

Public Enterprises Circular No. 49

Department of Public Enterprises

The Secretariat

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All Secretaries to the Ministries

**New Company Act No. 7 of 2007**

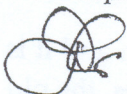
The new Companies Act No.7 of 2007 ("the Act") came into effect on the 03<sup>rd</sup> of May 2007 and it repealed the earlier Companies Act No.17 of 1982.

In this regard Treasury has prepared guidelines to facilitate the smooth operation of Government Owned Companies. Copy of the guidelines is enclosed herewith.

You are hereby requested to instruct the Government Owned Companies to follow these guidelines.

It would be noted this is only the guidelines and the Act will supercede in all circumstances.

If you have any comments you may contact, Director General Department of Public Enterprises, (Telephone No. 2484617).



N.G. Dayarathne

Director General

Department of Public Enterprises

Copies to : Auditor General



## The Companies Act No 7 of 2007

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### Introduction

The new Companies Act No. 7 of 2007 ('the Act') came into effect on the 03<sup>rd</sup> of May 2007 and it repealed the earlier Companies Act No. 17 of 1982.

The new Act has simplified several procedures including that of incorporation. The company forms are now available on the website of the Registrar of Companies. A Company can either adopt the Model Articles which is contained in the Act or draft its own Articles. The content of the Articles need not be now approved by the Registrar.

### Re-Registration

Under section 485 of the Act, an existing company is deemed to be incorporated under the new Act. However, section 487 of the Act requires these companies to apply to the Registrar within 12 months from the 3<sup>rd</sup> of May 2007, which is the date on which the Act came into operation, and obtain a new number. If this process is not completed within such time, the Registrar will cause a public notice to be published of such failure. Within 6 months from this publication, a Director of the Company, a Shareholder or a person who has a registered charge (a secured creditor) or a person who has instituted action against the Company either in Court or in arbitration proceedings could apply for and on behalf of the Company for a new number.

If the Company has failed to obtain the new number during this extended 6 month period, the Company's name will be struck off the register and all its properties and rights will vest in and be at the disposal of the State.

The company number must be used on all documents of the Company.

### Articles of Association

The new Act does not have a document called the Memorandum of Association and it is only the Articles of Association which applies. In the case of existing companies, the old memorandum would be deemed to form part of the Articles with effect from 03<sup>rd</sup> May 2007.

The Act provides for the establishment of general business purpose companies, which would have no restrictions on the types of business it could carry out. However, there is no prohibition on the inclusion of objects in the Articles.



Section 17 of the Act provides that restrictive objects however would not affect a third party acting in good faith with the Company and such a party would have a perfectly valid and binding contract with the Company, notwithstanding the fact that the Company has acted outside its objects. There is however a distinction between acting outside ones objects and a person who is not duly authorized entering into a transaction on behalf of the Company. Where an unauthorized person enters into a transaction a third party may not get a valid contract with the Company. If a company has included objects in the Articles, and then if it seeks to act outside those objects, a dissenting Director or a Shareholder could take steps to prevent the Company from acting outside those objects.

An amendment to the objects is always possible, but where it imposes or removes a restriction on the activities of the company, a minority shareholder can use his 'buy out rights' and the company would, in turn, have to buy back his shares.

### Names of Companies

A Private Limited Company could in addition to the words '(Private) Limited' use the abbreviated form of '(Pvt) Ltd.'. A Public Company could use the term 'Ltd.' instead of the current 'Limited' at the end of its name. In the case of a Public Quoted Company, the name should end with either the words 'Public Limited Company' or 'PLC.'

Under the Act, the Company need not have a company seal. Section 19 provides that a notarially attested instrument needs to be signed by either two Directors, a Power of Attorney holder or some person specifically authorized by the Articles. A normal contractual document could be signed by any person acting under the company's expressed or implied authority.

### Capital

Under the new Act, there is no concept of a par value of a share. However, the concept of 'share' exists and this denotes the proportionate entitlement of a shareholder in the Company. The total amount received or due and payable to the Company in respect to the issue of shares, forms the stated capital of the Company.

Section 52 of the Act requires the Board to resolve that in its opinion the consideration on an issue of shares is fair and reasonable to the Company and to all existing shareholders. The consideration for the issue of a share could be cash, property or services which include future services.

The new Act recognizes that on a new issue of shares the existing shareholders would have pre-emptive rights (i.e. where new shares are being issued, which rank equally or superior to the existing shares, the existing shareholders should be first given the opportunity of subscribing for such shares before it is offered to any outsiders).



Section 64 of the Act provides that a Company could buy-back its shares if the Board resolves,

- a) that the acquisition is in the interest of the Company;
- b) that the terms of the offer are in the opinion of the Company's Auditors a fair value; and
- c) that the Board is not aware of any facts, which would be material to the value of a share which is not known to the shareholders, accepting the offer.

A Company can also reduce its stated capital under the Act by way of a Special Resolution. Public notice of not less than 60 days must be given prior to the resolution being passed. This regime for reducing the stated capital is much more liberal than what was contained in the previous Act and does not require Court approval for any reduction scheme.

The Act also has provision for the issue of Redeemable Shares. Unlike in the previous act, there is no necessity for it to be Redeemable Preference Shares. The Act refers to shares which are redeemable at the option of the Company, shares which are redeemable at the option of the shareholder and shares which are redeemable on a fixed date in terms of the Articles. The latter two categories are treated more like the repayment of debt by a Company.

A Company may also reduce its Stated Capital by passing a Special Resolution to that effect. A public notice of not less than 60 days must be given before the resolution to reduce the Stated Capital.

### **Distributions and Solvency Test**

A distribution is the transfer of money or property of the Company, other than shares, for the benefit of a shareholder. This includes the payment of dividends, any repurchase or redemption of shares and any reduction of Stated Capital involving the return of money to shareholders.

A distribution must be authorized by the Board, and unless the Company's Articles provide otherwise, must be approved by the Shareholders by Ordinary Resolution. The Board must also be satisfied that *after* the proposed 'Distribution' the Company will satisfy the Solvency test. Where a distribution has been made, thereafter however if the Company fails to satisfy the Solvency test, it may be recovered from the shareholders, unless it is unreasonable to do so, particularly where the shareholder has received it in good faith. Where a Company is unable to recover the distribution from the shareholders, a Director may be held personally liable for such value for his failure to take reasonable steps to ensure that the Solvency test was satisfied.



A Company is deemed to have satisfied the solvency test if :

- a) it is able to pay its debts as they become due in the normal course of business;  
and
- b) the value of the Company's assets is greater than the value of its liabilities and its stated capital.

In computing the value of assets and liabilities, a fair valuation or other method of assessment could be taken into account.

### **Potential Insolvency and Serious Loss of Capital**

Section 219 of the Act requires a Director who believes that the Company is not able to pay its debts as they fall due, to immediately call a Board meeting to decide whether the Company should continue or be wound up. If the Company is continued and the decision has been made wrongfully and is subsequently liquidated, all Directors other than those who voted in favour of the winding up would be liable for the loss suffered by creditors. This Section has very serious consequences for Directors as far as creditors are concerned and it is important that the procedural requirements as well as the assessment of its ability to pay debts is done correctly by the Directors in a timely manner.

Section 220 of the Act provides that if it appears to a Director that the net assets of the Company are less than half its stated capital, the Board should convene an Extraordinary General Meeting of the Shareholders. The notice calling the meeting should be accompanied by a report which advises the shareholders of the nature and extent of losses, the cause of the losses and the steps being taken by the Board to prevent such losses. The shareholders should be given a full opportunity of discussing the matters contained in the report.

### **Directors Duties**

The new Act has given new powers to Directors. Similarly, it has also imposed additional obligations and also specifically set out certain duties which were hitherto part of the Common Law and not specifically set out in the Act.

A Director is defined as follows in the Act :

- a) a person occupying the position of Director of the Company by whatever name called;
- b) a person in accordance with whose directions or instructions, a Director or the Board is required or accustomed to act (the obligations with regard to Director's interests however do not apply to this category of a Director)



- c) A person who exercises the powers which apart from the Articles are normally required to be exercised by the Board (the obligations with regard to Director's interests however do not apply to this category of a Director);
- d) a person to whom a power or duty of the Board has been directly delegated by the Board with that person's consent or acquiescence
- e) a person who exercises the power or duty of the Board with the consent or acquiescence of the Board.

A person acting purely in a professional capacity would not however come within the definition of a Director.

The general duties of a director may be briefly listed as follows:

1. To act in good faith and in the best interests of the Company (section 187)
2. To comply with the Act and the Company's Articles of Association (section 188)
3. Not to act in a manner which is reckless or grossly negligent but to exercise the degree of skill and care that may reasonable be expected of a person of his knowledge and experience (section 189)
4. To make disclosure of interests (section 192)
5. Not to use company information other than for purposes of the Company (section 197)
6. To disclose any share dealings he has with the Company (section 200)
7. To approve remuneration and other benefits for directors only as provided for in section 216
8. Not to give loans or provide guarantee or security to a director unless permitted under section 217
9. To act as provided for in section 219 in a situation of potential insolvency
10. To call an extra-ordinary general meeting (EGM) if it appears that there is a serious loss of capital.



A Director shall forthwith after becoming aware that he is interested in a transaction or proposed transaction with the Company cause to be entered in the interest register the nature and extent of such interest.

Section 191 states that, a Director of a Company is interested in a transaction, if,

- a) he is a party to the transaction or may derive or material financial benefit from the transaction;
- b) has a material financial interest in the other party to the transaction;
- c) he is a Director, Officer or Trustee of another party to the transaction or is Director, Officer or Trustee of a person who may derive a material financial benefit from the transaction;
- d) he is a parent, child or spouse of another party to the transaction, or a parent, child or spouse of a person who will derive a material financial benefit from the transaction;
- e) he is otherwise directly or indirectly materially interested in the transaction.

The following should be noted with regard to a Director's interest in a transaction:

- a) a general notice disclosing that the Director is a shareholder, Director, officer or trustee of another Company, or other person, is sufficient disclosure of interest in relation to any transaction with that Company or person.
- b) a transaction entered into by the Company may be avoided by the Company at any time before 6 months have passed after the transaction, and the Director's interest in it have been disclosed to all the shareholders (whether through the Company's Annual Report or otherwise).
- c) however, a transaction cannot be avoided if the Company has received fair value for the same. If the transaction is in the ordinary course of business and on usual terms and conditions, the Company shall be presumed to have received fair value under the transaction.
- d) the avoidance of a transaction would not affect the title or interest of a person who acquire the property from a person other than the Company, for valuable consideration and in good faith without notice of the circumstances.
- e) also it is possible for a Director to attend the meeting, vote on the matter and sign any document relating to the transaction on behalf of the Company as if he



were not a party interested in the transaction. This is subject to the provisions in the Articles.

If a Director has an interest in a share of a Company, he must provide this information to the Board along with the number and class of shares and should also ensure that these particulars are entered in the Interests Register. Further, he must disclose to the Board any share acquisition or disposal and enter in the Interest Register the following details:

- a) the number and class of shares involved;
- b) the nature of the relevant interest;
- c) the consideration paid or received;
- d) the date of the acquisition or disposal

The Board of the Company may if authorised by the Articles or by an Ordinary Resolution

- a) approve the payment of any remuneration or the provision of other benefits to a Director for services as a Director or in any other capacity.
- b) The payment to a Director or former Director of compensation for loss of office.

If the Board is satisfied, that to do so is fair to the Company.

The Board has to ensure that the approval and the particulars of payment are entered in the Interest Register.

The Directors who vote in favour of the payment have to sign a certificate stating that in their opinion the payment is fair to the Company *and* the reasons for reaching that opinion.

Where the above provisions were not complied with or reasonable grounds did not exist for the opinion, the Director or former Director to whom the payment is made or the benefit is provided, shall be personally liable to the Company for the amount of the payment, except to the extent to which he proves that the payment or benefit was fair to the Company at the time it was made.

A Company is not permitted to give a loan to a Director in excess of Rs. 25,000/- or enter into any guarantee or provide any security in connection with a loan taken by a Director of the Company. There is however no prohibition in providing a Director with funds to cover expenditure incurred or to be incurred by him for the purpose of the Company or for the purpose of enabling him to perform his duties as an officer of the Company.



A Company should not indemnify or effect insurance (other than as set out below) for a Director or an employee of a Company or a related company in respect of any,

- a) liability for any act or omission in his capacity of a Director or an employee; or
- b) cost incurred by that Director or employee in settling any claim relating to such liability.

If authorized by the Articles, a company may indemnify a Director or an employee with regard to costs incurred in any proceeding that relates to liability for any act or omission and where judgment is given in his favor. If the Articles permit, a company may indemnify a Director or an employee for any act or omission or cost incurred in defending or settling any liability (which is not a criminal liability) and which does not involve a breach of the Director's overall obligation to act in good faith and in the best interest of the company.

The Company may also if expressly authorized by the Articles and with the prior approval of the Board effect insurance for a Director or an employee in respect of,

- a) any act or omission of such person which does not involve criminal liability;
- b) cost incurred in defending or settling any claim relating to any such liability; or
- c) cost incurred in defending any criminal proceedings in which he is acquitted.

Any such insurance must be entered in the Interest Register and in the event of non compliance, the Director or the employee shall be personally liable for the cost of the insurance except to the extent that it is fair to the Company.

### **Special Rights of the Government**

The new Act has introduced the concept of single shareholder companies. The Secretary to the Treasury is empowered to incorporate a single shareholder company, to be owned by the Government.

Section 139 provides for the Secretary to the Treasury to appoint another person, as his proxy for every 10% or part thereof, of a Shareholding of a Company held by the Secretary to the Treasury on behalf of the Government, and to appoint 3 persons, as his proxies, when the Secretary on behalf of the Government is a holder of a 'Golden Share' in a Company, to attend Shareholders Meetings on the same occasion.



Under section 144, subject to the Company's Articles, a Resolution signed by not less than 85% of the Shareholders entitled to vote, enables the company to pass Resolutions in writing on a matter that is required by the Act or by the Articles to be decided at a Meeting of the Company. However, where the Secretary to the Treasury is a holder of a Share in a Company, any such Resolution referred to in section 144 is not valid unless the Secretary to the Treasury's consent has been obtained in favour of such Resolution.

### **Major Transactions**

A 'major transaction' is defined as

- a) an acquisition or disposal involving more than half the value of the assets of the Company or
- b) the acquisition of rights or obligations amounting to more than half the value of its assets or
- c) transactions which have the purpose or effect of substantially altering the nature of the business carried on by the Company.

Section 186 of the Act provides that the Company shall not enter into a major transaction unless approval has been obtained by way of Special Resolution for such transaction or the transaction is subject to such approval or it is expressly provided for in the Articles.

### **Minority Buy Out Rights**

According to section 93 where a Special Resolution is passed to :

- a) alter the Articles imposing or removing a restriction on the business or activities of the Company
- b) approve a major transaction
- c) approve an amalgamation under section 241
- d) an interest group has approved taking of any action that effects the rights attached to the Shares,

a minority shareholder who has voted against the resolution is entitled to use his minority buy out rights and require the Company to buy out his shares. The Company would be required to purchase his shares at an agreed price, failing which a price considered fair and reasonable by the Auditors or failing which a price determined by Court.



### Accounts and Annual Return

Section 148 of the Act requires a Company to keep accounting records which will,

- a) enable the financial position of the Company to be determined at any time;
- b) enable the Directors to prepare accounts in accordance with the Act;
- c) enable the financial statements to be readily and properly audited.

The Accounts need to be prepared within 06 months of the Balance Sheet Date and it needs to be certified by 2 Directors and the person responsible for its preparation. A Private Company need not file its Accounts with the Registrar of Companies.

The Annual Report should be prepared within 06 months of the Balance Sheet Date and sent to the Shareholders not less than 15 days before the AGM. This report would contain amongst other things the Financial Statements, the Auditor's Report, entries made in the Interest Register and the names of Directors.

### Private Companies

The Act has granted certain benefits and dispensations to Private Companies, which are of importance. These include,

- a) by unanimous resolution of its Shareholders the Company may dispense with the requirement to keep an Interest Register
- b) by unanimous agreement by its Shareholders the Company may authorize the taking of any action notwithstanding the fact that it may be contrary to any provision in the Articles
- c) by unanimous agreement by its Shareholders, the Company may dispense with the following provisions contained in the Act (some of the dispensations only extend to procedure)

Section 52	-	Consideration for issue of shares
Section 53	-	Pre-emptive rights to new issues
Section 56	-	Distributions
Section 60	-	Dividends
Section 61	-	Recovery of distributions
Section 64	-	Purchase of own shares
Section 70	-	Restrictions on giving financial assistance
Section 90	-	Exercise of powers reserved to Shareholders
Section 92(1)	-	Powers exercised by Special Resolution
Section 99	-	Alteration of Shareholder Rights
Section 185	-	Major transactions