UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF LAW

BACHELOR OF LAWS EXAMINATION, YEAR IV – 2022

COMPANY LAW

(Three Hours)

Total Number of Questions: **06**

Answer **THREE (03)** questions and **no more.**
(Candidates will be penalized for illegible handwriting.)

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1. "In today's modern society, the scope of corporations' activities and the extent of their power are so expansive that the consequences of their actions impact every facet of human and societal life. If not curbed, the potential to inflict damage and commit crimes may result in devastating consequences. Although corporations have historically been exempt from bodies subject to strict regulation and accountability, concepts such as corporate social responsibility and corporate criminal liability have ensured that corporations will not use their powers in a manner that negatively impacts society."

   Critically discuss the validity of the above statement.

   (100 marks)

2. Lahiru is one of the five shareholders of Tiny Spoon Ltd (TSL), a company that manufactures infant food. Lahiru owns forty eight percent (48%) of the TSL's share, while the other four shareholders, Visha, Niraj, Sazna and Sandu, each owns thirteen percent (13%) of shares. Lahiru, Visha, and Sandu, three nutritionists, who are experts in infant health in the country, are the board of directors of TSL. Despite the fact that Sandu is a director, the other two keep him out of managerial decisions. For over ten years, TSL has maintained a strong research and development team. Since 2020, Lahiru outperforms new research projects with a young research team of which he is the principal researcher. TSL spends twice as much as it did previously. Visha is also in charge of certain research projects and receives a professional fee from the team. In addition to outsourcing the research, Lahiru and Visha register two patents for new product invented by

the internal research team of TSL and enter into numerous license agreements. Sandu objects, claiming that TSL's financial reserve has been reduced by Rs.50 million since 2020. Niraj alleges that the board failed to take action to inspect the quality of the food products and allowed low-quality infant food to enter the market, which will adversely harm the reputation of the product in the near future. Sazna, a junior medical officer refrains from taking action despite her dissatisfaction with those tasks due to her future prospects. For the past two years, TSL has been experiencing difficulties.

Sandu and Niraj, the minority shareholders of the company seek your legal advice on any action they may take. Advise them with reference to relevant statutory provisions and case law.

(100 marks)

3. a) At the time, company promoters and businessmen found the ultra-vires concept to be extremely unpopular and problematic. However, due to judicial vigilance, it maintained its sway with almost unflinching vigour.

In light of the Sri Lankan courts' approach to the doctrine of ultra-vires, to what extent do you agree with this statement? Support your answer with relevant case law and statutory provisions and consider the future of this doctrine in Sri Lanka's commercial sphere.

(60 marks)

b) Adam and Smith are the directors of Evergreen Energy (PLC) (the company), a renewable energy company. In response to the growing demand for renewable energy, the company planned to import technologically advanced but less expensive solar panels compared to other solar panels available in Sri Lanka's energy market. In order to finance this project, Adam and Smith issued a prospectus stating that the company is authorized to import a specific type of solar panel, despite the fact that the application for the import permit was still pending. Given this project's enormous future growth potential, Mark purchased a substantial amount of shares in the company. However, the company was unable to obtain the necessary import permit, and hence, the project was abandoned.

Mark wishes to take legal action against Adam and Smith. Advise Mark of the legal remedies available to him under the Sri Lankan law.

(40 marks)

4. a) Advocates of the capital maintenance doctrine claim that its enforcement protects creditors from excessive distribution of equity capital, ensuring creditor protection. On the contrary, the opponents argue that restrictions on payouts and equity disbursement distort the financial decision-making of a company, preventing it from engaging in economically viable transactions.

Has the Companies Act No. 07 of 2007 succeeded in resolving these contradictions? Discuss with reference to relevant statutory provisions.

(40 marks)

b) General Motors Company (PLC) (the company) is a well-known car manufacturer in the Ceylands. However, the company's financial status worsened during the pandemic and became extreme, given the country's economic crisis. Since the company's net assets have dropped to less than half its stated capital, Sen, the finance director, called an immediate board meeting and proposed to restructure the company's debt. However, the marketing director, Joy, proposed that the company could recover by venturing into new business avenues, particularly manufacturing and selling electric bicycles. Except Sen, the rest of the board members agreed to embark on the new venture. However, the demand for the electric bicycle manufactured by the company was feeble due to their manufacturing defects which caused numerous injuries and accidents, including one death. As a result, the company was sued by Ceyland's Consumer Affairs Authority for not following proper safety standards in manufacturing electric bicycles.

Assuming that the legal system of Ceyland is similar to the legal system of Sri Lanka, prepare a legal opinion discussing the legal issues arising from the above scenario.

(60 marks)

5. Arjun, Susila, Kapila, Poornima, Madushi and Nisali are the directors of 'Fancy Fabrics Ltd.' a company incorporated in 2017. Their well-planned strategy prior to the incorporation of the

company paid off and business was quick to pick up. While the business continued to thrive in 2019, the board encountered an unexpected challenge in June of that year when it was revealed that Kapila was, in fact, an undischarged insolvent, a fact that his co-directors were unaware of. The other directors were shocked and demanded Kapila's resignation. Kapila refuses, threatening that his resignation would nullify decisions made by the company in which he was involved. The other directors were concerned but allowed him to continue in office.

The company continues to thrive, when it begins to feel the consequences of the pandemic in 2020. As a result of the government's lockdowns and people's reluctance to expose themselves to the virus by mingling with other people while shopping, the company experiences massive reductions in sales. Nisali suggests that the company begin delivering its products to the homes of its customers in an attempt to navigate these challenges. The other directors agree. Upon Arjun's suggestion and recommendation, Fancy Fabrics decides to partner with Pass It On Delivery Services Ltd., a recent start-up company. Unbeknownst to the other directors, the founding director of Pass It On Delivery Services Ltd. was Arjun's son Ramesh. Arjun receives a 2% commission for each delivery that Fancy Fabric sends through this delivery service.

The Board notices that Poornima's commitment to her role as director appears to be waning. Despite most board meetings being held on Zoom due to ongoing lockdowns and Covid spread, Poornima failed to attend many of them. When she was present, she did not actively contribute to discussions and appeared to be out of touch with company activities and concerns.

As the company continued its best efforts to overcome the difficulties posed by Covid, it became clear that, with the additional blows to business caused by the Sri Lankan economic crisis, the company was truly struggling to stay afloat. Susila called a board meeting in early 2022, as the company struggled to pay its debts as they fell due, to discuss whether the company should consider winding up. However, despite the challenges, the board of directors decided to continue the business activities of the company. Subsequently, the company went into liquidation.

Discuss the legal issues that have arisen in relation to the directors of Fancy Fabrics Ltd.

(100 marks)

6. Ravi, Nilesh, Dinesh and Sunil are partners in S&S Computers (SC), a business that sells computer accessories. Discuss the legal issues arising from the following facts and the rights and liabilities of partners quoting appropriate authorities.

a) Ravi and Nilesh, who own more capital shares in the original capital than the other two partners, manage the business and make all critical decisions. They usually attend trade fairs and fly overseas to purchase discounted items for SC. The partnership agreement imposed a credit limit of Rs 1,000,000/- for any single partner contracting on their behalf. Ravi found the best deal on laptop computers at a trade fair during his private overseas tour. Since it was the last day of the fair, without the consent of other partners, he purchased laptops for Rs. 1,500,000. Nilesh purchased a considerable quantity of USB Drives from an overseas friend for a lower price. He sold them to SC at market price.

(40 marks)

b) Dinesh purchased some second-hand computer accessories from D&A Electronics (D&A) on credit in the name of the partnership for Rs. 700,000/-. Without the knowledge of the other partners, Kusum, Dinesh's brother, is the sole proprietor of D&A. D&A had a bad reputation for the quality of its products, and most of them were sold to customers without warranties. SC maintained a good reputation among its customers and earned a distinct position for its excellent customer service. Most of the items sold here were brand new with a substantial warranty period. SC was unable to resell the accessories at a profit and suffered significant losses in this particular transaction, including a loss of reputation. Meantime, the partners discovered that Dinesh had a share in the above trade.

(40 marks)

c) SC decided to open a new branch within the city limit to expand its business. For this purpose, Sunil approached Kumar to lease a shop space in a newly constructed shopping complex. SC agreed to pay the lease monthly out of the partnership profit. Kumar, a successful entrepreneur, advised SC on marketing and developing its business on several occasions. As per the advice, SC made a profit. SC paid Kumar’s consultation fees whenever such services were rendered. Sunil invited Kumar several times to join the SC as a partner and, on some occasions, Kumar represented himself in the partnership's business affairs at Sunil’s invitation. Kumar now claims to be one of the partners of SC.

(20 marks)

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