu*.

12. ACQUISITION OF SHARES

Shares may be acquired either,

(1) Direct from the company, by,

(a) subscription to the memorandum;

(b) allotment;

(2) From another person, by,

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

(b) transmission (occurring by an operation of law on 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. 36 (vide chapter 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. 36(3).

An application may be withdrawn, verbally or in writing at any time **before** the allotment letter is posted and the deposit reclaimed.[6]

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.

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6 Pentelow's Case (1869)4 Ch. 178; Wilson's Case (1869) 20 L.T. 962; 8 Eq. 240. In English Law applications are irrevocable until the third day after the opening of the lists.

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 allotee becomes a member when his name is entered on the register of members: s. 26.

15. RESTRICTIONS ON ALLOTMENT

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

A **public company** which does not issue a prospectus on or with reference to it's 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:** s. 41. These provisions apply only to a first allotment.

A **public company** which **issues a prospectus** may not allot any shares unless, within 40 days of the first issue of the prospectus, the minmum subscription has been subscribed[7] and the **application moneys** have been received. This applies only to first allotment. The application moneys must be at least 5% of the shares: s. 40. If this provision is not complied with the application moneys become immediately repayable and if repayment is not made within 48 days the **directors** become jointly and severally liable to repay the money with interest at 5% p.a. from the 48th day: s. 40 (4). Further, the directors are unable to make the declarations required by s. 93[8] and so will be unable to obtain the certificate to commence business.[9]

16. EFFECT OF IRREGULAR ALLOTMENT

An allotment in contravention of s. 40 and s. 41 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 allomeni) to compensate the company and the allotee: s. 42.

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[7] See E 3

[8] See B 8

[9] In English Company Law, shares or debentures may not be allotted until the beginning of the third business day after the issue of the prospectus, or until any later time stated in the prospectus as the time of opening the lists. There are further provisions if permission to deal in the shares in the Stock Exchange are being made.

17. RETURN OF ALLOTMENTS

Within **one month** of allotment there must be filed,

(1) A **Return of Allotments** giving particulars of the shares alloted, the names, addresses and descriptions of the allotees, and the amount, if any, paid, due or payable on each share;

(2) In the case of shares allotted for consideration other than cash, a **contract** in writing constituting the title of the allotee to the shares, and a **Return** giving particulars of the shares so alloted, the amount credited as paid up thereon and the consideration. If the contract is not in writing, particulars similarly stamped must be filed.

In case of non-compliance with this section, every director, manager, secretary or other officer of the company who is knowingly a party to the 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. 43.

18. ISSUE OF SHARE CERTIFICATES

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 director, manager, secretary, and other officer of the company who is knowingly a party to the default, is liable to a fine not exceeding Rs. 50/- for every day during which the default continues. 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. 68.

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 5 states,

"If a share certificate is defaced, lost, or destroyed, it may be renewed on payment of such fee, if any, not exceeding fifty cents, and on such terms, if any, as to evidence and indemnity, as the directors think fit".

Share certificates do not bear any stamp duty.

19. EFFECT OF SHARE CERTIFICATE

There is no requirement in the Ordinance that share certificates issued by a company must be under it's common seal, but s. 69 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. 99, 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 a 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 charge 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 it's 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) under the common seal of the company: s. 71;

(4) the company must be a public company,[10] 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 No. 24 of 1953.

On issuing a share warrant, the company must strike out of it's 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 it's number;

(3) the date of issue of the warrant: s. 96(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. 96(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. 96(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 a share warrant in respect of the shares therein specified without the warrant being surrendered and cancelled: s. 96(3).

Dividends may be paid by coupons or otherwise attached to the share warrants: s. 71.

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10 Private companies cannot issue share warrants as they must, by s. 27, restrict the right to transfer shares— see M 2.

Stock Warrants to bearer can be issued in the same manner and terms as share warrants.[11]

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. 106.

The difference between a share certificate and a share warrant are,

(a) The bearer of a warrant is not entered in the Register of Members: s. 96.

(b) A warrant is a negotiable instrument[12]

(c) The shares are transferable by delivery of the share warrant: s. 71. In the case of a share certificate a transfer must be executed.

(d) Manner of payment of dividends differ. In share warrants coupons for dividends are generally attached to the warrant: s. 71.

(e) When a share qualification for directors is required by the articles, the holding of share warrants is insufficient: s. 139.

Offences in connexion with share warrants:

If any person acts with intent to defraud with respect to share warrants, such as falsely obtaining share warrants or dividends 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. 72.

21. SHARES AT A PREMIUM[13]

There is nothing in the Ordinance to prevent a company from issuing shares at a premium, i.e., for a consideration cash or in kind, which exceeds the nominal amount of the shares. Provision in the

11 Pilkington v. United Railways of Havana (1930) 2 Ch. 108.

12 Webb, Hale & Co. v. Alexandria Water Co. (1905) 93 L.T. 339.

13 English Companies Act, 1948, requires that premiums be credited to a Share Premium Account and be treated as capital except so far as it may be used for certain specific purposes. There is no provision in the Ordinance.

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/-.

22. SHARES AT A DISCOUNT

When the market value of a company's share is lower than it's 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. 48, 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. 48, 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 and every balance sheet issued by the company subsequently 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 document in question: s. 48(3).

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. 11 states,

"The directors may from time to time make calls upon the members in respect of any moneys unpaid on their shares provided that no call shall exceed one-fourth of the nominal amount of the share, or be payable at less than one month from the last call; and each member shall (subject to receiving at least fourteen days' notice specifying the time or times of payment) pay to the company at the time or times so specified the amount called on his shares".

A call creates a debt due from the shareholder : s. 21[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. 49; Table A art. 15 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]

(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 it's 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. 7 states,

14 In English Company Law, it is a specialty debt.

15 Alexander v. Automatic Telephone Co. (1900) 2 Ch. 56.

16 Lock v. Queensland Investment Co. (1896) A.C. 461, 1 Ch. 396.

17 London and Northern Steamship Co. v. Farmer (1914) III L.T. 204.

18 Re Exchange Drapery Co. (1888) 38 Ch. D. 171.

'The company shall have a 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 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 regulation. 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 8 - 10 states,

art. 8: 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 some sum in respect of which the lien exists is presently payable, nor until the expiration of fourteen days after 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 be reason of his death, insolvency, or bankruptcy.

art. 9: For giving effect to any such sale the directors may authorise some person to transfer the shares sold to the purchaser thereof. The purchaser shall be 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. 10: 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 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 Brokers' Association by-laws provide 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]

[19] Contrast with procedure under forfeiture (G 25) where the member loses all the money paid on the shares.

[20] Charlesworth, Eighth Edition.

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 it's directors.[22]

Table A articles 23 to 29 deal with forfeiture. Articles, like the provision of 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 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. 28 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 it's 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 has 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.

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21 Hopkinson v. Mortimer, Harley & Co. Ltd. (1917) 1 Ch. 646.
22 Hope v. International Financial Soc. (1876) 4 Ch. D. 327.
23 Gowers' Case, (1868) L.R. 6 Eq. 77
24 *Per* Luxmoore, J in Re Bolton (1930) 2 Ch. 48.
25 Re Bolton, (1930) 2 Ch. 48.
26 See O 45.

A surrender of shares may be accepted if,

(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 it's own shares.

If the articles authorise, like forfetied shares, surrendered shares may be re-issued.

27. TRANSFER OF SHARES

Shares are moveable 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. 64. A transfer must be stamped: Stamp Ordinance, Ch. 247. A transfer of shares to a foreigner is forbidden without the consent of the Central Bank: Part III, Exchange Control Act No. 24 of 1953. Before registering a transfer in the register, a company must be satisfied that the transferee is a citizen of Ceylon and if not a citizen the tax payable on such shares have been paid: s. 60, Finance Act., No. 11 of 1963.

27 *Per* Lord Watson in Trevor v. Whitworth, (1887) 12 App. Cas. 409 at p. 429.

28 "Perhaps the most important characteristic of shares is their transferability." Farrar's Company Law.

29 Western Case (1868) L.R. 4 Ch. App. 20, but see G 29.

30 Lindlar's Case (1910) 1 Ch. 312 at p. 316.

A private company must by the articles, restrict it's right to transfer shares: s. 27.[32] A public company must normally be free from restriction on the right to transfer, if a stock exchange quotation is to be obtained.[33]

28. 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".[34, 35]

The transferee does not become a member until his name has been entered on the register, and the transferor remains 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.

29. RESTRICTIONS 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;[36]

(b) the instrument of transfer is not a 'proper instrument of transfer' or contravene some other statutory provision; or

(c) the transferee is not entitled to hold the shares, e.g., an infant[37] or insane person;[38]

(d) an order of court[39] has imposed restrictions;

32 See M 2.

33 Rules of the Colombo Brokers Association. Because of such rules securities quoted on the stock exchange are made more marketable.

34 *Per* Lindley, L.J. in Taylor, Phillips and Rickard's Case (1897) 1 Ch. 298.

35 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.

36 Table A, art. 19, 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 Brokers Association requires 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.

37 Curtis's Case (1868) 6 Eq. 455.

38 Wilson's Case (1869) 8 Eq. 240.

39 E.g., under s. 153 E, vide N 3.

If the articles are silent the directors cannot refuse to register a transfer[40] 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[41] 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.[42] 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*.[43]

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[44] unless the directors are not exercising their discretion *bona fide* for the benefit of the company.[45] If the directors state their reasons for their refusal, the court can decide whether they are sufficient to justify the refusal.[46] 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,[47] unless the articles provide that the 'grounds' are not merely the 'reasons' for the refusal need not be specified.[48] 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

40 Gilbert's Case (1870) 5 Ch. 559; Cawley & Co., (1889) 42 Ch. D. 209.

41 Delavenne v. Broadhurst (1931) 1 Ch. 234.

42 Pool Shipping Co. (1920) 1 Ch. 251.

43 Re Coalport China Co. (1895) 2 Ch. 404; Re Smith & Fawcett Ltd (1942) Ch. 304.

44 *Exparte* Penney (1873) 8 Ch. 446.

45 Re Smith & Fawcett, (1942) Ch. 304; Bennett's Case (1854) 5 De G.M. & G. 284.

46 Re Bede Steam Shipping Co. Ltd. (1917) 1 Ch. 123 (C.A.).

47 Sutherland v. British Dominions Corporation (1926) Ch. 746.

48 Berry & Stewart v. Tottenham Hotspur Football Co. (1935) Ch. 718.

pay calls, or is a quarrelsome person, or is acting in the interest 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 over-ridden by court.[49]

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.[50]

A transfer cannot be made to or from a foreigner or his nominee without the permission of the Central Bank: Exchange Control Act, No. 24 of 1953, Part III.

Notice of refusal to register a transfer must be sent to the transferee within 2 months of the lodgment of the transfer: s. 67.

30. FORGED TRANSFERS

If a shareholder's signature on a transfer is forged, the transfer is void and does not effect the title of the shareholder.[51] 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.[52] 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.[53] A broker who wrongly represents that he has authority to act for the supposed transferor is liable even if he is acting in good faith[54], and a person identifying a stranger impersonating the owner of the shares as the transferor is liable if a fraud is being committed.[55]

49 Re Bell Brothers (1891) 65 L.T. 245; Bede Steam Shipping Co. (1917) 1 Ch. 123.

50 Copal Varnish Co. (1917) 2 Ch. 349.

51 Simm v. Anglo-American Telegraph Co. (1879) 5 Q.B.D. 188.

52 Barton v. N. Staffordshire Ry. (1888) 38 Ch. D. 458.

53 Sheffield Corporation v. Barclay (1905) A.C. 392.

54 Starkey v. Bank of England (1903) A.C. 114.

55 Bank of England v. Cutler (1907) 1 K.B. 889.

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 stopped from proving that the transfer is forgery.[56,57]

31. 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 remains 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. 70 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 transfer: s. 65. 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. 20 - 22 deals with transmission.

56 Barton v. L. & N.W. Ry. (1890) 24 Q.B.D. 77.

57 See also G 9 on 'estoppel as to statements in share certificates'.

Art. 20: The legal representative of a deceased sole holder of a share shall be the only person recognised by the company as having any title to the share. In the case of a share registered in the names of two or more holders, the survivors or survivor, or the legal representative of the deceased survivor, shall be the only persons recognised by the company as having any title to the share.

Art. 21: Any person becoming entitled to a share in consequence of the death, insolvency or bankruptcy of a member shall, upon such evidence being produced as may from time to time be properly required by the directors, have the right, either to be registered as a member in respect of the share or, instead of being registered himself, to make such transfer of the shares as the deceased or the insolvent or bankrupt person could have made; 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 the deceased or the insolvent or bankrupt person before the death, insolvency or bankruptcy.

Art. 22: A person becoming entitled to a share by reason of the death, insolvency or bankruptcy 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.

Whether the representative is registered or not, the company is not in any way bound to see that the shares are not dealt with in contrary to the will or rules of intestacy.[58]

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,[59] 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[59] and in the case of a reconstruction order, the executors though not on the register of members, can dissent;[60] 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.[61]

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58 See F 11.

59 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

60 Llewellyn v. Kasintoe Rubber Estate (1914) 2 Ch. 670. This case was decided under s. 192 of the English Companies Act, 1908.

61 Buchan's Case (1879) 4 A.C. 549, 583.

CHAPTER H

GENERAL MEETING

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. 111 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 7 days before the statutory meeting the directors must send a report called the "statutory report" to every member and forthwith file a copy 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;

* Quoted companies must, in addition, send 3 copies of the statutory report to the secretaries and members of the Colombo Brokers' Association.

(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 manager.

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.

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 seven 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.

3. ANNUAL GENERAL MEETING

By s. 110 a general meeting of every company must be held once at least in every calendar year, and not more than fifteen months after the holding of the last preceding general meeting.[1]

It is the duty of the directors to see that the Annual General Meeting is held and the Annual Return is 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.

In case of default, every director or manager who is knowingly a party to the default is liable to a fine not exceeding Rs. 500/- and the court could on the application of a member, call or direct the calling of a meeting. In M. E. de Silva v. Croos (1952) 48 C.L.W. 15; 54 N.L.R. 96, itwas held, that where there is default in holding the annual general meeting under s. 110 and the default is referred to the court, the charge should set out that the offender was "knowingly a party to the default."

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 an year by s. 110 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. 112, 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

[1] The section does not refer to such meeting as the annual general meeting. In fact the Ordinance does not generally refer to an annual general meeting, (in the section dealing with auditors, i.e, s. 130, however, it is said that auditors will hold office until the next annual general meeting).

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 Textile 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. 113 (1), if the articles do not provide otherwise, two or more members holding not less than one-tenth of the issued share capital of the company may call a meeting;

(d) By s. 113 (2), 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 Ordinance, the **Court** may either on it's 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.

5. LENGTH OF NOTICE FOR CALLING MEETINGS

If the articles make no provision, **seven days written notice** is required for any meeting, except a meeting for the passing of a special resolution: s. 113. Articles may, however, provide otherwise.

A meeting for the passing of a special resolution requires **twenty-one** days notice; shorter notice may, however, be given if **all** the members entitled to attend and vote agree: s. 115.

6. PERSONS ENTITLED TO NOTICE

S. 113 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. 103: A notice may be given by the company to any member either personally or by sending it by post to him to his registered address, or (if he has no registered address within Ceylon) to the address, if any, within Ceylon supplied by him to the company for the company for the giving of notices to him.

Where the notice is sent by post, service of the notice shall be deemed to be effected by properly addressing, pre-paying and posting a letter containing the notice, and unless the contrary is proved, to have been effected at the time at which the letter would be delivered in the ordinary course of post.

art. 104: If a member has no registered address within Ceylon and has not supplied to the company an address within Ceylon for the giving of notices to him, a notice addressed to him and advertised in a newspaper circulating in the neighbourhood of the registered office of the company, shall be deemed to be duly given to him at noon on the day on which the advertisement appears.

art. 105: A notice may be given by the company to the joint holder of a share by giving the notice to the joint holder named first in the register of members in respect of the share.

art. 106: A notice may be given by the company to the person entitled to a share in consequence of the death, insolvency, or bankruptcy 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 assignee of the insolvent, trustee of the bankrupt, or by any like description at the address, if any, within Ceylon 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, insolvency or bankruptcy had not occurred.

art. 107: Notice of every general meeting shall be given in some manner herein before authorized to (a) every member except those members who (having no registered address within Ceylon) have not supplied to the company an address within Ceylon for the giving of notices to them, and also to (b) every person entitled to a share in consequence of the death, insolvency, or bankruptcy of a member, who but for his death, insolvency or bankruptcy, would be entitled to receive notice of the meeting. No other persons 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. 43, that the accidental omission to give notice to, or the nonreceipt 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 adderessograph machine. Held, the omission was accidental and within an article like Table A art.43: 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. 43 but an error of law: Musselwhite v. C. H. Musselwhite & Son Ltd., (1962) Ch. 964.

Under s. 132 (3) auditors are entitled to attend any general meeting of the company at which any accounts which have been examined or reported on by them are laid before the company, but the section does not state specifically whether the auditors are entitled to notice of such meetings.[2]

7. NATURE OF NOTICE

Table A art. 42 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. 44, which states, "All business shall be deemed special that is transacted at an extraordinary meeting, and all that is transacted at an ordinary meeting, with the exception of sanctioning a dividend, the consideration of the accounts, balance sheets, and the ordinary report of the directors and auditors, the election of directors and other officers in place of those retiring by rotation 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[3] or where in a reconstruction directors did not state that they were participating in the purchase consideration to be received by the selling company[4] 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 might be: S. 115. It appears that the **exact wording** of the resolution to be proposed must be set out in the notice.[5]

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2 Under the English Company Act, 1948, however, auditors must be sent notices of all general meetings.
3 Baillie v. Oriental Telephone Co., Ltd., (1915) 1 Ch. 503. See D 20.
4 Kaye v. Croyden Tramways, (1898) 1 Ch. 358.
5 Unlike the English Companies Act, 1948, the Ordinance does not provide for special notice, i.e., 28 days notice required for removal of director etc. nor for circulation of members resolution.

PROCEEDINGS AT GENERAL MEETINGS

8. QUORUM

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. 113 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,[6]

(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 provisions of Table A art. 46 (see below) then, at an adjourned meeting, if only one member is present, he would constitute the quorum.[7]

The quorum should be present throughout the meeting, unless the articles, as does Table A, art. 45 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. 46, that "if 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,

6 Though ss. 110 (3) & 113 (2) of the Ordinance gives the court power under certain circumstances (see H 3, 4) to order general meetings to be held, it does not empower the court to direct that at such meetings the quorum may consist of one person, unlike the corresponding sections of the English Companies Act, 1948.

7 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 Ordinance a single member could constitute the quorum of an adjourned meeting.

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, and if 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 the quorum".

9. CHAIRMAN

A meeting is not properly constituted if the proper person is not in the chair. S. 113 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 47 & 48 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.

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.[8]

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;

8 **See H 10.**

(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.

(12) To do everything necessary to further the business of the meeting.

10. CONDUCT

The conduct of a meeting devolves on the meeting itself, subject to the provisions of the Ordinance and the articles. In Carruth v. I.C.I. Ltd., 1937 A.C. 707,

"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".

11. 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 Ordinance. The chairman, however, is not bound to adjourn a meeting, even if the majority desire him to do so[9] unless the articles provide otherwise. Table A, art. 49 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. 111.

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. 111 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. 117 a resolution passed at an adjourned meeting is treated as being passed on that date and not at an earlier date.

Notice of an adjourned meeting is unnecessary unless the articles require or, unless the meeting were adjourned *sine die* (i.e., without fixing a date).[10] Table A requires notice to be given, as in the case of an original meeting, if the meeting is adjourned for ten days or more.

9 Salisbury Gold Mining Co., Ltd., v. Hathorn, (1897) A.C. 268.
10 Wills v. Murray, (1849) 4 Ex. 483.

Unless the articles allow, a meeting once convened cannot be postponed. The proper course is to hold the meeting and resolve to adjourn it.

12. 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.**[11] On a show of hands every 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. 115 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.

Poll—There is a common law rule that on the declaration of the result of voting on a show of hands, any member may demand a poll.[12] This rule may be varied by the articles, subject to s. 115 (4) which states:

"At any meeting at which an extraordinary resolution or a special resolution is submitted to be passed a poll shall be taken to be effectively demanded, if demanded—

(a) by such number of members for the time being entitled under the articles to vote at the meeting as may be specified in the articles, so, however, that it shall not in any case be necessary for more than **five** members to make the demand;

(b) if no provision is made by the articles with respect to the right to demand a poll, by three members so entitled or by one member or two members so entitled, if that member holds or those two members together hold not less than fifteen *per centum* of the paid-up share capital of the company.

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

11 Re Horbury Bridge Coal Co., (1879) 11 Ch. D. 109.

12 R. v. Vicar of St. Asaph, (1883) 52 L.J. (K.B.) 672; Campbell v. Maund, (1836) 5 Ad. & El. 865.

such power and proxies if necessary to ascertain the sense of the meeting.[13] The number of votes a member would have on a poll depends on the provisions of the Articles, (Table A, Art. 54, states that on a poll every member shall have one vote for each share of which he is the holder); s. 113 (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 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.

13. 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.

Unlike in English Company Law where the right to appoint a proxy for a general meeting is given by statute, the Ordinance does not give such power and such power must be provided for in the articles.

The Colombo Brokers Association By-Laws require duly stamped proxy forms to be sent to shareholders and debenture holders in all cases where proposals other than those of a purely routine nature are to be considered, and to word the proxy forms so that a shareholder or debenture holder may vote either for or against each resolution.

Table A articles 58 and 59 provide "on a poll, votes may be given either personally or by proxy" and "such proxy need not be a member." (The Ordinance gives a power, however, to members and creditors to appoint proxies to attend and vote on their behalf at meetings convened by the court in pursuance of a compromise or arrangement under s. 151). All matters relating to proxies are, hence, governed by the provisions in the articles. Table A, states as follows,

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[13] Second Consolidated Trust v. Ceylon Estates (1943) 2 All E.R. 567.

art. 59: The instrument appointing a proxy shall be in writing under the hand of the appointer or of his attorney duly authorised in writing, or if the appointer is a corporation, either under seal, or under the hand of an officer or attorney duly authorised. A proxy need not be a member of the company.

art. 60: The instrument appointing a proxy and the power of attorney or other authority, if any, under which it is signed or a notarially certified copy of that power or authority shall be deposited at the registered office of the company not less than forty-eight hours before the time for holding the meeting or adjourned meeting, at which the person named in the instrument proposes to vote, and in default the instrument of proxy shall not be treated as valid.

art. 61: An instrument appointing a proxy may be in the following form, or any other form which the directors shall approve:

..... Company, Limited.

I ....., of ....., being a member of..... Company, Limited, hereby appoint ..... of ....., as my proxy, to vote for me and on my behalf at the (ordinary or extra-ordinary, as the case may be) general meeting of the company to be held on the ..... day of ..... and at any adjournment thereof".

Signed this ..... day of .....

art. 62: The instrument appointing a proxy shall be deemed to confer authority to demand or join in demanding a poll.

It is the duty of the chairman to decide on the validity of the proxies. If the chairman wrongfully disallows a proxy, the courts may declare the chairman's decision invalid, unless the articles provide that votes submitted 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.[14] A mere misprint or some quite palpable mistake on the face of a proxy form does not entitle the company to refuse to accept the proxy.[15]

A shareholder who has appointed a proxy may attend andvote in person. His presence and vote has the effect of revoking the proxy.[16]

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.

14 Wall v. Exchange Investments Corporation (1926) Ch. 143.

15 Oliver v. Dalgleish (1963) 1 W.L.R. 1274.

16 Cousins v. International Brick Co., Ltd., (1931) 2 Ch. 90.

14. COMPANIES WHICH ARE MEMBERS

A company or other corporate body that is a member or creditor may, by resolution of it's directors or other governing body **appoint such person as it thinks fit** to act as it's 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. 114. 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 directors' resolution appointing him, authenticated by the signature of the chairman.

15. MINUTES

Every company must keep minutes of proceedings of general meetings and meetings of directors entered in books kept for that purpose: s. 118.

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. 118. In Re Fire Proof Doors (1916) 2 Ch. 142, outside evidence brought in was allowed as proof that a 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.[17]

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".

16. 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

[17] Kerr v. Mottram (1940) 1 Ch. 657.

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. 119 (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 twenty five cents per hundred words: s. 119 (2).

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 liable to fines: s. 119 (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. 132 auditors are empowered to inspect minute books of directors, and general meetings at all times.

RESOLUTIONS

17. ORDINARY RESOLUTION[18]

An ordinary resolution, which is not defined by the Ordinance, 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 Ordinance 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. 110, and may be used, e.g., for all alterations of capital under s. 51, unless the articles require some other form of resolution.

18. 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, at a general meeting of which notice, specifying the intention to propose such

18 (a) By the English Companies Act, 1948, certain resolutions and statements by members are required to be circulated by the company before meetings; there is no such provision in the Ordinance. (b) The Colombo Brokers' Association By-Laws require quoted companies to forward three copies to the Secretaries and to each of the members of the Association of all resolutions increasing the capital of a company, and of resolutions passed in general meeting adopting the Report and Accounts, declaring dividends, and re-electing directors and auditors.

resolution as an extraordinary resolution, has been duly given: s. 115. 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,

(a) To wind up the company voluntarily when insolvent: s. 216.

(b) To sanction the exercise of certain powers of the liquidator in a members' voluntary winding-up: S. 239.

(c) To sanction arrangement between a company being wound-up and its creditors: s. 242.

(d) To dispose of books and papers of a company in a members' voluntary winding-up: s. 271.

Articles may, however, require the sanction of extraordinary resolutions for other instances as well.

19. 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, specifying the intention to pass the resolution as a special resolution, has been duly given. But all those entitled to attend and vote may agree to shorter notice: s. 115.

A special resolution is required to,

(1) Alter the objects clause of the Memorandum of Asso-tion: s. 6.

(2) Alter the Articles of Association: s. 11.

(3) Change the company's name: s. 20.

(4) Reduce capital: s. 56.

(5) Create reserve liability: s. 50.

(6) Make liability of directors unlimited: s. 145.

(7) For assignment of a director's office: s. 149.

(8) Procure appointment of inspectors by the Registrar of Companies: s. 135.

(9) Procure winding-up by court: s. 162.

(10) Winding-up voluntarily when solvent: s. 216.

(11) Sanction sale to another company for consideration, in a voluntary winding-up: s. 225.

20. FILING OF RESOLUTIONS ETC.

By s. 116, a **printed copy** of the following resolutions or agreements must be filed with the Registrar of Companies 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 provision of the articles,

(a) 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.

21. 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 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 Ordinance 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

22. 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[19] 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 incapable of confirmation by a simple majority of the members, the court will not interfere at the suit of a minority of the members.

23. 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 Ordinance 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 Ordinance are,

(a) s. 6 whereby dissentient holders of 15% of the issued shares can apply for cancellation of an alteration of objects;
(b) s. 62 whereby share class rights are 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. 133 permits members holding not less than one-tenth of the issued shares to request the Registrar of Companies to carry out an investigation of the company's affairs;
(d) s. 153A and 153B 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.[20]

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.

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19 See H 24

20 See N 3, 4

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 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.

The other exceptions to the rule in Foss v. Harbottle (given below) are further examples of minority protection.

24. THE RULE IN FOSS v. HARBOTTLE

The rule is that if a wrong is alleged to be 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.

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.

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 illegaly 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 judgment 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.

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.

(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.[21] (1915) 1 Ch. 503, a shareholder was able to restrain the company from acting on a special resolution of which insufficient notice has been given.

(iii) Where a fraud on the minority is being committed.[22]

(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. Lushinghton (1877) 6 Ch. D. 70, a shareholder was able to compel the company to record his vote.

21 See D 20, H 7

22 See H 23

CHAPTER I

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 PRESENT 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 were 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.

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

1 Re Hoare & Co., Ltd., (1904) 2 Ch. 208 (C.A.).
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.).

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 in 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.

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; a statement of "unclaimed dividends" in the balance sheet submitted at a general meeting is sufficient acknowledgement.[7]

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.[8]

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.[9]

Articles may empower the directors to pay such interim dividends as appear to them to be justified by the profits, as Table A, art. 90 which states, 'the directors may from time to time pay to the

5 Towers v. African Tug Co., (1904) 1 Ch. 558.
6 Bond v. Barrow Haematite Steel Co., (1902) 1 Ch. 353.
7 Burnham v. Atlantic & Pacific Fibre Co., (1928) Ch. 836.
8 Re City Equitable Fire Insurance Co., Ltd., (1925) Ch. 407.
9 Re Buenos Ayres Great Southern Railway, (1947) Ch. 384.

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.[10]

S. 49 permits a company, if authorised by the articles, to pay dividends in proportion to the accounts paid up on the shares: Table A, art. 92 provides "dividends shall be declared and paid according to the amounts paid on the shares". 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.[11]

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.[12] The articles should, accordingly contain authority for the directors to pay dividends by means of warrants etc. sent through the post. Table A, art. 95 provides "any dividend may be paid by cheque or warrant sent through the post to the registered address of the member . . . . . etc."

By the Colombo Brokers Association By-Laws companies dealt with on the Exchange cannot by their articles provide for the forfeiture of unclaimed dividends within six years of declaration of the dividend.

5. CREATION OF RESERVES

Reserves may be created at any time, and power in the articles to create such reserves is not necessary,[13] articles, however, often provide for the creation of reserves as Table A, art. 93,

"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 meeting contingencies or for equalizing dividends, or for any other 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".

10 Scott v. Scott, (1943) 1 AII E.R. 582.
11 Oak Bank Oil Co. v. Crum, (1883) 8 App. Ca. 65.
12 Wood v. Odessa Waterworks Co., (1889) 42 Ch. D. 636.
13 Burland v. Earle (1902) A.C. 83 (P.C.).

6. WHEN INTEREST MAY BE PAID ON CAPITAL

Sec. 55 provides statutory authority for an exception to the rule that dividends may not be paid out of capital. It provides, 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) And **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** does not exceed 6% per annum, or such other rate as is prescribed by regulation;

(e) Such payment does **not operate in reduction of the amount paid up on the shares;**

(f) **Particulars** as to the capital and interest in question are shown in the **company's accounts.**

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 articles of association permit of such increase: Per Pulle J. in Sooranammah v. Amirnathapillai (1950) 53 N.L.R. 334.

The following must be observed on a capitalization of profits:

(a) A basic rule of company law is that a company cannot purchase nor pay for it's 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;**

(d) Dividends are payable in cash [14] unless articles provide otherwise, so that **provision in the articles** is necessary before bonus shares may be declared;

14 See I4

(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: sec. 43. 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 provide for capitalization, they will give the authority required; usually the authority required is the same as in a declaration of dividend.

8. SECRETARY

The Ordinance does not require a secretary.[15] Companies, however, usually have a secretary who is appointed by the directors.[16]

The position of a secretary has not been defined by the Ordinance.[17] Table A, art. 71 provides that "the seal of the company shall not be affixed to any instrument except in the presence of a director and of the secretary or such other person as the directors may appoint for the purpose; and that the director and the secretary or other person as aforesaid shall sign every instrument to which the seal of the Company is so affixed in their presence".

"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 anyone assume that statements made by him are necessarily to be accepted as trustworthy without further inquiry".[18] Hence, the company is not bound if the secretary borrows money[19] or enters into contracts[20] purporting to act on behalf of the company, nor if a forged share certificate is issued;[21] a secretary cannot summon a meeting[22] nor can he register a transfer[23] on his own authority.

15 The English Companies Act, 1948, s. 177 requires every company to have a secretary.
16 In England, sometimes, the secretary is named in the Articles.
17 The English Companies Act, 1948, defines a secretary as being an officer. In practice in Ceylon, some companies treat a secretary as an officer and others as an employee.
18 *Per* Lord Esher in Barnett, Hoares & Co. v. South London Tramways Co., (1887) 18 Q.B.D. 815 (C.A.) at p. 817.
19 Re Cleadon Trust, Ltd., (1939) Ch. 286 (C.A.).
20 Williams v. The Chester and Holyhead Ry. Co., (1851) 15 Jur. 828.
21 Ruben v. Great Fingall Consolidated, (1906) A.C. 439.
22 Re State of Wyoming Syndicate, (1901) 2 Ch. 431.
23 Chida Mines, Ltd. v. Anderson, (1905) 22 T.L.R. 27.

CHAPTER J

ACCOUNTS

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 Ordinance) at least once every calendar year. Annexed is the balance sheet, the directors and auditors report and statement regarding accounts of any subsidiary.

   (a) **PROPER BOOKS OF ACCOUNT** must be kept showing:

      (i) all **sums of money** received and expended, and the matters for which the receipt and expenditure takes place;

      (ii) all **sales and purchases;**

      (iii) the **assets and liabilities**: s. 120 (1).

If a director fails to take reasonable steps or wilfully defaults in keeping proper books of accounts, he will be liable on conviction to a fine not exceeding Rs. 2,000/- or to imprisonment not exceeding six months or to both: s. 120(3).

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 director, manager or officer knowingly a party to the default[1] are liable to imprisonment for not more than one year. For this purpose the books must comply with conditions which are much the same as in (i) above, and must include **annual stocktakings** and (except in retail trade) particulars of goods **sold and purchased** with sufficient information of **buyers** and to enable them to be identified: s. 262.

There is sufficient compliance with the provisions of s. 120 if the books of accounts contain an account record of each and every transaction which the section requires to be recorded. It cannot be

[1] If the director, manager or officer can prove that he acted honestly, or that in the circumstances in which the business was carried on the default was excusable, he would not be liable: s. 262.

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 Ordinance: Heen Banda v. Herath (1949) 51 N.L.R. 305.

The books of account must be kept at such place as the directors decide and be open at all times for inspection by all or any of them: s. 120(2).

(b) 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 (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 abroad. The Registrar of Companies may extend these periods of 9, 12 & 18 months.[2] A **directors report** must be attached to every balance sheet: s. 121[3]. The auditors report must also be attached to the balance sheet: s. 127.[4]

The profit and loss account and balance sheet must comply with the detailed requirements of the Ordinance.[5]

On non-compliance with the provisions of s. 121, 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) 69 N.L.R. 230

2. 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:** s. 121(2).

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2 From 1960 to 1967, (the latest years for which figures were available up to publication), the Registrar of Companies allowed extension of the prescribed period for tabling accounts to about 310 applicants.

3 see J 2

4 see J 13

5 see J 3

3. CONTENTS OF BALANCE SHEET AND ACCOUNTS

(a) Balance Sheet

The balance sheet must give a **true and correct view** of the state of the company's affairs, and the auditors must state that this is so in their report.

A summary must be given of the authorised and issued share capital of the company, it's liabilities and assets giving particulars disclosing the general nature of the liabilities and assets and distinguishing between the fixed and floating assets and stating how the values of the fixed assets have been computed. Preliminary expenses, expenses incurred in any issue of shares or debentures, goodwill, patents, and trade marks must be shown under separate headings. If liabilities are secured on any assets such fact must be stated: s. 122.

With regard to SUBSIDIARY COMPANIES:[6] shares held in a subsidiary, and monies owed to or by a subsidiary must be shown separately: s. 123. A statement, signed by the directors who sign the balance sheet, must be annexed to the balance sheet, stating (a) how the profits and losses of the subsidiary or subsidiaries have been dealt with in the accounts of the holding company, (b) how the losses of the subsidiary have been dealt with both in the subsidiaries' accounts and in computation of the profits and losses of the holding company, (c) if the auditors report on the subsidiary is qualified, particulars of such qualification. If the information necessary for the statement is not available, a report in lieu of the statement must be annexed, stating such fact: s. 124.

Any commissions or discounts paid, allowed, or written off on shares and debentures must be given in the balance sheet till the whole amount is written off: ss. 45, 48.

The amount of any outstanding loans given (a) to enable trustees to purchase fully paid shares to be held for the benefit of employees (including salaried directors), and (b) to enable employees other than directors to purchase fully paid shares, must be shown as a separate item in the balance sheet: s 46.

If redeemable preference shares have been issued, the amount of such shares and the date on or before which the shares may be redeemed: s 47.

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6 Unlike the English Companies Act, 1948, group accounts of holding and subsidiary Companies are not required. The Colombo Brokers' Association, however, require certain quoted companies to present group accounts under specified circumstances—see The Colombo Brokers' Association By-Laws, Part XI.

Particulars of any redeemed debentures which the company has power to reissue: s. 75.

(b) **Accounts**

It must be disclosed in the accounts,

(1) The rate of interest, if interest is being paid out of capital under: s. 55.

(2) As to loans to directors and officers:

(a) Loans made **during the financial year,** by the company or other persons, or guaranteed or secured thereby, to officers including any such amounts **repaid** during the year;

(b) Loans made **before the year** and **outstanding at the end** thereof. But the accounts may omit (i) Loans made in the **ordinary course** of business where the company's business includes the lending of money; and (ii) loans to employees, not exceeding Rs. 20,000/- each, where certified by the directors to be in accordance with a practice of the company to lend money to employees.

As to directors' remuneration, etc.,

Emoluments from company and subsidiaries, including all fees, percentages or other emoluments paid to or receivable, or consideration given directly or indirectly the estimated **cash value** of other benefits; in the case of a managing director or any salaried director, disclosure of remuneration received by them is not required, but only of their directors' fees; if the accounts do not show these particulars, the auditors must include them in their report, so far as they are able to do so: s. 126.

4. 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: s. 127.

Any statement annexed of any subsidiary's accounts must also be signed by the same directors: s. 124.

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: s. 121;

and, in the case of a **public company,** copies must be,

(ii) **sent to all persons entitled to receive notices of general meetings** of the company at least seven days before the meeting;

(iii) **supplied on demand** and without charge to any member or debenture holders: s. 128;

(iv) **filed** with the annual return: s. 108.*

The auditors report must be read before the company in general meeting and must be open to inspection by any member: s. 127.

In (ii) exceptions are made for persons who have not supplied addresses; copies need be sent to only one joint holder, and not to others who are not entitled to receive notices. All such persons, however, are entitled to copies on demand under (iii).

In the case of a private company, any member is entitled to be furnished within seven days of request, a copy of the balance sheet and auditors' report, at a charge not exceeding twenty-five cents for every hundred words: s. 128(2).

6. 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 falsified 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".

* Quoted companies must, in addition, send 3 copies of the directors' report and statement of accounts to the secretaries and members of the Colombo Brokers' Association.

AUDITORS

7. PERSONS QUALIFIED TO BE AUDITORS

Only a registered auditor will be eligible for appointment: s. 130(7). By the Company Auditors Regulation, 1964 ,only members of the Institute of Chartered Accountants are qualified to be auditors of public limited companies, while certain other specified persors registered for this purpose could audit private companies.

8. PERSONS NOT QUALIFIED FOR APPOINTMENT

(a) a director or officer of the company;

(b) a partner or employee of or officer of the company (private companies are exempted);

(c) a body corporate: s. 131[7]

9. APPOINTMENT OF AUDITORS

By s. 130, 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.

Subsequently, auditors must be appointed at **each annual general meeting** to hold office till the next annual general meeting.[8]

If no appointment of auditors is made at an annual general meeting, the Registrar of Companies may fill the vacancy, on the application of any member for the current year.[9]

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.

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7 In the English Companies Act, 1948, under (a), servants of the company, and directors officers and servants of subsidiaries too may not be appointed, and under (b), private companies are not excluded.

8 In the English Companies Act, 1948, the auditors are appointed till the conclusion of the first general meeting or the next annual general meeting; further, an auditor is automatically reappointed without any resolutions, except in specified circumstances whereas in Ceylon Law no provisions for such automatic re-appointment is provided for.

9 From 1960 to 1967 (the latest year's figures available for publication) the Registrar of Companies allowed about 8 appointments of auditors.

10. 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, provided notice of the nomination has been given to the members at least seven days before the meeting: s. 130.

Subsequently, a resolution for appointing at an annual general meeting a person other than a retiring auditor cannot be moved unless the member moving the resolution has given 14 days notice to the company and the company has given all members and retiring auditor 7 days notice; s. 130.[10]

11. POSITION OF AUDITORS

An auditor is not considered an "officer' for the purposes of s. 131. However, an auditor is treated in the same way as an officer by s. 150 (provisions relieving officers and auditors from liability) and s. 360 (relief of officers and auditors); he is an officer of the company for the purpose of a summons under s. 264[11] or for the purpose of offences under sections 259, 260, 261 and 262 of the Ordinance (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.[12]

An auditor is an agent of the company for the purposes of s. 133 dealing with investigations[13] 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 judgment are being relied on and he does not declare that he is not responsible for information or advice given by him.[14] For breach of this duty, if there is damage, there is an action for negligence.

The Ordinance or Table A does not provide for the resignation apart from s. 130(4) nor the dismissal of the auditor, or 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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10 In the English Companies Act, 1948, the retiring auditor or auditors to be removed may make representations to the company and it's members.
11 Re London and General Bank (1895) 2 Ch. 166 (C.A.)
12 R. V. Shacter (1960) 2 Q.B. 252 (C.C.A.)
13 Re M 1
14 Hedly Byrne & Co. Ltd. v. Heller & Partners, Ltd. (1964) A.C. 465.

12. 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 first annual general meeting, (b) when filling a casual vacancy. The Registrar of Companies may fix remuneration in the instances when they appoint the auditor: s. 130(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.[15]

13. RIGHTS AND DUTIES OF AUDITORS

Duties

The principal duties of auditors are prescribed by s. 132, which requires that the auditors shall make a **report** to the members on the accounts examined by them and on every balance sheet laid before the company in general meeting during the tenure of their office. The report must state—

(a) whether or not they have obtained all the information and explanations they have required, and

(b) whether, in their opinion, the balance sheet referred to in the report is 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, and as shown by the books of the company.

If the accounts do not give the statutory particulars as to loans of officers and directors, and 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: s. 126. Certain contents of the statutory report require to be certified as being correct by the auditors: s. 111.

In the absence of a balance sheet the auditors must make their report on the accounts examined.[15]

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

[15] Liquidator Turret Motors v. Charles (1943) 44 N.L.R. 451.

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 contain a true and correct representation of the state of the company's affairs".[16]

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.

"An 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".[17]

"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 suficient.... 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 ..."[18]

Auditors may have additional duties given them by the articles or terms of appointment. Their statutory duties may not, however, be varied.

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16 *Per* Stirling J. in Leeds Estate Co. v. Shepherd (1887) 36 Ch.D. 787 at p. 802.

17 *Per* Lopes, L. J. in Re Kingston Cotton Mill Co. (No. 2) (1896) 2 Ch. 279 (C.A.) at p. 288.

18 *Per* Lindley L.J. in Re London and General Bank (No. 2) (1895) 2 Ch. 673 (C.A.) at p. 68.

The auditors must acquaint themselves with their duties under the articles and the Ordinance.

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.[19]

Rights

Auditors of a company have the right of access at all times to the books, accounts and vouchers 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. 132(2).

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. 132(3).

[19] Re Allen, Craig & Co. (London) Ltd., (1934) Ch. 483.

CHAPTER K

EXECUTIVE

1. The evolution of 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 managers, 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. 363 (interpretation section of the Ordinance), '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: s. 137. In respect of private companies, the Ordinance is silent.[1] 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, clause 64 states, "the names of the first directors shall be determined in writing by a majority of the subscribers of the memorandum of association". If the articles are silent the subscribers to the memorandum would appoint them.

A person cannot be appointed 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,

1 Unlike English Companies Act 1948, which specifies at least one director for a private company.

(1) signed and delivered to the Registrar a consent in writing to act as director; and

(2) (i) signed the memorandum for his qualification shares if any; or

(ii) taken his qualification shares from the company; or

(iii) delivered to the Registrar an undertaking in writing to take and pay for his qualification shares; or

(iv) delivered to the Registrar a statutory declaration that the qualification shares are registered in his name: s. 138.

This section does not apply to —

(i) a company not having a share capital;

(ii) a private company ;

(iii) a public company which was formerly a private company;

(iv) a prospectus issued by or on behalf of a company after one year since it was entitled to commence business.

(b) **Subsequent appointments** are governed by the articles. In public companies it is usually stated as in Table A that at the first ordinary general meeting[2] 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.

(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. 149;

[2] I.e., in effect the annual general meeting.

(ii) 'additional' directors, e.g., technical advisers;

(iii) 'alternative' or 'substitute' directors, to act in place of directors temporarily absent;

'nominee' directors to represent particular interests such as debenture holders.

By s. 141 which provides that the acts of a director are valid, notwithstanding any defect that may afterwards be found in his appointment or qualification. But 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 tendered services, however, such as that of a managing director, he may be able to claim remuneration from them on a *quantum meruit*).

3. RESTRICTION ON APPOINTMENT

The following persons are disqualified by statute for appointment as directors:

(i) Uncertified insolvents or undischarged bankrupts, except with leave of court: s. 140.

(ii) Directors who have failed to obtain or retain their qualification, until again qualified: s. 139.

(iii) Fraudulent persons disqualified from acting by court, except with leave of the court: ss. 141 A, 153 I and 208.

Articles may contain other restrictions too. Thus, in public companies there may be a provision in the articles preventing the appointment or retaining of directors over 70 years of age, except with the approval of the company in general meeting.

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 Ordinance; 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: Fourth 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 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. 138.

(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 he does not acquire the necessary shares within that period, or at any time ceases to hold them, he **vacates office,** is liable to a fine of not more than Rs. 50/- for every day that they act as directors, and cannot be re-appointed until they are qualified again: s. 139.

(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. 93.

(e) The holding of a share warrant is insufficient: s. 139.

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. 65, provides 'remuneration of directors shall from time to time be determined by the company in general meeting'.

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 not profits and proved in a winding-up.[2]

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 of the company in general meeting: Young v. Naval etc. Socy. (1905), 1 K.B. 687.

2 Re Lundy Granite Co. (1872) 26 L.T. 673.

The directors cannot vote remuneration to themselves or appoint one of their number to a salaried post, unless authorised by the articles 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".[3]

In Kerr v. Marine Products, Ltd., (1928) 44 T.L.R. 292, where the articles were the same as Table A, art. 65 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 at 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.

6. DISCLOSURE OF INTERESTS IN CONTRACTS (Read in conjunction with J 13c)

By s. 147 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. A director who fails to comply with these provisions shall be liable to a fine of not more than Rs. 1,000/-.

7. LOANS TO DIRECTORS

(1) Loans by the company to directors are permitted[4] but certain particulars of such loans must, by s. 126, be disclosed in the accounts laid before the company in general meeting.[5]

(2) Any provision in the articles with respect to loans to directors by the company must be followed if the loan is to be valid. Thus, if the articles require the approval of the board, such approval must be obtained if the loan is to be valid; in such a case the quorum of the directors meeting should be a 'disinterested quorum', i.e., with the exclusion of the director to whom the loan is being given— see K 11. In Perera v. Perera (1963) 67 N.L.R. 445, where the articles contained

3 Re George Newman & Co. (1895) 1 Ch. 674 (C.A.)

4 In English Company Law Loans to Directors are permitted only in certain specified circumstances.

5 Vide J 3.

Table A, art. 72 which states that a "director directly or indirectly interested in any contract with the company, or participates in the profit of any contract with the company vacates office", a director who borrowed money from the company, was inferred as having vacated office.

8. COMPENSATION FOR LOSS OF OFFICE, OR ON RETIREMENT

No compensation for loss of office or consideration on retirement may be paid to any director, in connection with a transfer of the whole or any part of the undertaking or property of a company, **unless** particulars of the payment including the amount, are first disclosed to the members and approved by the company, (compensation includes any excess price or consideration paid on the shares, i.e., more than what the other shareholders could have obtained, to such director). When any offer is being made to the shareholders in connection with the transfer and notices are sent re such transfer, the director must take all reasonable steps to secure that particulars of the proposed compensation are included in such notice. If the provisions are not complied with, the compensation paid is illegal and the director is deemed to hold such payment in trust for the persons who have sold their shares as a result of the offer made. Further, the director is liable to a fine of Rs. 250/-:s. 148.[6]

9. REGISTER OF DIRECTORS AND PUBLICATION OF DIRECTORS NAMES, ETC.

Every company must, by s. 142,

(i) **keep at it's registered office** a register of it's directors or managers;

(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;

[6] By the English Companies Act 1948 it is illegal to pay compensation for loss of office or on retirement, even where payment is not in connection with the transfer of the whole or part of the undertaking, unless it is approved by the members.

(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, it's name and registered or principal office.

The register must be available for inspection for at least two hours during business hours, free to members and on a charge of not more than 50 cents to others: s. 142.

No register of directors' share holdings is required, unlike in English Company Law.

By s. 143 every company must state the following particulars of directors in all trade catalogues, trade circulars, show cards and business letters at which company's name appears:

(1) The directors' present or former names (or the initials thereof) and surnames;

(2) Nationality and nationality of origin, if different. The Registrar of Companies may by order grant exemption from these provisions.

From 1960 up to date of publication, the registrar of companies received only 2 applications for exemption.

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.[7] "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"[8]. "It does not matter what you call them so long as you

7 Re Forest of Dean Coal Co. (1878) 10 Ch.D. 450 and Faure Electric Accumulator Co. (1889) 40 Ch.D. 141.

8 *Per* Kay J. in Faure Electric Accumulator Co. (1889) 40 Ch. D. 141 at page 151.

understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and all the other shareholders in it".[9] In some respect they may be said to be,

(a) quasi trustees; and

(b) agents for the company.

(a) Directors as quasi-trustees

Directors have some attributes of trustees,[10] at least with respect of assets which come under their direction.[11]

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 judgment 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 trustee, and who are his *cestuis quo trustent* . . . . . The office of directors is that of a paid servant of the company. The director never enters into a contract for himself, but

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9 *Per* Jessel M.R., Forest of Dean Coal Mining Co. (1897) 10 Ch. D. 451 at page 453.

10 Directors are not trustees for individual shareholders: Percival v. Wright (1902) 2 Ch. 421.

11 Lands Allotment Co. (1894) 1 Ch. 631, 638.

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."[12]

(b) **Directors as agents**

Since the company has no physical existence, it's 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 contract on behalf of the company.[13] 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;[14] of course, 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.[15]

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 Ordinance 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.

12 *Per* James L.J., Smith v. Anderson (1880) 15 Ch. D. at page 275.

13 They may incur personal liability under s. 92 see D. 10

14 The company may be bound by Turquand's Rule, see D 21.

15 Hambro v. Burnard (1904) 2 K.B. 10

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 salaries and positions in the company: Kerr v. Marine Products, Ltd. (1928) 44 T.L.R. 292.

Unless the articles such as Table A, art. 68 empower the directors to appoint a managing director, the directors cannot appoint one.[16] 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 appointted for a specified number of years or for life, his appointment ceases if he ceases to be a director.

How directors act

The directors must act collectively at properly constituted board meetings. They cannot delegate their powers and duties to committees nor to a managing director unless authorised by the articles, such as Table A, articles 68 and 85 authorise. 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.[17] 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;[18] 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. 82 The quorum necessary for the transaction of the business of the directors may be fixed by the directors, and unless so fixed shall when the number of directors exceeds three be three, and when the number of directors does not exceed three be two.

16 *Per* Swinfen Eady J. in Boschoeck Proprietary Co. Ltd. v. Fuke (1906) 1 Ch. 148 at p. 159.

17 Re Homer Gold Mines (1888) 39 Ch. D. 546.

18 Barron v. Potter (1914) 1 Ch. 895.

Art. 83 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 regulations of the company as the necessary quorum of directors, the continuing directors 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 directors could not recover the amounts from the company: Re Cleadon Trust (1939) Ch. 286 (C.A.).

Table A, articles 81 to 88 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. 85 provides for delegation to committee and Table A, art. 68 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

Duties of directors have been classified as being (a) fiduciary duties and (b) duties of care and skill.

(a) Fiduciary duties

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. Nor must they make use of their position, power or knowledge for

their personal gain. Directors are "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."[19]

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[20] making calls[21] forfeiting shares[22] or approving transfers.[23]

Where a director on a contract gained an undisclosed commission and bonus, it was held that such secret benefits must be 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 Ordinance provides for the maintenance of this fiduciary position of directors in two respects, by requiring the disclosure of interest in contracts: s. 147[24], and disclosure on payment of compensation: s. 148[25].

(b) **Duties of care and skill**

Directors duties have been summarised[26] 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.

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19 *Per* Rigby L.J. in Alexander v. Automatic Telephone Co. (1900) 2 Ch. 56 at page 72.

20 Parker v. McKenna (1874) L.R. 10 Ch. 96.

21 Gilbert's Case (1870) 5 Ch. 559.

22 Harris v. North Devon Railway Co. (1855) 20 Beau 384.

23 Bennett's Case (1867) De G. M. & G. 284.

24 Vide K 6.

25 Vide K 8.

26 Charlsworth's Company Law, Eighth Edition.

(c) They are not liable for errors of judgment.

(d) They are not bound to give continuous attention to the company's affairs.

(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.

(f) Apart from the general duties summarised 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.

(c) **Contracts of directors with company** (Read in conjunction with K 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 option of company T: Transvaal Lands Co. v. New Belgium Co. (1914) 2 Ch. 488.

"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 authorise directors to make contracts in which they are personally interested on disclosing their interest to the board;[29] however, terms of the articles must be strictly

27 Transvaal Lands Co. v. New Belgium Land Co. (1914) 2 Ch. 488.

28 *Per* Lord Cains L.C. in Parker v. McKenna (1874) L.R. 10 Ch. A pp. 96 at p. 118.

29 Table A makes no provision.

complied with[30] and disclosure must be full and fair,[31] and to a disinterested board.[32] By s. 147 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.[33]

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] provided it does not amount to a fraud on the minority.[37]

14. VALIDITY OF ACTS OF DIRECTORS

The acts of directors or managers are valid notwithstanding any defect that may be afterwards be discovered in their appointment or qualifications: s. 141. Table 'A' art. 88 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

30 Toms v. Cinema Trust Co. (1915) W.N. 29.
31 Costa Rica Railway Co. v. Forwood (1900) 1 Ch. 756 (1901) 1 Ch. 740.
32 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.
33 See K 6.
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. Cas. 589 (P.C.).
37 Cook v. Deeks (1916) 1 A.C. 554 ante H 23.

appears to be duly appointed, as being so appointed.[38] If there has been no appointment at all, however, then these provisions do not apply.[39]

If the directors act in excess of their powers the company may be bound under the Rule in Royal British Bank v. Turquand (Vide D 21).

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. 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. 752. When a director is guilty of fraud, if there are no circumstances to arouse the suspicions of the co-directors, they are not liable for not discovering the fraud: Dovey v. Cory (1901) A.C. 477.

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. 144. If the memorandum does not so provide, a limited company, if so authorised by its articles, may by special resolution, alter its memorandum so as to render unlimited the liability of its directors or of any managing director: s. 145.

When a person is proposed as a director of a company having the liability of directors 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. 144.

17. DISCLOSURE OF REMUNERATION IN ACCOUNTS, etc.

Vide J 3 for disclosure in accounts.

If members having at least one-fourth of the total voting rights, request in writing, a company must furnish to **all members** within one month, a statement, certified by the auditors of the company giving with respect to the last **three preceding years** much the same information as is required to be disclosed in accounts and balance sheet: s. 146.

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38 Dawson v. African Consolidated Land and Trading Co. (1898) 1 Ch. 6, and British Asbestos Co. Ltd. v. Boyd (1903) 2 Ch. 439.

39 Morris v. Kanssen (1946) A.C. 459.

18. VACATION OF OFFICE

This occurs by—

(i) Retirement by **rotation** in accordance with the articles;

(ii) Resignation;

(iii) **Disqualification** through non-compliance with—

(a) statutory requirements, e.g., failure to retain qualification: s. 139 (3).

(b) Provisions of the company's articles,[40] e.g., vacating on reaching seventy years of age, on becoming of unsound mind, or on absence from directors' meetings over a period of say six months.

(iv) **Assignment** which can take place only if the articles or an agreement provides and sanction of a special resolution is obtained: s. 149. Assignment is resignation and simultaneous appointment of another as director in place of the retiring director.

(v) **Removal**, if provided for in articles.

19. REMOVAL OF DIRECTORS

No provision for the removal of directors before the expiration of his period in office is made in the Ordinance. Articles may provide for removal, such as Table A, art. 80 which states that a director may be removed by extraordinary resolution passed in general meeting.[41]

20. DISQUALIFICATION OF DIRECTORS

Articles sometimes provide that directors will vacate the office under special conditions. Table 'A', art. 72 provides,

"The office of director shall be vacated, if the director—

(a) ceases to be a director by virtue of section 139 of the Ordinance; or
(b) without the consent of the company in general meeting holds any other office of profit under the company except that of managing director or manager; or
(c) becomes insolvent or bankrupt, or
(d) becomes prohibited from being a director by reason of any order made under sections 208 or 263 of the Ordinance; or

40 see K 20.

41 The lack of provision for the removal of directors is a significant difference from the English Company Law, and is one of the chief indications that the Ceylon Company Law is outmoded. The Rules of the Colombo Brokers Association, however, provide that companies dealt with on the exchange must contain in their articles the power to remove a director by ordinary resolution in general meeting.

(e) is found to be a person of unsound mind or becomes of unsound mind; or
(f) resigns his office by notice in writing to the company; or
(g) is directly or indirectly interested in any contract with the company or participates in the profits of any contract with the company.

Provided, however, that a director shall not vacate his office by reason of his being a member of any corporation which has entered into contracts with or done any work for the company if he shall have declared the nature of his interest in manner required by section 147 of the Ordinance, but the director shall not vote in respect of any such contract or work or any matter arising thereout, and if he does so vote his vote shall not be counted".

If a director of a company having Table 'A', article 72 in it's Articles infringes such 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.

CHAPTER L

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 it's business and to secure such loan by pledging it's assets.[1] Non-trading companies cannot borrow unless express power is given in the Memorandum.

A public company with a share capital cannot borrow till the provisions of s. 93 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 restriction of either the amount which may be borrowed or the power of the directors to act with the sanction of a general meeting. Table A art. 69 provides,

"The amount for the time being remaining undischarged of moneys borrowed or raised by the directors for the purposes of the company (otherwise than by the issue of share capital) shall not at any time exceed the issued share capital of the company without the sanction of the company in general meeting."

A power to borrow includes the power to take a charge on the uncalled capital[3] unless there are provisions in the memorandum and 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]

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1 General Auction Estate Co. v. Smith, (1891) 3 Ch. 432.
2 See B 8.
3 Re Pyle Works, (1890) 44 Ch. D. 534 (C.A.).
4 See G 2.
5 Re Mayfair Property Co., (1898) 2 Ch. 28 (C.A.).
6 Brooks & Co. v. Blackburn Benefit Socy., (1884) 9 App. Cas. 857.
7 Baroness Wenlock v. R. Dee Co., (1887) 19 Q.B.D. 155.
8 Ashbury Carriage Co. v. Riche, (1875) L.R. 74 H.L. 653.

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.

3. DEBENTURES*

Legally, any bond containing and acknowledgment 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. 363 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.

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9 Sinclair v. Brougham, (1914) A.C. 398.

10 Irvine v. Union Bank of Australia, (1877) 2 App. Cas. 366 (P.C.).

11 See D21.

* The Colombo Brokers' Association provides for more stringent provisions with regard to debentures and trust deeds than is provided for in the Ordinance for companies quoted on the Official List.

A debenture is for a specified sum, such as Rs. 100/- and is transferable only in it's 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 a **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 or determinable time or at the company's discretion. S. 74 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. 76.

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 it's own debentures, though it cannot purchase nor give any assistance for the purchase of it's shares;

iii. Debentures may be issued at a discount without formalities whilst shares cannot be issued at a discount unless the provisions of s. 48 are complied with;[12]

iv. Interest on debentures can be paid out of capital. Interest on shares may be paid only under s. 55[13]

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12 See G 22.
13 See I 6.

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 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 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 it's business;

(c) the events specified in the debentures upon which the depenture 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. 253.

A floating charge may be **invalidated** if,

1. Not registered with the Registrar of Companies within 21 days of creation: s. 78;
2. In the event of a winding up it is found to be a fraudulent preference of it's creditors: s. 254;
3. In the event of a winding up a floating charge is created within 6 months of the commencement of the winding up, unless immediately after the creation of the charge the company was solvent, (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 rate of 5 per cent per annum, is expected): s. 255.

5. REGISTRATION OF CHARGES

Charges made by a company on it's 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.87 every **limited** company must keep at it's registered office a register of all (a) charges specifically affecting the property of the company, and (b) floating charges on the undertaking or any property of the company giving,

i 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 director, manager or officer 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.

Copies of instruments creating charges

By s.86 **every** company must keep a copy of every instrument creating a charge requiring registration under ss.78, 80.

Inspection

The company's register of charges and the copies of instruments creating charges must be open for inspection without fee, to any creditor or member for at least 2 hours each day during business hours. Any

person may, however, inspect the Register of charges at a fee of not more than 50 cents. If inspection is refused, fines will be imposed and the court may order inspection: s.88.

(b) **Registration with the Registrar of Companies**

By s.78 the following created by a company together with any instrument creating the charge must be sent to the Registrar of Companies within 21 days of creation:

1. a charge securing an issue of debentures;
2. a charge on uncalled share capital;
3. a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale;
4. a charge on land or any interest therein;
5. a charge on book debts of the company;
6. a floating charge on the undertaking or property of the company;
7. a charge on calls made but not paid;
8. a charge on a ship or any share thereof;
9. a charge on goodwill, on a patent or a licence under a patent on a trade mark or on a copyright or a licence under a copyright.

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 deep, 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.

Particulars of the amount or *per cent* of the commission, discount or allowance on an issue of debentures must be registered: s.78.

ii. In **other cases**—

a. The date of the creation of the charge;

b. the amount secured by the charge;

c. Short particulars as the property charged;

d. the persons entitled to the charge : s.81

It is the duty of the company to register the particulars required by s.78, but any person interested in the charge may register and recover the registration fees from the company s.79.

On registration, the Registrar gives a certificate of registration, which is conclusive evidence that the requirements of the ordinance as to registration have been complied with s.81.

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 registered. The penalty for default is a fine of Rs. 1000/-:s.82.

When the debt for which any registered charge was given is paid or satisfied, the Registrar enters a memorandum of satisfaction[14] on the register. The company is entitled to a copy of the memorandum s.83.

The register is open to public inspection on the prescribed fee, not exceeding Re. 1/- being paid :s.81.

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 is just and equitable to grant relief : s.84.

6. EFFECT OF NON-REGISTRATION

If a charge requiring registration under s.78 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.78.

[14] i.e., a memorandum of release.

2. The company, every director, manager, secretary or other person, who knowingly is a party to the default is liable to a fine not exceeding Rs. 500/- for every day during which the default continues : s.79.

7. ISSUE OF DEBENTURES

The issue of debentures is in accordance with the provisions of the articles.[15]

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 minmum subscription and as to the receipt of applicants money[16] must be complied with;
(*e*) Debentures may be issued at a discount without special authority and formality.[17]

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.41 on allottment apply to the issue of debentures as well.
(*b*) By s.68 debenture or debenture stock certificates must as in the case of share certificates be issued within 2 months after allottment or after the lodgement of a valid transfer.

A contract to take up debentures may be enforced by specific performance : s.76.

8. RE-ISSUE OF REDEEMED DEBENTURES

By s.75 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

15 Table A does not provide for the issue of debentures.
16 See B8.
17 S. 78 (9).

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.

Particulars of redeemed debentures which the company has the power to re-issue must be given in the balance sheet.

9. TRANSFER OF DEBENTURES

(*a*) **Bearer debentures**[18] are negotiable instruments and transferable by delivery; a *bona fide* transferee for value takes them free from my defects in the title of a prior holder.

A secretary pilfered bearer debentures of B company from a safe and deposited them with the bank as security for loans by him. Held, the bank was entitled to the debentures as they were 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 on the transfer of bearer debentures is not payable.

(*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.64. 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.68. If registration of a transfer is refused, notice of refusal must be given to the transferee within 2 months: s.67. In case of default, the company, every director, secretary, or other officer who was knowingly at fault is liable to a fine of not more than Rs. 50/- per day during which the default continues : ss.67,351.

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18 Bearer debentures are in the same form as registered debentures except that it is also stated that they are payable to bearer and coupon for the interest are attached.

10. REGISTER OF DEBENTURE HOLDERS

The Ordinance does not require the company to keep a register of debenture holders or debenture stock holders. In a public issue, however, the trust deed or terms of issue invariably requires a register of debenture holders to be kept, and if kept the register must comply with s.73. The provisions of s.73 are as follows:

Debenture holders and shareholders may, without fee, **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 25 cents 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 50 cents in the case of a printed trust deed or 25 cents 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 Rs. 50/- and in addition a default fine of Rs. 20/-.[19] 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 judgment 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,** sue on the charge.

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 the latter are numerous, scattered and unknown to each other. (The Colombo Brokers' Association requires, in the case of quoted companies, at least 2 trustees to be appointed, unless the sole trustee appointed is a company or corporation approved by the Committee

19 By s. 351 too.

of the Colombo Brokers' Association). A trust deed is a contract between the trustees and the company setting out the terms under which the debentures are issued.

The **contents** of a trust deed usually are,

1. An undertaking by the company to pay the principal moneys 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 probably 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 extraordinary resolution of the debenture holders.[20]

RECEIVERS AND MANAGERS

13. APPOINTMENT

A body corporate may not be appointed as receiver: s.283.[21]

When a company is being wound up by the Court, the offcial receiver may be appointed receiver on behalf of the debenture holders and creditors: s.284.

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20 The following provision of the English Companies Act (1948), is lacking in the Ordinance, "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".

21 If a body corporate becomes a receiver, it is liable to a fine not exceeding Rs. 1,000/-.

14. EFFECT OF APPOINTMENT

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 under a penalty fine of Rs. 200/- :s.285.

15. RECEIVER'S DUTIES AS TO ACCOUNTS AND RETURNS[22]

A receiver or manager appointed under the powers contained in any instrument, must,

(*a*) within one month, such or longer period as the Registrar of Companies may allow, after the expiration of 6 months from the date of his appointment; and

(*b*) every subsequent 6 months; and

(*c*) within one month after he ceases to act as receiver or manager,

deliver to the Registrar of Companies a statement of his receipts and payments for the period commencing from his appointment: s.287.

A receiver or manager not complying with these provisions is liable to a fine not exceeding Rs. 50/- 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 or the Registrar of Companies: s.288.

16. 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: s.286.

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22 The English Companies Act, 1948, contains more stringent provisions with regard to the receiver in the accounts and returns.

CHAPTER M

INVESTIGATION: PRIVATE COMPANIES: SUBSIDIARY AND HOLDING COMPANIES

1. INSPECTION OR INVESTIGATION INTO THE AFFAIRS OF A COMPANY[1]

Occasions may arise which make it desirable for a thorough investigation to be made in the affairs of a company. By s. 133 the Registrar of Companies **may** appoint[2] one or more competent inspectors to (a) investigate the affairs of a company, and (b) report thereon, on the application of—

(i) members holding not less than one-third of the issued shares, in the case of a banking company;

(ii) members holding not less than one-tenth of the issued, shares, in the case of a company having a share capital;

(iii) members constituting one-fifth of the total number of members, in the case of a company without a share capital.

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 applicants may be required to give security, not exceeding Rs. 1,000/- to meet the costs.

The inspectors may examine all books and documents of the company[3] and examine on oath the officers and agents of the company both past and present. If inspection of documents etc., is refused or any questions are unanswered, the inspectors may inform the court and the court may enquire in the case. An appeal, however, may be made against the court's order to the Supreme Court.

A **report** must be made on the investigation and sent to the Registrar of Companies, the registered office of the company and to the applicants, if any. Such a report, if authenticated by the seal of the company shall, by s. 136, be admissible as evidence of the inspector's opinion, in any legal proceedings.

1 Unlike the English Companies Act, 1948, investigation into the **ownership** of a company is not provided for in the Ordinance.

2 Since 1960 up to publication only one application was made for an investigation under s. 133, and this was not proceeded with.

3 Examination of books and documents of related companies are not provided for as in the English Companies Act, 1948.

If it appears to the Registrar of Companies that any person is guilty of a criminal offence, the Registrar may refer the matter to the Attorney-General to prosecute: s. 134.

A company may by **special resolution** appoint 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 if inspection of documents etc., is refused or questions are unanswered.

2. PRIVATE COMPANIES

A private company is a company which by it's **articles,**

(a) restricts the right to transfer it's shares;

(b) limits the number of it's members to fifty, exclusive of present employees who are, and past employees who were whilst employed and have continued to be members;

(c) prohibits any invitation to the public to subscribe for it's shares or debentures.

Where two or more persons hold shares jointly they are treated as a single member: s. 27.

Private companies must file their own articles of association, since Table A cannot be adopted as it does not contain the above restrictions.

3. PRIVILEGES AND DUTIES OF A PRIVATE COMPANY

(i) It need have only **two members;**

(ii) The Ordinance is **silent as to the minimum number of directors** unlike in the case of public company where the minimum must be two;

(iii) No **statutory report** need be filed or **statutory meeting** need be held;

(iv) The first directors do not need to **file a consent** to act on an **undertaking** to take their qualification shares, though they must nevertheless obtain the latter;

(v) There is no **minimum subscription,** and it need not file a prospectus or statement in lieu of prospectus before allotting shares;

(vi) It does **not need a Certificate to Commence Business** before it can enter into a binding contract, and may commence trading as soon as incorporated;

(vii) It need **not file accounts** with it's annual return.

It must however,

(i) **Observe the restrictions** in it's articles as to (a) maximum number of members, (b) offer of shares and debentures, and (c) restrictions on transfers of shares.

(ii) **File with it's annual return,**

(a) A certificate that the company has not since the last return offered it's 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, and employees and ex-employees.

4. LOSS OF PRIVILEGES AND CONVERSION OF A PRIVATE COMPANY

By s. 28,

(a) If a company **alters it's articles** by removing the provisions of s. 27 constituting it a private company, then, it ceases on that day to be a private company[4] and must within 14 days file with the Registrar of Companies a prospectus or a statement in lieu of prospectus in accordance with the Third Schedule of the Ordinance.

(b) If a company **fails to comply** with the restrictions (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; it must file accounts with it's annual return

4 From 1960 to 1967 (figures available on publication were up to 1967) private companies converted to public companies were 10 and public companies converted to private companies were 2.

and send such accounts to members and auditors once a year and on demand. But the Court, if satisfied that the failure was accidental or some other sufficient cause, may grant relief.

To **convert a public company into** a private company[4] 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 minimum.

5. HOLDING AND SUBSIDIARY COMPANIES

By s. 125,

A company is a subsidairy of another if the latter—

(a) holds more than 50 per cent of the issued capital or the voting power; or if

(b) the company has power directly or indirectly to appoint the majority of the directors (not being power given by or in connection with a debenture trust deed),

in the former company.

When a company's ordinary business includes the lending of money, and such company holds shares in another as security against loans given, such a holding shall **not** be counted for the purpose of determining whether the latter company is a subsidiary or not of the former company.

The Ordinance requires particulars of subsidiary and holding companies to be included in the balance sheets.[5,6]

5 Group accounts unlike the English Companies Act, 1948, are not required— see J 3. The Colombo Brokers' Association, however, require certain quoted companies to present group accounts under specified circumstances— see The Colombo Brokers' Association By-Laws, Part XI.

6 By the English Companies Act, 1948, a subsidiary may not be a shareholder of it's holding company.

CHAPTER N

RECONSTRUCTIONS, AMALGAMATIONS AND ARRANGEMENTS: OPPRESSION AND MISMANAGEMENT

RECONSTRUCTIONS, AMALGAMATIONS AND ARRANGEMENTS

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 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. RECONSTRUCTION can take place either under (a) s. 152 or under (b) s. 225 of the Ordinance. Under s. 152 the transferee must be a company within the meaning of the Ordinance, i.e., a company formed and registered under the Ordinance or an existing company: s. 363. Under s. 225 the transferee company need not be a company within the meaning of the Ordinance. Further, under s. 152 reconstruction can take place at any time during the company's existence or during winding up, unlike under s. 225 when a company must be or proposed to be in the course of winding up.

Reconstruction under Section 152: This section provides that where an application is made to the court under section 151 (see N 2 below) for the sanctioning of a compromise or arrangement as therein mentioned[1] 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 under the scheme the whole or any 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,

[1] The proper procedure under this section is, therefore, first to obtain an order under s. 151 sanctioning the scheme, with liberty to apply.

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 reconstruction or amalgamation shall be fully and effectively carried out (Sub-section 1).

Sub-section 2 enacts 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 freed from any charge which is by virtue of the compromise or arrangement to cease to have effect. The expression "property" includes property, rights, and powers of every description, and the expression "liabilities" includes duties (sub-section 4) but not a duty to serve under a contract of personal service.[2]

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 seven 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 (sub-section 3).

Reconstruction under section 225[3]: 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 it's business or property be transferred or sold to another company. In which case, the liquidator or the transferor company is empowered by this section to,

2 Nokes v. Doncaster Amalgamated Colleries, (1940) A.C. 1014.

3 By s. 234 the provisions of s. 225 applies 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 committee of inspection.

(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,

if he obtains the sanction of a special resolution. 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 the winding up becomes a winding up by court or supervision of court, within one year, **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 arbitration (the manner of arbitration being given in sub-section 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 225 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, but 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.

Dissension from Reconstruction: In the event of dissension among shareholders in the case of reference to arbitration, the dissentient has to prove the value of his interest, but he will not be allowed to examine the directors under section 206[4] to obtain evidence for this purpose: British Building Stone Co., (1908) 2 Ch. 450. 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.

[4] See O19.

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 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. 153[5]: 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 Ordinance 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. In such case the transferee company may, at any time within two months after the expiration of such four months, give notice to dissenting shareholder 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. The transferee company must, on the expiration of one month from the date of giving such notice or if an application to the Court by dissenting shareholders is then pending, after that application is disposed of, transmit a copy of the notice to the transferor company, and pay or transfer to the transferor company the purchase consideration for the shares, whereupon the transferor company must register the transferee company as the holder of those shares. Any sums so received by the transferee 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. 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.

2. COMPROMISE OR ARRANGEMENTS

Compromises or arrangements with members and creditors under s. 151: 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

[5] Ss. 153 A, B, C, D, E, F, G, H, I are dealt with in N 3.

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.

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. Peoples 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 section 151 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 winding up (i.e. voluntary) such a composition with creditors may be affected either under s. 151 or s. 242, 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. 239 1 (a) and s. 184 1 (e) with the sanction of an extraordinary resolution of the company in the case of a member's 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. 242 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 acquisence must be given to a scheme of composition.

OPPRESSION AND MISMANAGEMENT

3. OPPRESSION AND MISMANAGEMENT

Under s. 162 of the Ordinance a company may be wound up compulsorily by Court if it is just and equitable 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 **153 A** and **153 B**[6] 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 ss. 153 A and 153 B 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, the court could make any order it thinks fit; or if

(ii) (a) the affairs of the company are being conducted in a manner prejudicial to the interests of the company; or (b) that a change has occurred (e.g., in the board of directors, agents, secretary or ownership) that would result in the affairs of the company being conducted in a manner prejudicial to the interest of the company.

The following member or members[7] of a company have the right to apply under sections 153 A and 153 B,

(a) in the case of a company having a share capital, not less than ten *per centum* of the total number of it's members or the holders of not less than the aggregate of ten percent

6 Very little use has been made of these provisions in practice, as yet.

7 The oppression must be suffered by the members of the company in their character as members and not in any other character, for example as directors, secretaries or managers: Elder v. Elder & Watson, 1952, S.C. 49.

of the nominal value of the company's issued share capital provided that the applicant or applicants have paid all calls and other sums due on their shares;

(b) in the case of a company not having a share capital, not less than twenty per cent of the company's members;
(Joint holders are counted as one member): 153 c.

Application for relief under s. 153 A and s. 153 B may be made after the commencement of winding-up: s. 153 D.

4. POWERS OF COURT

153 A and 153 B gives the court general powers and without prejudice to such powers, 153 E[8] provides for—

(a) the regulation of the conduct of the company's affairs in future;[9]

(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 it's share capital.

(d) the termination, setting aside or modification of any 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

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8 There is no corresponding section in the English Companies Act, 1948, giving the court such extensive powers over a company's affairs. S. 210 of the English Companies Act, 1948, which affords protection to minorities gives the court limited power, (i.e., provision is made for matters dealt with in (a), (b), and (c) in s. 153 E).

9 In Re Harmer Ltd., (1959) 1 W.L.R. 62 (C.A.) it was held that the court order may regulate the future conduct of the company's affairs (i.e., in reference to the similar provision in s. 210 of the English Companies Act, 1948.

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 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. 153 A or 153 B): s. 153 F.

5. 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: s. 153 G.

Agreements

Where an order of a court made under section 153 A or 153 B terminates, sets aside, or modifies an agreement such as is referred to in paragraphs (d) or (e) of section 153 E—

(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;

(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. 153 I.

CHAPTER O

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 one 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 N 1, 2);

(4) **Winding-up.**

2. REMOVAL OF NAME OF DEFUNCT COMPANIES FROM THE REGISTER

By s. 277 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. 278 applies. The specified procedure is as follows, in the case of (a), i to iv applying, and in the case of (b), iii and iv applying,

(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: s. 277 (2), (3).

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. 277 (5).

If the company, or any member or creditor thereof, feels aggrieved by the striking off the register, it or he may, within twenty 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 it's 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. 277 (6).

3. WINDING-UP[1]

May be,

(1) **Compulsory,** i.e., by order of the court;
(2) **Under supervision** of the court;
(3) **Voluntary:** s. 154.
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

1 From 1960 to 1967 (the latest year's figures available up to publication) the companies wound up were approximately 4 compulsorily, 2 under supervision of the court and 120 voluntarily.

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 it's 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. 161, 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.

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 it's business within a year from its incorporation or suspends it's 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 it's debts;

(6) the court is of opinion that it is just and equitable that the company should be wound-up: s. 162.

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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'.

3 See H 2

4 See M 2

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: Amalgamated Syndicates, (1897), 2 Ch. 600; Pirie v. Stewart, (1905), Court of Sess. 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.

(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. 153 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 to 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. 162 (6) is wide on the face of it, the courts have acted under this sub-section only in the following cases,

(i) where majority shareholders having controlling interests used such power perversely;

(ii) where the substratum has disappeared;

(iii) where the deadlock is such that no remedy is obtainable by recourse to the courts.

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5 See H23, N3

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,

(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;

(3) It is **proved to the satisfaction of the court** that the **company cannot pay it's debts.** Contingent and prospective liabilities must be taken into account: s. 163.

7. WHO MAY PETITION

The petition may be presented by,

1. The **company** itself, or
2. Any **creditor** or creditors; or
3. Any **contributory** or contributories; or by all or any of the above; or
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 or creditors or contributories - s. 164.[6]

[6] Under the English Companies Act, (1948) the Board of Trade is empowered to present petition in consequence of an investigation.

A contributory can present a winding up petition only if,

(a) 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; 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.

Otherwise a contributory can present a petition only on the ground that the number of members is below the statutory minimum. It would be inequitable to forbid him this right, since it may be his only way of avoiding personal liability under s. 29.

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.

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. 164.

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. 165 (1)

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. 165 (2).

Although the court will usually make an order if a case a 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 restrain of proceedings when any action against the company is pending: s. 166[7]. 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. 169.

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. 170.

(b) The order operates in favour of all the creditors and contributories of the company as if made on the joint petition of a creditor and of contributory: s. 172.

(c) After a winding-up order has been made or a provisional liquidator has been appointed, no action can be proceeded with or commenced against the company except by leave of the court: s. 171.

(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. 167;

7 By s. 243 (see O 43 under Provisions Applicable to Every Voluntary Winding-up) the provisions of s. 166 are applicable to a voluntary winding up too: Vanguard Insurance Co. Ltd. v. Ruhunu Transit Co. Ltd. (1962) N.L.R.LXV.

(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. 168;

(f) The Official Receiver by virtue of his office becomes provisional liquidator, and he continues to act until he or another person becomes liquidator: s. 179.

(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, (1866), L.R. 1 Eq. 346.

(i) The company's property and things in action are taken into the liquidator's custody: s. 182.

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. 173, 174.

His duties are:—

(1) To receive the **statement of affairs**— s. 175.

(2) To summon separate meetings of creditors and contributories— s. 179.

(3) To **report** to the court of the company's affairs— s. 176.

STATEMENT OF AFFAIRS

By s. 175, 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 is 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 any one stating himself in writing to be a creditor or contributory.

13. REPORT BY OFFICIAL RECEIVER

By s. 176 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 it's 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. 207 and 208 (see O 20, 21.)

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. 179, 191.

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. 177, 179.

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. 180.

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. 178.

Powers

S. 184 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 a proctor to assist him in his duties.[8]

(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 any authorisation required to be given by the committee: s. 193).

(2) On his own responsibility and **without obtaining any sanction,** the liquidator can,

(a) Sell the property of the company.

[8] Provided that where the liquidator is a proctor 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 of 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.[9]

(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 it's assets.

Further, by s. 211 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 of committee of inspection);

(5) the fixing of a time with which debts and claims must be proved.

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. 185.

If any person is aggrieved by any act or decision of the liquidator, that person may apply to the court which may confirm, reverse, or modify the act or decision complained of: s. 185.

[9] The rights and duties of the Public Trustee cannot be affected.

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: s. 189.

Books & 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 the court control: s. 186.[11]

All moneys 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/- for more than 10 days without court permission, and may not pay sums received by him as liquidator into his private account: s. 187.

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. 188.

Remuneration of Liquidator

In the matter of The Winding-up of the Travancore National and Quilon Bank, Ltd., (1939), 41 N.L.R. 428, it was held,

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 over payment.

Vacation of Office of Liquidator

The liquidator vacates his office,

(a) on resignation; or

10 Any further matters which the court may require to be recorded in the liquidator's books.

11 In the English Companies Act, 1948, the liquidators are required, in addition, to keep a cash book and a Trading Account.

(b) on removal by the court if there is sufficient cause: s. 181;

(c) on being released. 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 the court and after consideration of any objection from any interested party, the court may grant release: s. 190.

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. 191.

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.

If there is a vacancy, the liquidator must summon a meeting of the creditors or contributories to fill in the vacancy: the remaining members, if not less than two, can act in the meantime: s. 192.

If there is no committee of inspection, the court acts: s. 193.

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: s. 194.

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. 195.

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 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. 197.

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. 202.

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 a 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. 198.

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 Ceylon, or otherwise to abscond, or to remove or conceal any of the 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 moveable property to be seized: s. 209.

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 it's 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. 206.

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[12] stating that in his opinion a fraud has been committed by a promoter, director or official of the company, the court may order a public examination of such person(s) on an appointed date.[13] The official receiver must take part in the examination and may employ a proctor with or without counsel. The liquidator and any creditor or contributory may take part in the examination either personally or by proctor or counsel. A person ordered to be examined must be provided with a copy of the official receiver's further report, and may employ a proctor with counsel. Evidence is given on oath and taken down in writing and signed by the person examined: s. 207.

21. RESTRAINT OF FRAUDULENT PERSONS FROM MANAGING COMPANIES

In a winding-up by the court, if the official receiver has made a further report[14] stating that in his opinion a fraud has been committed by a promoter, director, officer, of the company, on the application of the official receiver, the court may order that that person, director, 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 official receiver must give at least 10 days notice of his intention to apply for the court order to the person charged with the fraud: s. 208.

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12 See O 13.

13 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) 1 W.L.R. 59.

14 See O 13.

22. SPECIAL MANAGER

The court may appoint a special manager[15] 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. 201.

23. DISSOLUTION IN COMPULSORY WINDING-UP

When the affairs of the company have been completely wound up, the court makes a **Dissolution Order,** and 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. 212.

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 servants.

(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 dissoled by order.

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[15] Other than the official receiver.

A voluntary winding-up is deemed to **commence at the time of passing of the resolution** for voluntary winding-up: s. 218.

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 (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 creditors' voluntary winding-up): s. 216.

Notice of winding-up resolution must be given in the Gazette within 7 days of passing of the resolution: s. 217.

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;

(2) All **transfers of shares are void** unless sanctioned by the liquidator;

(3) Any **alteration in the status of members is void**: ss. 219, 220.

(4) Floating charges granted within **six months** preceding the passing of the winding-up resolution becomes void, except as to any cash paid over at the time, unless the company was afterwards solvent: 255.

On the appointment of the liquidator.

(5) 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: s. 223 (2), 232 (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 held before the notices of the meeting at which winding-up resolution is to be passed are sent out; the statutory declaration must state to the effect that the directors having made a full inquiry into the affairs of the company are of the opinion[16] 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: s. 221.[17]

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): s. 223, s. 224.

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16 By the English Companies Act, 1948, any director making the declaration without having reasonable cause for the opinion that the company will be able to pay its debts in full within the specified period, is liable to pay the company's debts in full and is liable to imprisonment, for a period not more than 6 months.

17 By the English Companies Act, 1948, 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.

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 as soon thereafter as may be convenient, and lay before the meeting an **account** of his acts and dealings and of the conduct of the winding-up during the year: s. 226.

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 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. 227[18].

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. 227.

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 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).

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18 The English Companies Act, 1948, provides that 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.

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. 116.
Gazetted within 7 days: s. 217.
Notice of liquidator's appointment gazetted and registered within 21 days: s. 241.

(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. 226.

(ii) send to the Registrar of Companies at prescribed intervals the prescribed particulars of the proceedings and position of the liquidation: s. 272.

(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. 227.

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 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. 229.

35. APPOINTMENT AND REMUNERATION OF LIQUIDATOR

At the two above meetings the members and creditors may appoint their liquidator. If the members and creditors appoint different persons the creditors' nominee will be the liquidator, unless no person is appointed by them in which case the members' nominee would be the liquidator; within 7 days of nomination by the creditors, however, 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. 230. The creditors may fill any vacancy in the office of a liquidator, except in the case of a liquidator appointed by court: s. 233.

The liquidator's remuneration is fixed by the committee of inspection or if there is no such committee, by the creditors: s. 232.

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 appoint 5 persons too 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 creditor's winding-up is the same as under winding-up by court, and the provisions of s. 192 (2) to (8) apply: s. 231.[19]

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 as

[19] See O16.

soon thereafter as may be convenient, and lay before the meeting an account of his acts and dealings and of the conduct of the winding-up during the year: s. 235.

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: s. 236.

38. THE OUTLINE OF PROCEDURE IN A CREDITORS' VOLUNTARY WINDING-UP

(1) Notices are issued by the Board simultaneously for,

(a) **extraordinary general meeting** of the company to pass a resolution (usually an extraordinary resolution) for the winding-up of the company.

(b) 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, except in addition, meetings 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 required too.

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. 240. The liquidator must give notice to the court within 21 days of appointment; in case of default, the liquidator is liable to a fine of Rs. 50/- per day for every day during which the default continues: s. 241.

Powers and Duties

By s. 239,

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,** exercise any of the powers given in (d), (e) and (f) of subsection 1 of s. 184 to a liquidator in a winding-up by Court.[20]

(b) without sanction exercise any of the other powers of a liquidator under a winding-up by court.[21]

(c) settle the list of contributories.[22]

(d) make calls;

(e) summon general meetings of the company;

The liquidator **must,**

(a) pay the debts of the company;

(b) adjust the rights of the contributories among themselves.

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 DISTRIBUTION 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. 244.

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: 238.

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20 See O 15

21 See O 15

22 In a voluntary winding-up the liquidator's list of contributories is *prima facie* evidence of the liability of the persons named therein as contributories: s. 239.

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: ss. 225, 234.[22]

42. ARRANGEMENTS BINDING ON CREDITORS

Any arrangement entered into between the company about to be or in the course of winding-up and it's 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. 242.

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:[23] s. 243.

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. 245.

WINDING-UP SUBJECT TO SUPERVISION OF COURT

44. WINDING-UP SUBJECT TO SUPERVISION OF COURT

When a company has passed a resolution for voluntary winding-up, the court may order that the voluntary winding-up shall continue

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22 See N 1, 2
23 E.g., (a) the enforcing of calls and (b) the application of s. 166 (see O 9) as decided in Vanguard Insurance Co. Ltd. v. Ruhunu Transit Co. Ltd., (1962) 65 N.L.R. 60.

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 think just: s. 246.[24]

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[25] and of little importance because in a voluntary winding-up if creditors and contributories are dissatisfied they can,

(a) petition for a compulsory winding-up; or

(b) by the powers granted by s. 243[26] 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. 247. Consequently, the court has the s. 166[27] power to stay proceedings against the company and under s. 171[28] actions are stayed when the supervision order is made. For the purposes of ss. 167 and 168[29] winding-up subject to supervision is deemed to be a winding-up by court: s. 248.

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. 249.

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

24 It has been held that the court has an absolute discretion as to the granting of a supervision order and that a creditor has no right to such an order as a right: Crawford v. Cowper (1902) 4 Fra. 849.

25 Only about two companies were wound up under supervision of court from 1960 to 1969.

26 See O 43

27 See O 9

28 See O 11

29 See O 11

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. The various sections set out in the Eighth 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. 250.

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[30] is liable to contribute to the assets of the company to an amount sufficient for the payment of it's 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. 155 (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. 155 (1).

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. 155 (1).

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. 155 (1).

In the event of the death or bankruptcy of a contributory his estate would be liable to contribute: ss. 158, 159.

30 Directors are, under certain circumstances treated as contributories when their liability is unlimited under the Ordinance: s. 155 (2).

46. 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 provable: s. 251.

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. 252.

47. 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 liquidation: ss. 244, 205.
(3) Preferential debts: s. 253 (vide O 48).
(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.

48. PREFERENTIAL DEBTS

The following preferential creditors must, by s. 253, be paid in prior to all other debtors, i.e., unsecured creditors:

(a) Income 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 of Income Tax);
(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) 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, not exceeding Rs. 500/-;

(d) Wages of workman or labourer for services rendered within the proceeding 2 months not exceeding Rs. 250/-;

(e) 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.

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, workmen or labourer employed by the company has the same priority as the persons whose wages are paid out of the money advanced.

49. EFFECT OF WINDING-UP ON TRANSACTIONS

(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.

(b) **Fraudulent Preference**

A fraudulent preferance is **void.**

A fraudulent preference is a transaction done,

(1) with the intention of preferring one creditor over another;[31]

(2) voluntarily by the company and not under pressure;[32]

(3) whilst unable to meet it's debts;

Further,

31 Peat v. Gresham Trust, Ltd. (1934) A.C. 252.
32 Sharp v. Jackson, (1899), A.C. 419.

(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 or done by or against the company is deemed in the event of it's being wound up, a fraudulent preference of its creditors: s. 254 (1)[33];

(5) Any conveyance or assignment by a company of all it's property to trustees for the benefit of all the creditors is a fraudulent preference: s. 254 (3).

The sole directors and shareholders of a 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 it's creation: s. 78[34]

(2) If created within 6 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 5 per cent p.a.), unless it is proved that the company was solvent immediately after the creation of the charge: s. 255;

(3) If given as fraudulent preference: s. 254.

The following claims have a precedence to the floating charge and must be paid out of the proceeds of the assets subject to the floating charge,

(a) fixed charges on the same assets.

(b) preferential creditors.

(d) **Disclaimer of Onerous Property**

When a company is being wound-up if any part of it's property consists of,

33 By the English Companies Act, 1948, such an act is a fraudulent preference if committed within six months before the commencement of the winding up.

34 See L 5, 6

(1) Land burdened with onerous covenants; or

(2) Shares or stock in companies; or

(3) Unprofitable contracts; or

(4) 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**[35] with the **leave of the court** disclaim the property. The disclaimer must be,

(a) in writing, signed by the liquidator; and

(b) 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. 256 (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 rights or liabilities of any other person: s. 256 (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. 256 (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

35 The liquidator may disclaim property, notwithstanding that he has endeavoured to sell or has taken possession of the property or has exercised any act of ownership in relation thereto: s. 256 (1).

to grant rescision 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. 256 (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. 256 (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. 256 (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.[36] 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: s. 257.

50. OFFENCES[37]

Offences by Officers under ss. 259, 260, 261.

During winding-up, any person, being a past or present director, manager or other officer of the company found guilty of the following offences would be liable to imprisonment for a,

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36 The receiving of the 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 purposes of this section.

37 Ss. 264, 265 are procedural only and do not give any new cause for action against directors and officers. S. 264 empowers court to examine the persons charged with offences and order repayment or restoration with interest, where necessary. S. 265 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, (if the liquidator does not report to the Attorney-General, the court may on it's own motion or on the application of any person interested direct the liquidator to make such report).

(1) Term not exceeding 5 years if during the 12 months preceding winding-up or during winding-up has,

(a) 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;

(2) Term not exceeding 2 years if during the 12 months preceding winding-up or during winding-up he does not,

(a) 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 or affairs of the company or to defeat the law: s. 259.

S. 260 provides a term of imprisonment not exceeding 2 years for the wilful falsification of books, papers, accounts, securities etc.

S. 261 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, every director, manager, or other officer knowingly at fault are liable to imprisonment for a term not exceeding one year. They can escape liability if they can show they acted honestly, or reasonably in view of the circumstances in which the business of the company was carried on: s. 262.

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 creditor or contributory, may order that any directors who were knowingly parties to the fraudulent trading shall be made personally liable for the company's debts and other liabilities without any limitation of liability.[38] Such persons are also liable to imprisonment for a term not exceeding one year. Further, the court may order that persons found guilty may not be a director or in any way directly or indirectly participate in the management of a company; in case of default of such an order a fine not exceeding Rs. 5,000/- or imprisonment of a term not exceeding 2 years or both may be awarded: s. 263.

Fraudulent trading occurs when to the knowledge of the directors the company is unable to make payment, the company carries on business and incurs debts: Re Leitch (William C.) Bros., Ltd., (1932), 2 Ch. 71.

51. 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 at fault are liable to a fine of Rs. 200/-: s. 268.

52. LIQUIDATOR

A body corporate cannot be a liquidator: s. 266.

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. 267.

If the winding up continues for more than one year after it's 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. Creditors, contributories or their agents may inspect and obtain copies of such statement. A defaulting liquidator is liable to a fine not exceeding Rs. 500/- for each day during which the default continues: s. 272.

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[38] i.e., shall lose the privilege of limited liability.

53. 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. 271.

54. 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. 275.

55. DISSOLUTION

In a members' or creditors' voluntary winding-up dissolution occurs automatically 3 months after the liquidator has filed his final account and return of the holding of the final meeting (s).

In compulsory and supervision winding-ups 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. 276. If the company has been struck off the register as defunct the corresponding period is 20 years: s. 277. When making the 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.[39]

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39 Re Kenyon (Donald) Ltd., (1956) W.L.R. 1397.

CHAPTER P

MISCELLANEOUS

1. OVERSEA COMPANIES[1]

Companies incorporated outside Ceylon and carrying on business within Ceylon would at common law, be under no restrictions as to trading or obtaining capital here; so that it would be possible for foreigners and even for Ceylon citizens to form companies abroad for trading here, and thus overcome all the controls and restrictions imposed on Ceylon companies. To prevent this, the Ordinance contains provisions controlling all companies formed abroad and opening places of business here.

By ss. 319 to 329 companies incorporated outside Ceylon which establish a place of business within Ceylon must within **one month** 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 is required by the Ordinance 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 Ceylon, **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 Ceylon.

Moreover,

(5) Any **alteration** in the above particulars must be filed;

(6) The company's **name 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 Ceylon.

1 About 18 foreign companies were registered between 1960 and 1967 (the latest year's figures available up to publication).

(7) The company must file annually the balance sheet as a registered company, unless it is required by it's country of incorporation to file accounts in accordance with the provisions of that country, in which case it must file such accounts annually within four months of presentation to it's shareholders. A certified translation must be annexed if the balance sheet is not in English.

A company incorporated outside Ceylon which has complied with provisions 1 to 4 has the same power as companies incorporated in Ceylon under the Ordinance, to hold lands in Ceylon.

A document is served on the company if it is addressed and delivered to any person whose name has been delivered to the Registrar of Companies.

When an oversea company ceases to have a place of business in Ceylon, it must inform the Registrar of Companies.

Restrictions on sale of shares and offers of shares for sale are imposed on foreign companies.[2]

2. (a) SERVICE OF DOCUMENTS ON COMPANY

A document may be served on a company by delivering or posting to,

(i) the registered office of the company;

(ii) any director, secretary, manager or other officer of the company;

(iii) any member of the company, if for any reason it cannot be served to persons under (b): s. 357.

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".

[2] The Registrar of Companies may extend the point if circumstances warrant.

(b) 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. 150.

3. RE LEGAL PROCEEDINGS—power of court to grant relief in certain cases.

In any legal proceeding for negligence, default, breach of duty, or breach of trust against directors, managers, officers, or auditors (whether they be officers or not) of a company, court may grant relief if such persons have acted **honestly and reasonably** and with regard to all circumstances of the case (including those connected with their appointments) ought fairly to be excused: s. 360.

4. REGISTRAR OF COMPANIES — some provisions regarding the Registrar of Companies.

Any person may inspect the document kept by the Registrar of Companies or require copies or extracts of such documents or a certificate of incorporation of any company, on payment of a prescribed fee; documents kept at the Registrar's are admissible as evidence in all legal proceedings, as being of equal validity with the original document; the Registrar may after two years of winding-up of a company dispose of any documents relating to such company, in any manner as may be prescribed: s. 293.

If any document with the Registrar is damaged or becoming illegible the Registrar may request that a further certified copy of such document be sent to him: s. 347.

5. 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, 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[3] 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

[3] See D 2.

a member, or within one year after he ceases to be a member, for payment of it's 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 is (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 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. 7. 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. 12.

The articles of a company limited by guarantee must state the number of members with which the company proposes to be registered: s. 8. 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. 8.

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. 19[4].

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. 22.

If the company has a share capital it must make the annual return required by s. 106[5]. If it has no share capital, it must make an annual return, stating by s. 107,

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[4] See D 11.

[5] See F 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,[6]

and annexed must be,

(c) particulars of the total amount of the company's indebtedness in respect of all mortgages and charges required to be registered with the Registrar.[7]

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. 112.

Apart from what has been said, most other provisions applying to companies limited by shares, applies to companies limited by guarantee.

6. 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. 12. The company must register articles with the memorandum: s. 7. 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. 8. 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. 106. To an unlimited company with no share capital, the provisions of ss. 107 & 112, ante, apply.

An unlimited company may, register as a limited company under s. 17. The rights, liabilities, obligations, or contracts entered into by the company before the date of registration, however, remain unaffected.

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6 See K 9.
7 See L 5.

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 Socy., (1893), 2 Ch. 242.

7. SHARES OF NO PAR VALUE

The Ordinance, (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 as 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.

8. COMPANIES ADVERTISING FOR DEPOSITS

In recent years there have been a number of companies borrowing money by inviting members of the public to deposit money with them at attractive rates of interest. Most such companies are engaged in providing finance to hire purchase retailers or in property development or speculation. In England, because the operation of such deposit taking companies disclosed that there were substantial opportunities for fraud as the advertisements of such companies were not prospectuses (since they did not invite for subscriptions for shares or debentures) and hence were not bound by the legal requirements of disclosure applicable to prospectuses and, moreover, as depositors were in a weak position for finding out the current financial position of the company, the Protection of Depositors Act, 1963 was passed. In Ceylon, however, there is no legislation controlling deposit taking companies and protecting depositors.

Deposits are generally not secured unlike in the case of loans. Depositors in Ceylon are, at present, in a vulnerable position due to the lack of statutory protection and the lack of security for their deposits.

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