COMMERCIAL LAW

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INTRODUCTION

On 4th February 1948, Sri Lanka was granted independence with dominion status. A period of nearly 52 years have now lapsed since independence. This article, in the main, provides a broad sketch of the salient features of and the changes needed in commercial law to keep pace with the rapidly evolving world of commerce. Originally, English Law, from which our law is largely derived, was applicable to commercial law of the Island. On independence this pattern did not change. Thus commercial legislation in Sri Lanka has tended to follow to a very large measure the company law in England. The first few years after Independence did not see any substantial change in the existing commercial law of the country.

Before we proceed any further, it is necessary to define the term "commercial law." Commercial law is a growing subject with the changing circumstances of trade business and commerce. That means commercial law as the law of trade business and commerce, looks to facilitate the commercial practices of the business community and as those practices change and develop often to accommodate modern technology, the contents of commercial law may change and develop with them. With the increasing complexities of the modern business world the ambit of commercial law has enormously widened. This branch of law comprises many different spheres of commercial activities and is generally understood to include *inter alia*, the laws relating to companies, partnership, contracts, sale of goods, banking, negotiable instruments, insurance, insolvency, carriage of goods, arbitration and intellectual property.

This paper is not intended to deal with all the above branches of law comprising commercial law because it is not possible to do so in a paper of this nature. The aim of this article is to give an elementary account of the most prominent aspects of companies, partnerships, security

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laws, viz. law relating to Stock Exchange, law relating to banking and arbitration, being the branches of commercial law of ever increasing complexity. These areas play an important role in the economic life of the country and the laws applicable to them deserve study on that ground alone because in recent years these areas of laws have gained importance as key areas of the economy. Companies and partnerships deserve a careful and detailed analysis, as they are the only options of organisational form that are available to business people where multiple owners want to create a business.[1]

The policy of economic and trade liberalisation, promoting foreign investments, export-led industrialisation and private sector developments have been important features of the economy of Sri Lanka since the late 1970's. Accordingly, the laws relating to these economic restructuring policies should be directed to reach such objectives and should be formulated to meet the needs of the modern commercial world in providing stability and promoting economic development. Thus it is necessary, in this context, to create a legal framework for private sector development including the promotion of foreign investment.

LAW RELATING TO COMPANIES

Company law deals mainly with the formation, management and control of companies, financial and other disclosure requirements, external fund raising and winding up. The greatest challenge in writing about company law is that it is a very large subject with a dynamic and exciting body of law which is of enormous practical and commercial importance. This area of law enables people to use the corporate form as a service to those who wish to take advantage of artificial entities with separate legal personality which they can control and put into legal relationships without being directly responsible for them.

The influence of English law in this branch of Sri Lanka is strong and thus English Law will be referred to clarify certain principles of the law which were or still are a feature of our legal system. The Joint Stock Company concept was introduced to Sri Lanka (then Ceylon) by the Civil Law Ordinance No. 5 of 1852, which provided, *inter alia,* that the law relating to corporations in Great Britain would apply to similar organisations in Ceylon. Therefore, during the period from 1853-1861, the then Joint Stock Company Law of Great Britain applied to Ceylon. The Joint Stock Companies Ordinance of 1861 was the primary legislative document enacted in Ceylon and was modelled on its predecessor in Great Britain. The second company legislation in Ceylon was passed in 1938. The Companies Ordinance of 1861 and its subsequent ordinances relating to Joint Stock Companies were repealed by this legislation, Companies Ordinance No. 51 of 1938. This was passed on the lines of the English Companies Act of 1929. Subsequently, the Companies (Amendment) Act No. 15 of 1964 was enacted.

1 Business people in other jurisdictions such as UK conduct their activities and strive to accomplish their goals through a variety of organisational forms - Companies, Partnerships and Limited Partnerships. The availability of these options for operating a business is even greater in the USA. They are corporations, and Limited Liability companies.

In 1982, the Companies Act No. 17 was passed and came into operation on 2nd July 1982. This was based on the Companies Act of 1948 of England subject to some minor changes, which were adopted to satisfy the peculiar business conditions in this country.[2] The 1982 Act remained in force for nearly two decades. In other countries such as the UK, new legislation was enacted every few years to keep in line with changing commercial trends. The reform of Sri Lankan law was long overdue. A number of weaknesses and omissions in the law had come to light. The Minister of Trade and Commerce appointed in the early 1990s an advisory committee to review the law relating to companies and suggest proposals for law reform. It is understood that a draft bill was prepared by this committee based on these proposals to revise Sri Lankan Company Law.

As noted earlier, significant changes took place since the mid 1970s in the economic perspectives with the ushering in of an open economic policy by the government in power. In order to encourage foreign investment, the law relating to companies should seek to promote economic efficiency by providing for the protection of investment with a stable investment environment, which enhances the confidence of investors.

There now exists a draft of a new Companies Act. The recommendations in this draft, made by the committee which drafted the law includ the total reform of the company law. The present draft contains some interesting changes and amendments. A study of the present Sri Lankan company law and the new draft can never be completed without reference to the law of England, which is still very much in force.

In Sri Lanka companies could be created in four different ways:(a) a company limited by shares;(b) a company limited by guarantee;(c) a company limited by both shares and guarantee; and (d) unlimited companies. There is another classification, which depends on the number of shareholders, called private, public and peoples companies. It must be noted that the new draft of the Companies Act suggests the recognition through regulations of single member private limited liability companies. It is therefore not necessary to have an artificial member to exist as in many private companies which, in actual fact, have a sole proprietor but where, for example, a spouse holds a nominee share to fulfil the present two member requirement.[3]

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[2] A separate section was introduced for Insider Dealing which was later repealed by, and incorporated in the Securities Council Act No. 36 of 1987. The Companies (Amendment) Act No. 33 of 1991 made some amendments to the above 1987 Act.

[3] In English law, since the *Solomon's Case* (1897 A.C. 22) it has always been possible to form a "one man" company. In response to the Twelfth EC Company Law Directive, the Companies (single member Private Limited Companies) Regulations 1992 (SI 1992 / 1699), since 15th July 1992 it has been possible for one person to sign the memorandum and incorporate a private limited company. Thus notwithstanding section 1 of English Companies Act 1985, which states that two persons are required to incorporate a company, a new subsection (3A) inserted into the English Companies Act 1985, allows one subscriber for a private limited company.

The provision incorporating this new development is included in section 4(2)(a) of the proposed Sri Lankan company law. However, since severe criticism has been levelled at introducing single member companies, a safeguard has been imposed prescribing certain limits to the operation of this new concept. The proposed section provides:

> *"A Company may have one shareholder only, if that shareholder is a body corporate, and where the single shareholder is a natural person the nominee shall be a body corporate."*

Under the present system to create a new registered company it is necessary to prepare the company's constitution contained in two documents called the Memorandum and Articles of Association. The separation into two documents emphasized that the matters in the Memorandum were fundamental and under the 1856 Act (UK) unalterable, which was the same for Sri Lanka**,** whereas the Articles could be altered by the company. However, at present all the provisions in the Memorandum can be altered with specific procedures prescribed for each type of alteration, so that no distinction exists between the two documents.[4]

The preparation of documents for the registration of a new company requires careful consideration and specialist knowledge. Thus persons wishing to incorporate companies have to employ legal advisers. This process is both expensive and complex. Business people are concerned about financial matters such as the cost of complying with the registration requirements. Thus, the creation of companies ought to be made as cheap and straightforward as possible. People might be discouraged from creating new companies, if they feel that the law on creating them is unsatisfactory due to unexpected costs, obstacles and delays. It must however be stressed that although the above relaxing provisions should be enjoyed by private companies, and where a company does not comply with the law, in order to protect the society the intervention of the legislature is really necessary.

Thus it is clear that companies are expensive to be established due to this process of incorporation which involves certain documents including the constituent document being lodged with the Registrar of Companies. The purpose of registration is to ensure publicity and thereby transparency. Any member of the public has the right to inspect the company's constituent instruments. It is suggested by the draft Act that a company could be incorporated with a single form called the "application for incorporation" which sets out the key details such as the name, whether limited or unlimited, etc. Standard Articles of Association set out in the Companies Act would apply. Although the draft provides a model set of articles, any company is entirely free to choose any alternative articles. No doubt the business community will warmly welcome this relaxation.

[4] This was introduced by the Joint Stock Companies Act 1856 (UK). Before that, under the Joint stock Companies Act 1844 (UK), a company was required to have only one document called the deed of settlement.

It has become increasingly popular for businesses to be carried on by companies since it confines the shareholders' risk to the amount of capital they have invested in the company and not put the whole of their personal assets in jeopardy. Among these a large proportion of companies are private companies as it provides the most advantageous machinery for operating a small business. Thus, the economic importance of private companies is immense and they undoubtedly add impetus to the tremendous growth in business activity.

Clearly, since the vast majority of registered companies are intended by their promoters to be private companies, it would seem appropriate for private companies to dispense with those irrelevant and inappropriate impositions which derive from company statutes and judicial precedent. The disadvantage of having to comply with some of these inappropriate impositions may heavily outweigh the advantages conferred by the incorporation. The draft Companies Act put forward many proposals to grant certain concessions in relation to private companies. According to the definition in the 1982 Act, a private company is required by the company's Articles to include restrictions on the transfer of the company's shares. This requirement is not embodied in the proposed draft. Moreover, the English Law limitation on a company's membership to 50 is no longer there, and this will be given statutory force under the new regime in Sir Lanka.

Without doubt, the most significant concession made to private companies is the dispensation from keeping an "interests register" with the sanction of a unanimous resolution of its shareholders. Shareholders for their part are quite happy to dispense with this troublesome requirement. Despite certain legislative concessions granted to private companies by the proposed draft which are not enjoyed by public companies, the draft fails to inject some much needed relaxation.[5] This may preclude the use of such companies as business vehicles for many small entrepreneurs. One may level a severe criticism that by granting some of these legislative concessions to private companies it might result in losses to the government, the public and the shareholders who are outside the sphere of company's management. It is appropriate to note at this point that much of the burgeoning laws and regulations apply equally and invariably to private companies as well as to public companies. There are considerable number of protections aiming towards shareholders. Only those provisions that are found to be irrelevant and inappropriate in regard to private companies should be dispensed with. Certainly the encouragement of new businesses is an important aspect of current governmental economic policy and private companies as business vehicles provide the most advantageous machinery for a great many small entrepreneurs.

The draft Act needs to concentrate on providing a legal framework that promotes economic efficiency. People might be discouraged from creating new companies if they feel that the law governing them is unsatisfactory.

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5 In English Law private companies are released from the statutory requirement of filing copies of annual financial statements with the Registrar of Companies. Thus companies were permitted to keep their financial affairs secret in the same way as sole traders and partnerships.

Section 55 of the present Companies Act of 1982 provides that a company may not provide anyone with financial assistance for the purchase of its own shares. This is a long established principle in English Law and has been given statutory authority since the Companies Act of 1929 and retained in subsequent legislation until 1981.

The reason for this prohibition is that it may constitute a misuse of company funds and threaten the assets of the company. As described by Denis Keenan:[6]

> *"The prohibition is to defeat the asset stripper who might, e.g. acquire shares in a company by means of a loan from a third party so that he came to control it and once in control could repay the loan from the company's funds and then sell off it's assets leaving the company to go into liquidation with no assets to meet the claims of creditors."*

However the proviso to the above section permits such grants where: (1) companies which in their ordinary course of business lend money for various purposes; and (2) providing money to employees of the company to purchase fully paid shares.

There has been some doubt under English Law whether it was worth retaining these prohibitions, because some legitimate commercial transactions also were threatened by illegality by virtue of this rule. It was also realized that this rule was stricter in English Law than in other jurisdictions such as in the United States and Canada.[7]

Section 74D of the proposed draft, while prohibiting the providing of financial assistance, has relaxed the law in the following situations and a company may give financial assistance

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[6] Smith and Keenan's Company law for students, 10th edition at page 148.

[7] In English Law there are two important statutory exceptions to the general prohibition on the giving of financial assistance. This law is contained in sections 151-158 and is designed to bring UK companies in line with United States and other continental companies. The first exception applies to both public and private companies and is contained in section 153 of the Companies Act 1985 (UK). This section provides that a company is not prohibited from giving financial assistance if it's principal purpose in giving that assistance is not to give it for the purpose of any such acquisition or the giving of the assistance for the purpose of the acquisition is but an incidental part of some larger purpose of the company. In either case, the assistance must be given in good faith in the interests of the company. The second exception to the general prohibition on the giving of financial assistance applies to private companies only. By virtue of section 155 (1) of the Companies Act 1985 (UK), a private company is able to give financial assistance of any kind subject to certain conditions and strict procedure spelt out in the Act. Accordingly, a private company can give assistance in the same circumstances as a public company. In addition as private companies are not affected by the principal purpose rule, they could provide assistance as the sole purpose and object of a particular exercise, provided the assistance is given in good faith and in the interests of the company (see section 155 to 158 of the Companies Act of 1985 (UK).

for the purpose of or in connection with the acquisition of its own shares if the board has previously resolved that:

a. giving the assistance is in the interest of the company;

b. the terms and conditions on which the assistance is given are fair and reasonable to the company and to shareholders not receiving that assistance; and

c. immediately after giving the assistance, the company will satisfy the solvency test.

Section 74E of the proposed draft further provides the transactions not prohibited by section 74D and this wording is identical with that of section 153 of the Companies Act of 1985 (UK), as discussed above. However, there is no distinction between a private and public company as exists in English Law.

The most innovative change brought about by the new draft is the provisions in regard to the concept of doctrine of *ultra vires*. In company law the general principle of the common law was that a company which is incorporated for some specified objects, stated in its Memorandum of Association cannot do anything outside the powers specified in the objects clause in the Memorandum. Pursuing an object which fell outside the scope of its object clause is *ultra vires* and void, devoid of all legal effects, incapable of ratification even by a unanimous vote of the company's members. This court ruling was very unpopular with the commercial community, both the business community and the commercial enterprises as it impeded the progress of commerce and is inconvenient and a hindrance to normal business activities. The most troublesome aspect is the injustice it can cause to third parties. If a third party enters into an *ultra vires* contract with a company, that party cannot enforce it against the company. If they have supplied goods or performed services under such a contract, they cannot obtain payments, and if they have lent money, they cannot recover it. This resulted in third parties incurring heavy losses**.** Section 3 of the Companies Act of 1982 required a company to state its objectives in the Memorandum. Also the statutory requirement embodied in section 4 makes the *ultra vires* doctrine still vital in Sri Lankan law. Section 13 of the proposed draft provides that the Articles of Association may state the objectives of the company. Thus, the persons forming a company have the choice of including the objectives of the company in the Articles. If the Articles do not have objectives and express restrictions or express prohibitions on the exercise of powers by the company, then the doctrine of *ultra vires* will have no application. On the other hand, if the company has objectives or express restrictions etc., on the exercise of its powers, the company will still be capable of acting beyond its constitutional powers. However, the traditional consequences will not flow, so as to protect people who deal with companies from having their transactions repudiated. The fact that acts are *ultra vires* will, however, still be important in internal disputes in the company.

Expressed briefly, the new provisions are aimed at preventing a plea of *ultra vires* from having untoward results in disputes between the company and third parties. Put simply, the company has full legal capacity. The proposed provision 17(2)(a) still permits the plea of ultra vires to be raised in inter-company disputes. Thus, whilst the external effects of *ultra vires* will be abolished, the internal aspects of the rule will remain. However, some of the more important provisions set out in the English Companies Act 1989 following the recommendations of Prentice Report, is untouched by the proposed draft and thus is not in conformity with the English law.[8]

In addition, a high degree of freedom has been left to companies to draft their Memorandum and Articles. When drafting the Articles, the position generally is that the Articles confer wide powers on the Board of Directors and this can lead to a diminution of the powers of the shareholders. Although this is necessary to enable companies to operate more efficiently in an increasingly complex environment, it has to be recognized that shareholders and creditors need further protection. Thus, the regulation of the internal operation of companies should be reflected in changes to company law.

The foregoing discussion dealt with some of the main features introduced by the proposed draft. However, all the principles and novel features of the new draft are too numerous for inclusion in this article. Some of these features include the minority buy out rights, minority shareholder bringing a derivative action, the abolition of the doctrine of constructive notice, the expansion of directors' duties and their liabilities. The draft aims at giving greater flexibility to companies and at the same time prescribes stricter norms in the field of raising capital, internal management, company accounts, audit and disclosures. This draft will produce a highly controversial report and it appears to have made significant progress in response to global competitive conditions. Although there are striking similarities in most of the key features, the rules laid down in the proposed Act are different from the rules relating to the same subject prevailing in England. The fact that the proposed Act is not intended to be a servile copy of the English Act can be regarded as a welcome step in the right direction because commercial law is not an abstraction, it is a tool for its users, whose needs will vary from place to place according to national practices, tradition and the level of sophistication of its business and financial institutions.

To sum up, it is still too early to make any judgment on the impact and effectiveness of the proposed Act. These developments will undoubtedly improve the position in Sri Lanka and can be regarded as a fundamental step forward. However, this Bill has been in storage for a long time and it is uncertain when it will come into force.

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8 Under section 322 A, transactions with the directors of the company or its holding company are voidable by the company if they are *ultra vires*, and once again the contents of the objects clause will be relevant there.

LAW ON PARTNERSHIPS

It is not the purpose of this section to embark on a detailed study of the creation, operation and extinction of a partnership or to explore in greater detail the advantages and disadvantages of the partnership organisation. However a brief study of the basic principles in relation to partnerships in modern times will be helpful in understanding the need for its regulation.

Partnerships are found in small as well as large businesses. It is true that partnerships have declined for a number of reasons with private companies taking over the commercial world for small businesses. However a revival of partnerships have been witnessed in recent times. They can be easily formed, the cost of forming a partnership is relatively low and in addition, they provide the freedom to operate on any terms which are agreed to by the partners. The increased and inconvenient formalities and lesser flexibility associated with the formation of registered companies have led small businesses to return to partnerships. Hence their stability will be of great benefit to the economy in which they operate.

The Partnership Act 1890 (UK), section 1(1) defines 'partnership' in the following way:

> *"Partnership is the relation, which subsists between persons carrying on a business in common with a view of profit."*

Like companies the history of partnership legislation in Sri Lanka also starts with section 3 of the Introduction of Civil Law Ordinance No. 5 of 1852 which provides that Law of England is to be observed in relation to the law of partnership except when altered or modified by express enactment.

The first statute - the Partnership Ordinance No. 21 of 1866 - contained only seven provisions introducing certain amendments to the law of partnership and became the law on 24th December 1866. Prevention of Fraud Ordinance No. 7 of 1840 compelled the registration of a partnership deed.

Section 18(c) of the Prevention of Fraud Ordinance provides:

> *"No (Promise) contract (bargain) or agreement unless it be in writing and signed by the party making the same or by some persons thereto lawfully authorized by him or her is in force or avail in law... for establishing a partnership where the capital exceeds Rs. 1000/-."*

The consequences of non-compliance with this section are the disability of the partners and of the firm to take legal action. In other words, if a partnership is established without a written agreement where the initial capital exceeds Rs. 1000/- a partner of such a partnership cannot bring a suit to enforce a right arising out of that partnership.

However, there is an exception provided by the section itself. Third parties may sue partners or persons acting as such and offer in evidence circumstances to prove a partnership existing between such persons and parol testimony (oral evidence) may be given concerning transactions by or the settlement of any account between partners. Thus, this restriction does not equally apply in relation to third parties when they seek to enforce rights against a partnership; such action is maintainable even though it is in relation to a partnership established without the requirements in section 18(c) of the Prevention of Frauds Ordinance.

Thus, it is clear that the law relating to partnership prevailing in England shall continue to be the law in Sri Lanka except for the provisions provided by Ordinance No. 21 of 1866 and Ordinance No. 7 of 1840. These are the only statutes in force in Sri Lanka on partnership. No statute on partnership has been enacted in Sri Lanka since independence and our law on partnership is determined in accordance with the English Law for the time being. Hence, a study of the law on partnership in Sri Lanka must be made with reference to the legal position in England.

Although the concept of partnership has existed for several centuries, the partnership law as we know it today originated in the English Common Law. The partnership law in England is contained in the Partnership Act 1890.[9] There has been no amendment to the Partnership Act of 1890 and thus the partnership law in UK has undergone very little change. Also, this Act of 1890 was not intended to be a complete and self-contained code on the subject of partnership. As a result, the law of contract, agency and equity and also the cases dating before the Partnership Act are still important in certain circumstances such as the law relating to the nature of partnership, dealings with third parties etc. As the Act had codified the case law on partnership up to 1890, these cases are examples of what the Act was seeking to achieve and presumably has achieved. Section 46 preserves all equitable and common law rules applicable to partnerships where the partnership law has in fact developed except so far as they are inconsistent with the express provisions of the Act. However, there are no provisions in the Act on administering partnership assets in the event of death or bankruptcy or in relation to goodwill.

The Act of 1890 does not however provide the answers to the most fundamental questions in the areas of both common law and equity such as the liability of a partner to account for his share of an unauthorized profit, the liability of partners for torts done by others, etc.

[9] This Act has been the basis for a number of Partnership Acts in Commonwealth countries.

Geoffrey Morse, a specialist in this field, in his book entitled ‘Partnership Law’[10] stated that, “by modern standards this Act is a short one with short sections.” He further points out when comparing the Act of 1890 with Companies Act 1985, it is like man and ape, though they are cousins the relationship is sometimes difficult to imagine. Comparing the Partnership Act of 1890 with the Companies Act 1985 the former differed from the latter in various respects. For example, section 19 of the Partnership Act allows a partner to give oral evidence of a course of dealing the result of which could be to overturn the written terms. In other words, the rights and duties of partners, contained in the partnership agreement can be varied by their express or implied consent inferred from a course of dealing.

Partnerships are governed by either:

(a) the terms of the particular partnership agreement or deed that has been specifically drafted for the purposes of the business; or

(b) if no Partnership Agreement has been drafted, the provisions of the Partnership Act 1890.

The Act does not say how a partnership must be established. However, it should be borne in mind that if the parties have agreed to be partners, then they would be. According to the definition persons who carry on a business in common with a view to profit are partners, even if they have not expressly agreed to be. This means that a partnership, which is a voluntary association, can be formed orally, in writing or inferred by the conduct of parties. No forms or registrations are necessary to establish a partnership although a written contract may be desirable to clarify the relationship of the partners. A written contract can avoid confusion, disputes and litigation later. The position in Sri Lanka is different. As explained earlier, according to the Prevention of Fraud Ordinance, in certain circumstances the partnership agreement has to be in writing and the failure to adhere to this requirement may result in partners being denied access to courts.

In the case of forming a company, there is a system known as incorporation or registration, where certain documents must be lodged with the Registrar of Companies. On the contrary in the case of a partnership the partners can decide whether to adopt a partnership agreement or not.

From the foregoing discussion it is evident that no formal agreement is necessary to establish a partnership and the mere fact that two partners carry on business together may be sufficient to indicate that a partnership in fact exists. Indeed, a partnership may exist in law while the parties concerned may be unaware that they are in fact partners. Although the intention to form a partnership is necessary, it has been decided in a large number of cases that the intention can be implied by the conduct of the parties. In other words, there can be situations

[10] (Third edition) on pages 3 and 4.

where persons are engaged in some form of a joint business activity without realising that they have, in law, entered into a partnership and that they may incur unexpected liabilities and duties. Thus, the question is how can a partnership be established. The definition in the Partnership Act contains three elements:

(a) that there are two or more people;

(b) carrying on (which implies some degree of continuity) a 'business'(which is defined by section 45 of the Partnership Act to include every 'trade, occupation or profession' and section 1(2) of the Partnership Act excludes companies);

(c) with a view of making a profit.

Also a partnership may arise in law, by the operation of the principle of 'estoppel.' Thus if a person holds himself out or allows himself to be held out as a partner, he may incur the liabilities of a partner.

Black's Law Dictionary,[11] defines a partnership as:

> *"A voluntary contract between two or more competent persons to place their money, effects, labour, and skill or some or all of them in lawful commerce or business, with the understanding that there shall be proportional profits and losses between them."*

This indicates that problems may arise in a partnership where infants, insane persons, or those under other legal disabilities desire to become partners. The capacity to enter into a partnership is governed by the ordinary law of contract.

Under English partnership law the firm does not have separate legal recognition. As Farewell CJ remarked in *Sadler* v. *Whiteman*[12]

> *"In English Law a firm as such has no existence; partners carry on business both as principals and agents for each other within the scope of the partnership business; the firm name is a mere statement, not a legal entity, although for convenience... it may be used for the sake of suing and being sued. It is not correct to say that a firm carries on a business; the members of a firm carry on business under the name or style of the firm."*

[11] (4th edition).

[12] (1910) 1 KB 868 at 889 CA.

In this respect partnerships are clearly distinguishable from companies, and the latter has always been recognized as an entity, separate and distinct from its composite members. However, in some other jurisdictions such as the USA and Scotland, a firm is a legal person distinct from its partners. In essence, in terms of status, it lies midway between the English firm and a corporate body; it is a 'quasi–corporation' possessing many, but not all the privileges which the law confers upon a duly constituted company.

In general, each partner is personally responsible for the liabilities of the firm. If the assets of the partnership are inadequate to pay the creditors the personal assets of individual partners may be sequestrated to satisfy their obligations. This element of unlimited liability imposes an unwelcome burden on a partner who enjoys substantially greater personal wealth than the other partners.

The Act of 1890 does not provide the answers to the most fundamental questions posed in the modern context. Moreover, this Act is now over 100 years old and in most respects is not appropriate for modern conditions and to respond to the demands of a growing and complex economy. The constraints of the Act were not seen particularly significant in the early part of the 20th Century when partnerships generally operated on a smaller, localised scale. However, with technological development, an increasing number of partnerships started operating in various countries irrespective of national boundaries. In an increasingly complex environment, the above Act has ceased to be relevant. Thus, reform in this area has been a long felt need even in the UK. However, reform in the UK in this regard has been piecemeal and this has led to very unfortunate results.[13] Legislative tinkering here and there will not create a satisfactory atmosphere for partnerships and will never achieve a high level of popularity in business circles. The law of partnerships needs to be totally restructured as the existing provisions are outdated and inadequate in the present context. Thus to clarify and modernize the laws of partnership, the regulatory authorities may have to consider in toto the present regulatory and legal framework in this regard instead of introducing ad hoc and piecemeal laws and regulations.[14]

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[13] Business Names Act, regulating the use and disclosure of firm names and the Insolvency Act 1986, as applied by the Insolvent Partnerships Order 1994 concerning the insolvency of the firm and or the partners. Thus we must find the laws relating to the partnerships from many sources.

[14] USA and UK Legislatures have permitted the creation of a business form that offer taxation advantages similar to partnerships, yet extend limited liability to the owners of the business. This forms the limited partnerships. Business managers want an infusion of capital into a business yet are reluctant to surrender managerial control to those contributing capital. Investors wish to contribute capital to a business and share in its profits yet limit their liability to the amount of their investment and be relieved of their obligation to manage the business. The limited partnerships serve these needs. The limited partnerships have two classes of owners: general partners, who contribute capital to the business, manage it, share profits and posses unlimited liability for its obligations; and limited partners, who contribute capital and share profits, but possess no managerial powers and have liability limited to their investments in the business.

LAW RELATING TO SECURITIES

Stock exchange laws are also widely regarded as an important economic and confidence indicator which, in turn, affect business expectations and certainty. An understanding of the laws with respect to securities in Sri Lanka is therefore fundamental. The first legislation in Sri Lanka to regulate securities is the Securities Council Act No. 36 of 1987. Prior to this, securities were governed by the provisions of the Sri Lankan Companies Act of 1982. Since then there has been only one amendment to the securities exchange law, i.e. Securities Council (Amendment) Act No. 26 of 1991.

In our country the majority of the population is far from affluent. Therefore, it is necessary to protect them from misrepresentations and abusive stock market practices such as price manipulation. The stock market practices should be designed to acquaint investors (give potential investors sufficient information so that they can make intelligent investment decisions) with the laws designed to protect them. A clear understanding of security regulations is essential if managers of these markets are to avoid liability, both civil and criminal. Registration requires the disclosure of relevant information so that investors can appraise the merits of a security. To that end, investors must be given a prospectus which contains the necessary information. The Act prohibits false and misleading statements and gives investors the right to sue for any losses incurred. However, whereas in other jurisdictions these provisions relating to disclosure are duly enforced, in Sri Lanka, there has never been a reported case where these provisions have been applied.

Financial flows are being increasingly mediated through the capital market. In contrast to the rapid expansion of the securities market our law reflects some deep-rooted structural weaknesses in the regulatory framework. The government must identify the inherent problems affecting the securities market. Our legislation is not sufficiently effective in coping with abuses such as insider trading and market manipulation. The law should be amended far more comprehensively for ensuring fairness in securities transactions. Reforms should, *inter alia,* includ definitions of securities (including bills of exchange and promissory notes), the improvement of the disclosure system, proper implementation of provisions relating to insider trading, provisions covering fraudulent and unfair acts and an increase in penalties.

LAW ON BANKING

Banks and financial institutions which form our financial system perform an important business function by offering various services such as deposit taking, lending and exchange services to the people of this country. Thus, the role such institutions play in our economic system is important. Major changes have been effected in the banking sector both at national and international levels. Numerous commercial banks and their branches have appeared on the scene. New financial services and instruments such as electronic banking, tele banking, ATMs, SWIFT systems, issue and use of credit cards etc. have emerged and the paper based payment system has been substituted substantially by electronic fund transfers. Technology has been a major driving force of the changes in the banking sector all over the world. Information technology makes financial functions better and faster by providing improved data collection, calculation etc.

The law pertaining to banking has been growing fast. Over the years there has been a dramatic boom in banking activities. There has been a significant growth in banking and financial services in Sri Lanka as well. Changes and growth in this sector have given rise to an urgent need to review and reform the law and regulatory framework relating to banking and the financial sector. However since the days of independence, unlike in many countries, legislative intervention in the banking sector has been rare in Sri Lanka, as is the case in other areas of commercial law.

The Civil Law Ordinance No. 5 of 1852 introduced into Sri Lanka the English Law relating to banking. The Civil Law Ordinance of 1852 was succeeded by Ordinance No. 22 of 1866 which confirmed the introduction of English Law of Banking to Sri Lanka. Although the law relating to banking in Sri Lanka is mainly based on English Law, there are a number of Acts that are applicable to banks. These are too numerous to consider here and only the salient features of the most important statutes will be discussed. The Bills of Exchange Ordinance No. 25 was enacted in 1927. It was in most respects modelled on the British Bills of Exchange Act (1882) which codified the law relating to cheques and other bills of exchange.

The Debt Recovery (Special Provision) Act No. 2 of 1990 as amended by Act No. 9 of 1994 provides for the recovery of debts. However loans are restricted to sums over one hundred and fifty thousand rupees (150,000/-). It is necessary to widen the ambit of the Debt Recovery Laws and remove legal obstacles in this regard. Providing loan facilities to the public and private sector is an important function of banks. Banks will be enthused to provide credit but their foremost concern would be their recovery. The major drawback in our banking system is the risk and uncertainty associated with recovery of loans. This has resulted in a significant reduction in extending credit to people and has had a serious effect on the economy which by no means is healthy. The safety of their funds should be the primary concern of banks as only financially viable banks can serve their clients efficiently. Thus, it is essential to provide facilities which enable banks to approach civil courts for recovery of their dues speedily and expeditiously and this in turn will help the banks to expand their lending.

Although there are several statutes implemented on a relatively informal basis there is no comprehensive legislation on banking which can improve the banking system as a whole. There is no doubt that legislative changes and fundamental reforms of banking laws are necessary in order to encourage the efficiency and stability as well as to improve the quality of banking institutions in an effort to ensure their smooth functioning. With the rapid growth in international trade and capital inflows, the need for a successfully functioning and efficiently operating banking system is even greater. New avenues will have to be explored and at the same time traditional banking practices will have to be adapted to meet the modern needs. With the globalization of financial businesses, it is now vital that financial systems works in an orderly, efficient and effective manner.

Outdated technology is also a serious drawback as the trend across the world is for banks to move away from traditional banking functions. In order to bring our banking system to international standards, and to provide a wide range of banking services in an efficient and profitable manner, the utilization of new technology is necessary. Also these modern technological tools will be much cheaper and far more powerful than existing outdated technology. Therefore, it is necessary to identify the weaknesses and drawbacks which our banking sector is suffering from. It is clear that the existing laws on banking have proved to be insufficient for the changing financial environment. Accordingly, far reaching banking sector reforms should be implemented to meet future challenges. Overcoming this serious deficiency is an urgent issue that must be constructively addressed.

When considering the new legislative framework, it is necessary to take into account the protection of depositors and the maintenance of an orderly credit system. It is appropriate to abolish the present banking law altogether and introduce reforms to provide the necessary framework for banking institutions to contribute to the economic growth in a better way. Thus in order to provide a proper legal and regulatory framework for banking and financial instrument it is necessary to review and reform the existing legislations such as The Banking Act of 1988, The Monetary Law Act of 1949, Recovery of Loans by Banks (Special Provisions) Act of 1990, The Bills of Exchange Ordinance of 1927, Exchange Control Act of 1953. Also it is vital that our banking system is made compatible with those overseas so that the system is easily accessible to both domestic and foreign banking institutions.

ELECTRONIC COMMERCE

Electronic Commerce is a strategy in the new era which uses technology to manage business and commerce in a professional manner. It has become an essential feature of the new global economy and plays a very important role in the 21st century. It has opened up new vistas for business and has changed the way business and commerce are conducted. Also novel systems and methods have been developed to achieve business objectives. Although information technology and business was not so closely related before, with the development of e-commerce, a new dimension of trade and commerce has emerged. Electronic commerce has begun to transform business and commerce in many fundamental ways and enables whole new ways of satisfying the needs of businessmen and customers in various stages such as advertising, searching, ordering, payment and delivery. With the globalization of the market place there are continuous changes in the market, the market place can be entered from any where, which can take its users any where. Diverse range of products and services are traded through the internet.

The benefits of e-commerce such as the reduction of paper work, increased efficiency and competitiveness, cost savings etc. are so compelling, that the need to use information and communication technologies for business and commerce is increasingly felt. To take advantage of avenues in technology and to compete effectively in the rapidly changing domestic and international market place the number of existing businesses, banks companies etc. are using e-commerce tools to redesign their traditional process and to restructure and to reorganize them selves.

The last two decades have seen a spurt in the growth of the use of e-commerce within Sri Lanka. Business community within Sri Lanka use the internet and e-commerce in promoting and expanding their activities through new and cost effective methods which has resulted in enhanceing the growth of their businesses. Most Sri Lankan business organizations operate at entirely new levels of effectiveness in finding and interacting with customers, communicating with trading partners, developing new products and markets, carrying out their trade transactions, both domestic and international etc., by means of electronic data interchange and other means of communications which in turn has created new jobs and new careers. The technology also creates new opportunities for crimes.

Other than the Evidence (Special Provisions) Act No. 14 introduced in 1995, there are no information technology or e-commerce laws in the country yet. Many countries such as England, Australia, Singapore, Malaysia have enacted cyber legislations. There is a concern in many other jurisdictions in providing a strong legal framework to facilitate e-commerce.

As the electronic documents substitutes paper documents with digital methods of authentication instead of the traditional signatures, these electronic documents should have a legally binding effect. Also issues relating to security of transactions, confidentiality of messages and integrity of data etc. should be addressed when making a legal framework. Thus there is an urgent need for clear policies, rules and principles and a framework that will encourage the use of new technology while protecting the public safety and national security.

Electronic commerce has brought a new dimension to commercial law. With the rapid expansion of the internet and e-commerce the right commercial and legal environment is crucial. In order to understand and to apply the tools of e-commerce effectively and to find solutions for our society, measures are required to establish a suitable legal environment. People involved in business and commerce need an environment in which business transactions can be electronically conducted safely and securely. This calls for fundamental changes in the legal, commercial and economic framework in Sri Lanka. The role of the government is to provide a strong legal framework for e-commerce, ensuring that domestic and international trade, privacy problems, intellectual property issues such as patents y, copy rights etc., prevention of frauds, consumer protection etc. are all addressed properly.

Electronic Banking

The rapid changes made in the sphere of information technology plays a major role in the field of banking and finance as well. These technological changes improves the operational efficiency and strategic effectiveness of the banking industry in the changing environment arisen due to process and influence of globalization, financial liberalization etc. The banks worldwide are pursuing electronic banking with vigor.

Many banks in Sri Lanka with the new development of information technology activities, have been exposed to fundamental changes during last two decades. They have successfully implemented massive restructuring programs to revamp and re-oriente their banking and financial systems. Heavy investments are made in computerization and in up grading of systems. Using this modern technology our banks are keen to introduce their innovative products and services to their customers to satisfy their new demands and expectations. Majority of bank transactions are being conducted electronically and electronic settlement of payments is well established.

Although electronic banking has spread out vastly in the Sri Lankan banking industry and many banks today are adapting rapidly to the electronic banking environment, Sri Lanka does not have any laws regulating electronic banking. Thus the legal regime is an essential to accept the electronic fund transfer system and to regulate the electronic environment in banking.

LAW ON ARBITRATION

Disputes are inevitable whether in business or in every day life. What is important is the existence of a successful and effective process of resolving those disputes with an adequate method of obtaining relief. The commercial community, facing an increase in claims in their commercial activity and transactions, need to make sure that there exist ways to resolve their disputes without jeopardizing their businesses. Arbitration is an important and attractive method of dispute resolution and is an alternative to judicial resolution**.**

It is a universally accepted view that litigants are always losers. Prior to the enactment of the Arbitration Act No. 11 of 1995, our legal system preferred litigation over arbitration as a means of resolving disputes. However, litigation is often time consuming and expensive. Business people are fed up with the cost, delay, stress and the risk of litigation. The business may not recover from the prospect of litigation which may spell a financial disaster for it.

Arbitration is the process that can be utilized by the parties to a dispute as an alternative to litigation in a speedy, flexible, efficient and economical way. This saves litigation cost and the time that have to be spent in resolving disputes. The goal of arbitration is to obtain a quick resolution of the dispute.

In arbitration, disputing parties submit their dispute to a neutral and impartial third party or to a panel of arbitrators under an agreement called the compromise. The arbitrator listens to the opposing parties to the dispute and renders the decision. The arbitral award is final, binding and enforceable in a court of law, and has the general effect of excluding the jurisdiction of the courts on the matter referred to arbitration. The Sri Lankan law on arbitration permits an appeal of an award only on the most limited grounds embodied in section 32 of the Act. As a practice, a law court will almost never overturn an arbitral award unless the award is against the public policy of Sri Lanka.

The modern trend clearly favours arbitration for commercial disputes and has been widely accepted as the best method to resolve such disputes. A number of arbitration cases arise from disputing parties agreeing to arbitrate, not litigate. Parties to a contract, who anticipate possible disputes and wish to avoid the expenses associated with the litigation process can agree to settle their disputes through arbitration. Thus, they insert a binding arbitration clause in their commercial contracts to resolve disputes. In the present context arbitration has become very important in resolving commercial disputes, as in major projects, as it is neither feasible nor practical to litigate each dispute that arises. As explained earlier, the basic advantages of arbitration are speed, low cost, informality and the prospect of a decision by a person with knowledge and experience in business affairs which can preserve business relationships that are usually destroyed in the acrimony of litigation. Arbitration may satisfactorily resolve a dispute in a fair and dignified manner and permit the business to continue avoiding delay, costs, and other risks associated with litigation.

As the foregoing discussion noted, Sri Lanka has given the highest priority to attracting foreign investments. It is necessary for Sri Lanka to have an appropriate and feasible legal framework capable of resolving commercial disputes. It is equally important to provide a similar framework for the settlement of investment disputes, both state-state mechanisms and investor-state mechanisms which provide an expeditious, cheap and just means of resolving disputes in an effort to encourage investment.

There is no doubt that the provisions contained in the Sri Lanka Arbitration Act are designed to provide a mechanism to achieve a just, fair and equitable award which will be acceptable to the parties to the dispute.

CONCLUDING COMMENTS

There are various issues which are yet to be addressed in the proposed Companies Bill and further improvement are needed; for example, relaxing some of the rigid requirements relating to private companies, which will lead to a greater increase in the number of such companies. It is hoped that this Bill will be enacted soon without waiting for the positive features to become outdated.

It was evident that the English Partnership Act does not purport to be a comprehensive code covering all aspects of partnership law. Rather, the statute must be read in conjunction with case law, which gives the legislation a greater meaning. Moreover, it is unclear to what extent the English Law on partnership is still in force.

A further matter for concern relates to the lack of adequate regulation and supervision of the stock exchanges and securities markets. This is an important consideration for large scale businesses, as increased investor confidence through more effective protection of investors leads to more funds being available to large companies. Many developments have taken place in England and other jurisdictions which have a bearing on Sri Lankan law. Our law must respond to these developments.

Some of the existing laws on banking which were designed for the domestic sphere have become insufficient to cope with newly emerging problems. Changes have taken place from time to time, both nationally and internationally. It is appropriate to make legislative amendments to these existing laws or enact new laws where necessary in order to accommodate new financial products and electronic technology, which are playing an increasigly important role in this sector.

The foregoing review highlighted that the general business environment in this country is not favourable for commercial transactions. There are many disturbing elements such as lack of certainty, extremely varied and complex laws which hinder foreign investments and create a major setback to economic growth. Overcoming these serious deficiencies is an issue that must be urgently addressed. This process will not be simple and problems will inevitably arise. Looking at the experience of other countries would be relevant here. Prudent safeguards, the removal of existing obstacles, generating new attitudes and practices and sound commercial principles are of paramount importance.

It is generally regarded that the political and economic climate for foreign investments in Sri Lanka is sound and that the future prospects for foreign investments are encouraging. Thus investor confidence should be strengthened by the changes in the legal sphere. Government has recognized the need to address the above issues. Commercial Law Reform Project of the Ministry of Justice, funded by the World Bank, have appointed a technical group to provide expert resources required for the implementation of an appropriate commercial law reform programme. Following are the areas which legal reforms and legislative changes are envisaged by the technical group in order to facilitate private sector led economic growth in Sri Lanka:

(i) Sale of goods;

(ii) Partnership Law;

(iii) Financial instruments and services;

(iv) Product liability and Consumer Protection; and

(v) Information Technology Law

Furthermore, it has become evident to the technical group, the necessity to amend some other laws, such as the Intellectual Property Law.

Much will depend on the success of these reforms and the necessary amendments to commercial law are awaited with interest.