THE EFFICACY OF THE CORPORATE LEGAL REGIME IN KENYA; A CRITICAL ANALYSIS.

NDAMBUKI ELIZABETH MUMBE
LLB/9751/61/DF

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DECLARATION

I, **Ndambuki Elizabeth Mumbe**, declare that this research is my original work and has not been presented in any other academic institution for academic qualification or usage of any kind.

Dated ......2nd..............of.........July...............2010.

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NDAMBUKI ELIZABETH MUMBE

LLB/9751/161/DF

APPROVAL

This is to certify that this dissertation has been submitted for examination with my approval as a University supervisor.

Dated ....2nd........of........July........2010.

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JOSEPH KYAZZE

DEDICATION

I dedicate this research to my mother and father Mr.& Mrs. Daniel Ndambuki, my brothers Tony and Richard Ndambuki and to my entire family for their support and to God for his guidance that has brought me this far.

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This paper has come to be not through the effort of one person, but through the help and effort of other people, I am therefore heavily indebted to the following people who helped me accomplish this piece of work. I owe particular debt of gratitude to Mr. Joseph Kyazze, my supervisor, who provided valuable supervision and guidance throughout the preparation of this paper.

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Abstract

The contribution of companies to the economic development of any country can no longer be underestimated. Companies play a vital role as mechanisms of generating business, sources of employment and avenues of government revenue through taxation.

Nevertheless, the effectiveness of companies and their success and sustainability so much depends on the effectiveness and strength of the legal and enforcement framework governing management and control of companies. This raises the crucial issue of whether Kenya's legal and policy framework contains extensive provision for effective management of companies to ensure their success and sustainability.

In the context of the East African Community, one of the salient considerations is the attempt to harmonise all legislations within the community which necessarily incorporates the need to make a comparative analysis of the law in the member states to highlight areas of difference and therefore worth modification.

The effectiveness of a particular legislation is ordinarily determined by the level of enforcement mechanism available under the law, ranging from administrative, policy and judicial. The study therefore analyses the continued efficacy of the legal regime in Kenya in so far as ensuring effective management of companies is concerned.

In a final analysis, the study highlights the lacuna in the existing legal framework and practice of company management and proposes quite a number of recommendations, aimed at creating avenues for moderating the law to make it more useful and practical.

CHAPTER ONE

Introduction

Company law is a branch of public law which is concerned with the regulation of establishment administration and management of companies. Company law is concerned with the regulation of the relationship between the state and companies, and the stakeholders whether pubic or private companies. It is also concerned with the relation between the company and individuals and what conduct the company should exercise towards the general public.

Background

The Kenyan corporate law regime is based on the English company law. Over the time, there have been reforms in the corporate governance structures worldwide. This study seeks to evaluate the current law in Kenya on corporations. This study is based on the premise that corporate law is on of the most dynamic areas of law with new trends emerging everyday on corporate governance. This study therefore recognizes the importance of the law being able to catch up with the fast pace at which the corporate world is moving.

Problem Statement

Company law in Kenya is not dynamic and does not live up to the emerging trends in corporate law globally today. There has emerged new incorporation and management practices and the law should be fluid enough to encapsulate these changes.

Hypothesis

The hypothesis of this research paper is, 'regulation and oversight of companies will be more effective if there corporate law regime is reformed to reflect emerging principles in corporate management'.

Significance of the Study

This study is important for several reasons. Firstly, Kenya lacks an elaborate corporate law regime. This is not to say that there are no avenues through which the government can effectively regulate and supervise corporate behavior. There is in place the Companies Act[1] which basically provides for the rules to be followed in corporate management.

Secondly, the legislative framework in Kenya does not guarantee effective and water tight management of corporate entities. It is important to safeguard the interests of investors and therefore thus the need for an elaborate and comprehensive reform of the current law on companies.

Objectives

The Main Objective

The main objective of the study is to analyse the effectiveness of the legal framework regulating incorporation and management of companies in Kenya with the ultimate aim of highlighting the weaknesses within the law and avenues of modification of the said law

This research also has other various objectives. These include but are not limited to the following.

1. The study will seek to establish the current corporate law regime is effective for the proper management of corporate entities in today's age.

[1] CAP 486 Law of Kenya

2. The study helps to understand why it is important to safeguard investors' interests' in corporate governance.
3. Another objective of the study is to critically analyze the state of public governance in Kenya and what the possible remedies are within the law.

Research Methodology

This research will be based on primary and secondary data. Primary data used in this paper will be mainly from statutes, some from Kenya and the rest from other countries. Most of the data and information in this paper will be from secondary sources like books, journal articles conference papers and internet sources. Most of the books in this area of study are available locally but the researcher will not be limited to book sources only in the research.

The nature of this study will be analytical and prescriptive. The researcher will analyze the basic principles of company law and what other countries have done in the area of corporate law and governance. The study will also prescribe possible ways of promoting corporate governance. The paper will prescribe possible legislative measures that Kenya can undertake to improve the corporate law regime.

Literature Review

There have been several publications in respect of this study. This study will be based on all available texts on corporate law. Most of the text relied on will be on Corporate Law. ***Avtar Sing*** in his book ***Introduction to Company Law*** discusses major concepts in relation to this topic. He discusses the background of corporate law in Kenya, principles of corporate law in Kenya.

This research seeks also to explore the corporate law regimes in Tanzania and Uganda and whether there are any similarities and differences when comparing both regimes with the Kenyan Regime.

Another Relevant Text to this field of study is ***Company Law and Corporate*** **Finance** by ***Ellis Ferran*** .This focuses on procedural and substantive corporate law in Kenya. The study also considers various journal articles that have been published in his area of study .Conference papers and commentaries made in this area of study will be considered. The study being a fairly recent one availability of text is restricted but the researcher will not be limited to he above mentioned texts. Other relevant texts on the corporate law regime of Kenya shall be referred to later in the research.

This research paper will be based on two legal theories; the social contract theory and the rule of law theory.

Social Contract Theory

This is the major theory behind government and regulation of legal persons such as companies. Under this theory, the state derives its authority from the people by way of a contract in which the people agree to relinquish some of their powers to the state and the state in return guarantees to protect their rights. This is referred to as the social contract theory.

The essential features of social contract theory are these; ***that man lived in a state of nature in which there was no law, no order and no government***. This state of affairs to some was a paradise, to others it was chaos. Men have at some point passed to a state of society by means of a contract in which they undertake to respect each other and live in peace ***(pactum unionis).*** To this contract is added a second pact by which the people unite and undertake to obey a government which they themselves have chosen ***(pactum subjectionis)***[2]**.**

[2] Friedman W, *Legal Theory* p68

Political theory, by which governments are formed, derives its power from the social contract theory. The political theory provides that ***'no man can be subjected to the political power of another without his consent'***[3]. The social contract is therefore the forerunner to the democratic theory through which political authority is realized. In this theory the people are represented in the government by the people they choose through a political process. In this political process, the people choose their representatives who by a majority form a government.

Scholars have come up with different views on this theory. These views have played an important role in shaping this theory. ***Grotius (1583-1645)*** uses the construction of the social contract theory for two purposes. First, he uses it as a justification for the absolute duty of obedience of the people to the government and second, internationally to create a basis for legally binding and stable relations among states[4]. It is the first construction that this study is interested in.

According to Grotius the social contract creates the obligation upon the people to obey the government. There exists a contract between the government and the people and therefore the people are bound to honor their obligations in that contract. This obedience to the state is legitimized by voluntary submission to those who exercise authority. People cannot be subjected to obey a government against their own will. There must be submission, which is voluntary and exercised freely. The people must freely choose their representatives who in turn form a government that the people shall be obedient to.

Thomas Hobbes (1588-1679) starts by looking at the state of affairs before the social contract. According to him, the state of nature in which man lived before the social contract was "***a war of every Man against every Man***" a condition of internecine strife in which the life of man was "solitary, poor, nasty, brutish and short"[5]. Man did everything possible to guarantee his survival and as a result therefore there was no order and peace. It emerged that law and government were therefore necessary to promote order and

[3] Per Locke, *Two Treatises of Government* Vol. 2, s 95
[4] Freidman W, *Legal Theory* p 69
[5] *Leviathan* Pt 1 Chap. 13

personal security. For law and order to prevail, there had to be obedience. To preserve his own life, each citizen must give absolute and unconditional obedience to the law[6]. This justifies the authority of the state and creates upon people obligations to obey the government. According to Hobbes, characteristics of political obligation should be inferred from the *intention* of him that submitteth himself to his power which is understood by the end for which he so submitteth[7]. Hobbes used this theory to justify authoritarian government.

In Hobbes' view, there is the gem of a concept of natural rights; the idea that man may make certain legitimate demands on his fellow men[8]. Man, by virtue of submitting himself to the authority of the state, is entitled to certain rights to be accorded by the state. The state has obligations to protect and guarantee certain rights of the people. This is the basis of the argument on legitimate expectations which is discussed in the course of this research.

John Locke (1632-1704) also starts by evaluating the state of nature that preceded the social contract. He refers to this state before the social contract as that of a 'golden age'. Locke was concerned about property rights and according to him property was insecure in this state. To remedy this, man renounced his otherwise idyllic natural condition and by contract gave up part of his liberty to a sovereign. The purpose of the state and the sovereign was to protect human entitlements.

Locke talks about revolution in his book, ***Two Treatises***. In this book he proclaimed the right of revolution. Though he wasn't an enemy of political authority, he saw it as a human good. According to him, rulers had the right to rule, to use their political power for the public good. But all men had the right to resist the ruler, even of a legitimate political society, where he manifestly abuses his power. Here, Locke was concerned with abuse of power by the state that would injure or prejudice the people and he argued that

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6 Friedman M.D.A *Lloyds Introduction to Jurisprudence* 7th Ed, p112

7 *Leviathan* Pt 2 Chap. 21

8 Friedman M.D.A *Lloyds Introduction to Jurisprudence,* 7th Ed, p112 This forms the basis for the principle of legitimate expectations in administrative justice to be discussed later on in the paper.

they had a right to stand up against this abuse of power by the state. Central to Locke's conception of the government was the idea of trust. There is a conceptual shift involved here from the concept of contract to a fiduciary relationship. Whereas the concept of contract emphasizes the conduct of individual citizens, that of trust emphasises the conduct of the rulers[9]. Men put their trust in the sovereign and therefore a ruler who betrays this trust may be overthrown. Locke's concept of trust can be merged with the social contract theory to come up with an enhanced contract that has better and well defined duties and obligations between the state and the people and remedies in cases of breach or abuse.

Rousseau (1712-1778) was of the opinion that the social contract is a mystical construct by which the individual merges into the community and becomes part of the 'general will'. He talks about the general will which implies that man must have a will or purpose to be governed by the state and that is why man has obligations towards the state. Ideally, the people should govern themselves. But this is only an ideal, in reality; people are governed by their representatives. Rousseau says that the law is "the register of the general will". It is through the law that the general will of the people is represented. If the law does not represent the will of the people then it is null and void. And the government which is a construction of the law can only be tolerated so long as it accurately reflects the general will.

Rousseau was however critical of the theory of legislative representation. He says that people are only free during the elections of their representatives. Once elected, the people do not have a say on what their representatives do. He says that "every law that the people have not ratified in person is null and void - is in fact, not a law"[10]. According to him, direct citizen participation is thus a necessary condition of establishing the moral basis of obedience to the law. Rousseau therefore brings to light the new idea of citizen participation in law making and governance.

[9] M.D.A *Lloyds Introduction to Jurisprudence* 7th Ed, p114
[10] *Social Contract* Bk. III, Chap. 15, p240

Rule of Law

The rule of law doctrine is the main theory in public law, which is the basis of this study. Company law is concerned with the control of corporations and the rule of law doctrine is important because it has its foundation in constitutional law, from which governments derive their powers from. The Constitution of Kenya, like the unwritten British Constitution is founded on the Rule of Law[11]. Public law is the area where the rule of law principle is to be seen in its most active operation.

It therefore becomes paramount to define what rule of law means in order to exhaustively discuss it as foundation of this study. The primary meaning of the rule of law doctrine is that everything must be done according to the law. Applied to company law, this requires that every government authority or company which does some act which would otherwise be a wrong, or which infringes a man's liberty, must be able to justify its action as authorized by law – directly or indirectly by an Act of Parliament.[12] Every act of government power that affects the legal rights, duties, or liberties of any person, must be shown to have a strictly legal pedigree[13]. The affected person can resort to the courts to invalidate the act if it is shown that the legal pedigree is not in order. Corporate law is concerned with the rights of a person vis-à-vis the rights, duties and obligations of a company. These rights are to be protected through the rule of law by ensuring that corporate actions are within the law.

The second meaning of the rule of law is that government should be conducted within a framework of recognized rules and principles which restrict discretionary power. In company law, the courts have discretion in various matters. The state also in regulating companies has discretionary powers. Acts of Parliament confer upon ministers and other government officer's wide discretionary powers in the exercise of their duties. This

[11] Kenya follows the English legal system and English legal doctrines are applicable in Kenya. Kenya, a former colony of Britain, borrowed a majority of it laws from Britain. That is reason why the constitution of Kenya and the British one have similar doctrines, despite the latter being unwritten.
[12] H.W.R Wade & C.F Forsyth *Administrative Law* 9th Ed p20
[13] *ibid*

occurs mostly where the law is unclear. An essential part of the rule of law is a system of rules for preventing the abuse of discretionary power. The rule of law requires that courts should prevent its abuse, and for this purpose they have performed many notable exploits, reading between the lines of the statutes and developing general doctrines for keeping executive power within proper guidelines, both as to substance and as to procedure.[14]

There are also other important principles that emerge from these meanings that are not related to company law but are worth mentioning. In this second meaning, there emerges the principle of legality. Under this principle, every act of government or public body must be exercised within the law as may be prescribed by an Act of Parliament. It is concerned with the discretionary powers conferred upon ministers and government officials. It is a clear cut concept but the restrictions to be put upon discretionary power are a matter of degree. Faced with the fact that Parliament freely confers discretionary powers with little regard to the dangers of abuse, the courts must attempt to strike a balance between the needs of fair and efficient administration and the need to protect the citizen against oppressive government.[15] It is therefore important for the corporate law regime to follow the law in order to protect investors and the rights of people in general.

The third meaning of the rule of law is that disputes as to the legality of acts of government are to be decided by the judiciary which is independent of the executive. This is the principle of separation of powers under which independence of the judiciary is guaranteed. In Kenya, it is guaranteed by the constitution though there are inconsistencies, for example in the appointment of judges. In Kenya judges are appointed by the president who heads the executive arm of the government and this therefore appears to be a contradiction to the doctrine of separation of powers.

The final meaning of the rule of law theory is that the law should be even-handed between the government and the citizen. This is the principle of fairness. It cannot be the

[14] *Ibid* p21
[15] *Ibid* p21

same for both the government and the citizen since every government must as of necessity have many special powers. The law requires that the government should not enjoy unnecessary privileges and exemptions from ordinary law.[16] In principle all public authorities should be subject to all normal legal duties and liabilities which are not inconsistent with their governmental functions.

The basis of this research will be the above mentioned theories; social contract and the rule of law theory. The study will relate these theories to the problem being addressed. A critical analysis of the area of study will reveal that these theories are of great importance.

Overview of Chapters- Synopsis

Chapter One

Chapter one is the introduction to the research. It sets out the problem that the research undertakes to study. It discusses the objectives, justifications and the theoretical framework of the study. It also looks at the literature review in this field. There has been several works on this area of study and the literature review will highlight and briefly discuss these. The introduction chapter will also highlight the methodology the researcher will adopt in the study. The researcher will mainly be relying on secondary data, from published books and papers presented by scholars at various forums.

Chapter Two

This chapter will look at the various principles of company law and how they operate. In this chapter the researcher will look at the following principles of company law; separate identity, limited liability, ultra vires and the corporate veil. In this chapter the researcher will look at how the courts have rules on these principles. The researcher has used case law to illustrate how the courts interpret these principles and how the law operates with regards to these principles.

[16] *Ibid* p22

Chapter Three

In this chapter the researcher will look at the types of companies that can be registered in Kenya. This chapter will look at how companies are incorporated. In this chapter, the various mode of carrying out business as stipulated under the Companies Act will be discussed. The researcher will look at the requirements for incorporation, annual general meetings and how directors are elected.

Chapter Four

In this chapter the researcher will look the corporate law regime in East Africa with Uganda and Tanzania being the case study and whether there are any comparisons and differences in comparison to Kenya's corporate law regime.

Chapter Five

This is the final chapter of the research paper. In this chapter, the researcher will look at the shortcomings of the current company law regime in Kenya and make recommendations to the possible change that can be done to improve the system. The researcher will look at various true-life scenarios and suggest legislative reforms that can be implemented to improve the administration of company law in Kenya. The researcher will use examples from other legislative regimes to compare and analyze the global trend in corporate law.

CHAPTER TWO

Principles of Company Law in Kenya

There are various principles that govern company law in Kenya. These are the principles that are in place to facilitate the everyday to day running of companies. Through these principles the company is able to effectively and efficiently carry out its mandate. The interests of various stakeholders in a company are also protected by these principles. Most of these principles are borrowed from Britain from where Kenya has borrowed its laws.

These principles include the principle of separate identity, lifting the corporate veil, limited liability and ultra vires among other principles.

Separate Identity

This principle is also known as the corporate entity or corporate personality principle. Under this principle companies are recognized at law as separate legal entities and upon registration, the company becomes a separate legal entity. Such legal personality sets out this business structure apart from partnerships, trusts and unincorporated associations. Through this principle, companies are accorded the powers of a natural person and can, *inter alia,* hold property, contract, sue or be sued in the company's own name.

It is therefore paramount to define what company is in order to exhaustively discuss the corporate personality principle in company law. ***Section 2 of the Companies Act***[17] defines a company as a company formed and registered under this Act or an existing company. A company can be said to be an association formed for a business purpose and registered under the Companies Act.

[17] CAP 486 Laws of Kenya

A company has also been defined as a body of persons who collectively form one, but who have a separate existence distinct from that of the corporation itself.[18] The corporation therefore has a legal personality of its own distinct from that of its members. The individual members have rights and liabilities distinct from those of the corporation. Simply stated, it is an association of a number of people for some common object or objects.[19] In common parlance, the word company is normally reserved for those associated for economic purposes; i.e. to carry on a business for gain.

A more clear definition of a company is given by *Lord Justice Lindley*[20]. He stated; that by a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising there from. The common stock so contributed is denoted in money and is the capital of the company and the persons who contribute it, or to whom it belongs, are called as members. The proportion of capital to which each member is entitled is his share which is always transferable although the right to transfer them is more or less restricted.

Therefore a company may be defined as an incorporated association which is an artificial person, having a separate legal entity, with a perpetual succession, a common seal, a common capital comprised of transferable shares and carrying limited liability. It is called an artificial person because of its very nature that law alone can give birth to a company and law alone can put it to an end.

It follows from the definition of a company; the principle of separate identity clearly emerges. The Company becomes a legal person in its own right, distinct from the shareholders and management. This was seen in the famous case of ***Salomon v Salomon & Co. Ltd.***[21] However there are instances, as will be discussed in the next principle, when it becomes necessary to go beyond the separate personality of the company and look

[18] Jackson, Tudor *The Law of Kenya,* 3rd Ed pp 42
19 Davies, Paul, *Gower's Principles of Modern Company Law*, 6th Ed., (London: Sweet & Maxwell, 1997), page 3.
[20] Dunlop Nigerian industries Ltd v. Forward Nigeria Enterprises Ltd and Farore 1976 N.C.L.R 243
21 [1897] AC 22

deeper at the members of the company. This is called lifting the veil of incorporation of lifting the corporate veil.

The Veil of Incorporation

The principle that a company is a legal entity separate from its members, and that as a matter of law these parties are divided by a "corporate veil", permeates commerce, the taxation system, corporate structures, and the way in which business is carried on in many jurisdictions. The 'veil of incorporation' is the rather poetic term given to this separation of the company from its shareholders or members.

The concept of separation of a company from its members has its legal genesis in the decision of House of Lords in the ***Salomon v Salomon & Co Ltd*** **case**[22]. In this case, Mr. Salomon had a boot manufacturing business which he decided to incorporate into a private limited company. He sold his business to the newly formed company, A Salomon & Co Ltd, and took his payment by shares and a debenture or debt of £10,000. Mr. Salomon owned 20,000 £1 shares, and his wife and five children owned one share each. Some years later the company went into liquidation, and Mr. Salomon claimed to be entitled to be paid first as a secured debenture holder. The liquidator and the other creditors objected to this, claiming that it was unfair for the person who formed and ran the company to get paid first.

In that case, the trial judge Vaughan Williams J at first instance held that to allow a man who carries on business under another name to set up a debenture in priority to the claims of the creditors of the company would have the effect of defeating and delaying creditors.[23] The Court held, inter alia, that the business was Salomon's business, that the company was his agent, and that accordingly the creditors of the company could have sued Salomon personally.[24] His judgment was affirmed on appeal by the Court of Appeal.

[22] *ibid*
[23] [I8951 2 Ch 323 at 331
[24] *ibid*

Salomon appealed to the House of Lords, which allowed his appeal. Lord Halsbury LC observed:

> *I am simply here dealing with the provisions of the statute, and it seems to me to be essential to the artificial creation that the law should recognize only that artificial existence – quite apart from the motives or conduct of individual corporations. In saying this, I do not at all mean to suggest that if it would be established that this provision of the statute to which I am adverting had not been complied with, you could not go behind the certificate of incorporation to show that a fraud had been committed upon the officer entrusted with the duty of giving the certificate, and that by some proceeding in the nature of scire facias you could not prove the fact that the company had no real legal existence. But short of such proof it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are. I will for the sake of argument assume the proposition that the Court of Appeal lays down that the formation of the company was a mere scheme to enable Aron Salomon to carry on business in the name of the company. I am wholly unable to follow the proposition that this was contrary to the true intent and meaning of the Companies Act. I can only find the true intent and meaning of the Act from the Act itself; and the Act appears to me to give a company a legal existence with, as I have said, rights and liabilities of its own, whatever may have been the ideas or schemes of those who brought it into existence.*[25]

Accordingly, in the view of the Court the fact that the secured creditor had originally been the major shareholder in the company did not prevent enforcement of the security to the detriment of the unsecured creditors.

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[25] [I8971 AC 22 at 29-30

Since the decision in Salomon case, the fundamental common law principle applicable to corporate identity has been that the company is separate from its members.[26] However, shortly after the decision in the ***Salomon case***, courts started recognizing exceptions to the application of the rule, where the corporate veil would be ***'lifted'***, ***'raised'*** or ***'pierced'*** in order to attribute liability of he company to it members. Primarily, circumstances where the Courts have been prepared to lift the corporate veil have involved the use of the company as a sham or fraud; however, situations where the veil has been disregarded do not necessarily satisfy this criterion. In addition, legislation has intruded to permit the corporate veil to be raised in circumstances prescribed by Parliament.

There are two ways through which the corporate veil can be lifted. First is by specific provision in legislation. This occurs where an Act of Parliament expressly provides for situations in which the corporate veil will be lifted. Legislative lifting of the veil is usually for the purpose of enforcing company law. Secondly, the corporate veil will be lifted by the courts. This is also referred to as lifting the corporate veil under common law. Here, the courts have discretion and the cases when the veil has been lifted vary with the facts of the cases. The court will be seeking to prevent the occurrence of fraud in exercising their discretion in lifting the veil.

Under the Kenyan Companies Act, there are various ways through which the corporate veil will be lifted under statutory provisions.

Firstly, the corporate veil will be lifted when there is a reduction in the number of members of a company.[27] ***Section 33*** refers to membership that has fallen below the statutory minimum in a public company. The Act provides that the only those members who remain after the six month during which the company has fallen below the provided minimum period can be sued. These remaining members are liable if they have

[26] See, for example, cases In England (e.g. *Macaura c Northern Assurance Co Ltd* [I9251 AC 619), Australia (e.g. *Walker v Wimborne* (1976) 137 CLR 1) and New Zealand (e.g. *Lee* v *Leek AirFarming* [I9611 AC 12 (Privy Council))
[27] Section 33 of the Companies Act, CAP 486 Law of Kenya

knowledge of the fact that the membership has fallen below the statutory minimum and are only liable in respect of debts contracted after the expiration of the six months.

Secondly, the corporate veil will be lifted where there is evidence of fraudulent trading. This is provided for in ***Section 323 of the Act.***[28] The section provides that if in the course of winding up of the company it appears that any business has been carried on with the intent to defraud creditors or for any fraudulent purpose, the courts will on the application of the official receiver or liquidator, may declare that any persons who are knowingly parties to fraud be personally responsible for the debts and liabilities incurred by the company.

An equivalent provision in the English Company Act was explained by Justice Maugham J where he said that if a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payments for those debts, it is in general a proper reference that the company is carrying on business with the intent to defraud.[29]The statutes are not clear on the meaning of fraud. The question arises that once money has been recovered from the fraudulent director, it is to be laid on the part of the company's general assets available to all creditors or should it go back to those creditors who are actually defrauded?

Thirdly, lifting the corporate veil under statutory provisions occurs in cases of holding and subsidiary companies. One of the most important limitations imposed by the Companies Act on the recognition of the separate personality of each individual company is in connection with associated companies within the same enterprise. In practice it is common for a company to create an organization of inter-related companies which is theoretically a separate entity but in reality one represents the group as a whole. Such is particularly the case when one company is the parent or holding company and the rest are its subsidiaries.

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[28] CAP 486

[29] Re William Leitch Ltd [1932] 2 Ch. 71

Under ***Section 154 of the Act,*** a company is deemed to be a subsidiary of another if that other company either is a member of it and controls the composition of its board of directors or holds more than half in nominal value of its equity share capital.

Section 150 (1) provides that where at the end of the financial year a company has subsidiaries , the accounts dealing with the profit and loss of the company and subsidiaries should be laid before the company in the general meeting when the company's own balance sheet and profit and loss accounts are also tabled. This means that group accounts must be laid before the general meeting. The group accounts should consist of a consolidated balance sheet for the company and subsidiaries and also a consolidated profit and loss account of the parent and subsidiary companies.

Therefore, under ***Section 151 (2),*** it may be observed that the treatment of these accounts in a consolidated form qualify an old rule that each company constitutes a separate legal entity. The statute here recognizes enterprise entity rather than corporate entity. The veil of incorporation will be lifted so that they will not be regarded as separate legal entities but will treated as a group.

The fourth instance in which the corporate veil will be lifted will be in cases of mis-description of companies. Section 109 of the Companies Act requires that a company's name should whenever it does business on its seal and on all business documents. If an officer of a company or any person who on its behalf signs or authorizes to be signed on behalf of the company any bill of exchange, promissory note, cheque or order for goods wherein the company's name is not mentioned as required by the section, such an officer shall be liable to a fine and shall also be personally liable to the holder of the bill of exchange, promissory note, cheque or order for the goods for the amount unless the it is paid by the company. This section makes a company's officer incur personal liability even though they might be contracting as the company's agent. Liability under this section normally arises in connection with cheques and company officers have been held liable where for instance the word limited has been omitted or where the company has been described by a wrong name.

Under common law, the corporate identity will be ignored in four instances. Here the court will exercise its discretion in lifting the veil incorporation depending on the various circumstances of the case.

Firstly, the corporate identity will be ignored by the courts where there is an agency relationship. Generally, there is no reason why a company may not be an agent of its shareholders. The decision in ***Salomon's case*** shows how difficult it is to convince the courts that a company is an agent of its members.

In spite of the foregoing, there have been occasions in which the courts have held that registered companies were not carrying on business in their own right but rather as agents of their members or holding companies. The case in reference here is that of ***Smith, Stone & Knight v Birmingham Corporation***[30]. The plaintiffs were paper manufacturers in Birmingham city and in the same city there was a partnership called Birmingham Waste Company. This partnership did business as merchants and dealers in waste paper. The plaintiffs bought the partnership as a going concern and the partnership business became a part of the company's property. The plaintiffs then caused the partnership to be registered as a company in the name Birmingham Waste Corporation Ltd with its subscribed share capital being 502 pounds divided into 502 shares. The plaintiffs held 497 shares and the remaining shares were registered in the name of each director. Thereafter the director executed a declaration of trust stating that their shares were held by them on trust on for the plaintiff company. The new company had its name placed upon the premises and on the note paper invoices as though it was still the old partnership carrying on business. There was no agreement of any sort between the two companies and the business carried on by the company was never assigned to it. The manager was appointed but there were no other staffs. The books of accounts of the new company were all kept by the plaintiff company and the manager of the new company did not have access to them. There was no doubt that the plaintiff company had complete control over the waste paper company. There was no tenancy agreement between the two companies

[30] [1938] 4 All E.R 115

and the waste company never paid any rent. The Birmingham Corporation compulsorily acquired the premises upon which the subsidiary company was carrying on business and the plaintiff company claimed compensation for removal and disturbance. The Birmingham Corporation replied that the proper claimants were the subsidiary company and not the holding company since the subsidiary company was a separate entity. The court held that occupation of the premises by a separate legal entity was not conclusive on a question of a right to claim and as a subsidiary company it was not operating in its own behalf but on the parent company. Therefore the subsidiary company was an agent.

However, there have been cases where the *Salomon's* case has been upheld that a company and a subsidiary company are different entities. In ***Ebbw Vale UDC v South Wales Traffic Authority***[31] Justice Cohen L.J stated that;

> "*Under the ordinary rules of law, a parent company and a subsidiary company even when there is a hundred percent subsidiary, they are distinct legal entities and in the absence of an agency contract between the two companies, one cannot be said to be an agent of the other*".

Secondly, courts will ignore the corporate veil where there is fraud or improper misconduct. Courts will disregard corporate identity in situations such as those where the company is formed for fraudulent purposes or to facilitate the evasion of legal obligations. The case of ***Gilford Motor Co v Horne***[32] illustrates this point. The defendant was subject to a restraint of trade clause in his contract of employment with the plaintiff, which bound him not to solicit the plaintiff's customers if he left the company. On leaving his employer, Horne set up a company and used this format to solicit customers from his former employer. The court held that the company was formed for an improper purpose, i.e. to defeat an employment contract, and thus the court could lift the veil of incorporation and identify Horne with the new company. In ***Jones v Lipman***[33], the defendant made a contract to sell his house to Jones and then wished to get out of the contract. He formed a company, conveyed the house to it and then claimed he could no

[31] [1951] 2 K.B 366
[32] [1933] Ch. 935
[33] [1962] 1 All E.R 442

longer sell the house to Jones. The court held that this company was formed as a 'device or sham' to frustrate the sale contract, and an order of specific performance of the sale contract was granted to Jones.

Thirdly, courts will under common law lift the veil of incorporation in cases of group companies. In their exercise of their original jurisdiction courts have displayed a tendency to ignore the separate entities of various companies in a group. By so doing, the courts give regard to the economic entity of the group as a whole. The case of *Power Supermarkets Ltd v Crumlin Investments Ltd and Dunnes Stores (Crumlin) Ltd*[34] illustrates this. The plaintiff, the Quinn worth chain of supermarkets, leased a large unit in a shopping centre from Crumlin Investments Ltd. The lease contained a restrictive covenant whereby Crumlin Investments Ltd covenanted not to allow another grocery as tenants in the centre. Subsequently, Crumlin Investments Ltd sold the centre to Cornelscourt Shopping Centre Ltd, which was part of the Dunnes Stores group of supermarkets. Each of the retail units in the Dunnes Stores Group was operated as a separate company, although they were all controlled by the Dunne family. A new company, called Dunnes Stores (Crumlin) Ltd (the second defendant), was formed and began to operate a supermarket in the shopping centre. The High Court held that Dunnes Stores (Crumlin) Ltd was bound by the restrictive covenant, although it was not a party to it. The judge stated that 'a court may, if the justice of the case so requires, treat two or more related companies as a single entity so that the business notionally carried on by one will be regarded as the business of the group, if this conforms to the economic and commercial realities of the situation.' There are certain conditions that must be met before the court can lift the corporate veil in relation to group companies; firstly, the acts of one company must be factually identified with another company and secondly, there must be circumstances where justice would be served only if the court ignores the distinction of the separate companies.

However, it's not always that the court will lift the corporate veil. In its exercise of discretion, the court will be guided by what is just and fair in the circumstance. The court

[34] [1985]

in ***The State (McInerney & Co Ltd) v Dublin County Council***[35] stated that 'the corporate veil is not a device to be raised or lowered at the option of the parent company or group. The arm which lifts the corporate veil must always be that of justice.'

The applicability of the Doctrine of Ultra Vires to Corporate Management

This doctrine provides that a company being a creature of the law has no power to do anything except that which is set out in its Memorandum of Association.[36] A company cannot effectively do anything beyond the powers which are either expressly or by implication conferred upon it in its Memorandum of Association. Any purported activity in excess of those powers will be ineffective even if agreed to by the members of the company. This is the scope of the doctrine of ultra vires in company law.

There are two reasons why the doctrine of ultra vires is entrenched in company law. Firstly, it is meant for the protection of the investors who thereby know the objects in which their money is to be applied. Secondly, it is intended for the protection of the creditors by ensuring that the company's assets to which creditors look for repayment their debt are not wasted in unauthorized activities.

This doctrine was first articulated by the courts in the case of ***Ashbury Railway Carriage v Richie.***[37] In this case the courts were very rigid in their interpretation of the company's articles that were said to be in excess of authority. However, the courts with time eased on their application of the doctrine. Lord Selbourne said that,

> *"........the doctrine of ultra vires as it was explained in Ashbury's case should be maintained but this doctrine ought to be reasonably and not unreasonably understood and applied and whatever may be fairly regarded*

[35] [1985]
[36] Maema, William *Legal Considerations of For Doing Business in Kenya 2007* pg 4. The author of this paper an Advocate of the High Court of Kenya. This paper was first presented at The Competitive Enhancement Programme Conference in Nairobi organized by Centre for Development of Enterprise (CDE) on 2nd February 2007.
[37] [1875] L.R 653

as incidental to or consequential upon these things that the legislature has authorized ought not to be held by judicial construction to be ultra vires".[38]

An act of the company therefore will be regarded as intra vires not only when it is expressly stated in the objects clause but also when it can be interpreted as reasonably incidental to the specified objects. As a result of the above decision there is now a considerable body of case law that deciding what powers will be implied in a case of particular types of enterprise and what activities will be regarded as reasonably incidental to the act.

However, businessmen nowadays do not wish to leave matters for implication. They now prefer to set in the Memorandum of Association not only the objects for the company is being established but also the ancillary powers which they think the company might need.

Additionally, instead of confining themselves to the business which the company is initially intended to take up, they also include all other businesses which they might want the company to turn to in the future. The original intention of Parliament was that the company's objects should be set out in short paragraphs in the Memorandum of Association. But with a practice of setting out not only the present business but also any business which the promoters would want the company to turn to, the result is that the company's objects clause could contain about 30 to 40 different clauses covering every conceivable business and all that incidental powers which might be needed to accomplish them.

In practice therefore, the objects clause of practically every company does not share the simplicity originally intended in favour of these practice. It may be argued that the wider the objects clause, the greater is the security of the creditors since it will not be easy for the company to enter into ultra vires transactions because every possible act will probably be covered by some paragraph in the objects clause. Unfortunately this does not ensure

[38] *Attorney General v Great Eastern Railway* [1880] 5 A.C 473

preservation of the company's assets or any adequate control over the directors' activities thus the original protection intended vanishes.

There have been questions about gratuitous gifts issued by the company and whether they are limited by the doctrine of ultra vires. The question is normally whether company can validly make a gift out of corporate property or assets. The law provides that a company has no power to make such payments unless the particular payment is reasonably incidental to the carrying out of the company's business and is meant for the benefit of the company

CHAPTER THREE

Procedural and Substantive Company Law in Kenya

Types of Companies

There are various forms of companies in Kenya. There are statutory corporations which are different from the ordinary companies registered under the Companies Act. Statutory companies are created by an Act of Parliament. The Companies Act does not create any corporations. It only lays down a procedure by which two or more persons who so desire can themselves create a corporation by complying with the rules for registration which the Act prescribes.

The process of registration of a company calls for compliance with quite a number of steps dependant on whether it's a private company of public limited liability company. In the course of registration of a company, the promoters must make up their minds as to which of the various types of registered companies they wish to form. They must choose between a limited and unlimited company. ***Section 4(2) (c) of the Companies Act*** states that 'a company having not the liability of members limited in any way is termed as an unlimited company. The disadvantage of an unlimited company is that its members will be personally liable for the company's debts. It is unlikely that promoters will wish to form an unlimited company if the company is intended to trade, but if the company is merely for holding land or other investments the absence of limited liability would not matter.

If they decide upon a limited liability company, they must make up their minds on whether it will be limited by shares or by guarantee. This will depend upon the purpose for which it is formed. If it is to be a non-profit concern, then a guarantee company is the most suitable. If they intend to form a profit making company, liability should be limited by shares.

A company can also be a private or public company. Section 30 of the Companies Act defines a private company as one which by its articles restricts the rights to transfer shares, restricts the number of members to fifty and prohibits invitation of members of public to subscribe for any share or debentures of the company. A company which does not fall under this definition is described as a public company. In order to form a public company, there must be at least seven subscribers signing the Memorandum of Association whereas only two people need to sign the Memorandum of Association in the case of a private company.

Incorporation of a Limited Liability Company

In order to incorporate them into a company, those people wishing to trade through the medium of a limited liability company must first prepare and register certain documents. These are;

1. Memorandum of Association

This is the document in which they express *inter alia* their desire to be formed into a company with a specific name and objectives. The Memorandum of Association of a company is its primary document which sets up its constitution and objectives. In the current corporate law regime in Kenya makes it a mandatory requirement for companies to have a memorandum of association

2. Articles of Association

Whereas the Memorandum of Association of a company sets out its objectives and constitution, the Articles of Association contain the rules and regulations by which its internal affairs are governed, dealing with such matters as shares, share capital, company meetings and directors among others. This is also a mandatory requirement for a company to be registered in the current corporate regime.

Both the Memorandum and Articles of Association must each be signed by the seven persons for a public liability company or two persons for a private liability company. These signatures must be attested by a witness. If the company has share capital, each subscriber to the share capital must write opposite his name the number of shares he takes and must not take less than one share.

The Articles of Association are the more important of the two documents in as much as the most court cases in company law deal with the interpretation of the Articles. ***Section 9 of the Companies Act*** provides that a company limited by guarantee or an unlimited company must register with a Memorandum of Association and Articles of Association describing the rules and regulations of the company. A company limited by shares may or may not register articles of Association. A company's Articles of Association may adopt any of the provisions which are set out in Schedule 1 Table A of the Companies Act. Table A is the model from of Articles of Association of a company limited by shares. It is divided into two parts designed for public companies inn Part A and for private companies in Part B (II).

In the case of a company limited by shares, if no articles are registered or if articles are registered in so far as they do not modify or exclude table A, the regulation in Table A automatically become the company's Articles of Association.

Section 12 of the Companies Act requires that the Articles must be in English, printed, divided into paragraphs, numbered consecutively, dated and signed by each subscriber to the Memorandum of Association in the presence of at least one attesting witness.

The relationship between the Memorandum and the Articles, the Memorandum of Association is the dominant instrument so that if there is any conflict between the provisions in the Memorandum and those in the articles, the Memorandum provisions prevail. However if there is any ambiguity in the Memorandum one may always refer to the Articles of Association for clarification but this does not apply to those provisions which the Companies Act requires to be set out in the Memorandum as for instance the objects of the company.

Whereas the Memorandum of Association confers powers for the company, the Articles of Association determine how such powers should be exercised. Articles regulate the manner in which the company's affairs are to be managed. They deal with *inter alia* the issue of shares, the alteration of share capital, general meetings, voting rights, appointment of directors, powers of directors, payment of dividends, accounts and winding up among other things. Articles further provide a dividing line between the powers of share holders and those of the directors.

3. Statement of Nominal Capital

This is only required if the company has a share capital. The fees that one pays on registration will be determined by the share capital that the company has declared. This as well is a mandatory

4. Declaration Of Compliance

This is a statutory declaration either made by the advocates engaged in the formation of the company or by the person named in the Articles of Association as the director or secretary to the effect that all the requirement of the Companies Act have been complied with. Where it is intended to register a public company, ***section 184 (4) of the Act*** also requires that the registration of the list of persons who have agreed to become directors. ***Section 182 (1)*** requires the written consents of the directors.

These are the only documents that must be registered in order to secure the incorporation of a company. In practice however, two other documents which would be filed within a short time of incorporation.
These are;

a) Notice of the situation of the Registered Office which under section 108 of the statute should be filed within 14 days of incorporation.
b) Particulars of directors and secretary which under section 201 of the Act are normally required within 14 days after the appointment of the directors and secretary.

The documents are then lodged with the Registrar of Companies and if they are in order then they are registered. Registrar then grants a Certificate of Incorporation and the company is thereby formed. Section 16 (2) of the Act provides that from the dates mentioned in the Certificate of Incorporation, the subscribers to the Memorandum of Association become a body corporate by the name mentioned in the Memorandum capable of exercising all the functions of an incorporated company. It should be noted that the registered company is the most important corporation.

5. Company Organs and Officers

Since a company is an artificial person, it can only act through an agency of a human person. Most of the actions of a company are affected by or through the Board of Directors.

6. Directors

The authority to exercise a company's powers is normally delegated neither to the individual members nor individual directors but to the board of directors. The directors may however delegate powers to an individual Managing Director. Section 177 of the Companies Act requires every public company to have a t least two directors and every private company to have at least one director. The Act does not provide for the means of appointing directors but in practice the Articles of Association provide for initial appointments by subscribers to the Memorandum of Association and thereafter to annual retirement of certain number of directors and filling of vacancies at the annual general meeting.

Under section 184 (1) of the Act, every appointment must be voted on individually except in the case of private companies or unless the meeting unanimously agrees to include two or more appointments in the same resolution. The appointment is usually effected by an ordinary resolution. However, no matter how a director is appointed, under ***section 185 of the Act*** he can always be removed from office by an ordinary resolution in addition to any other means of removal which may be embodied in the articles.

Unless the articles so provide, directors need not be members of a company, but if the require a share qualification, then the shares must be taken up within two months of incorporation or otherwise the office will be vacated. Undischarged bankrupts are not allowed to act as directors without leave of the court. A director need not be a natural person. A company can be appointed a director of another. The disqualifications of directors are set out in Article 88 Table A. the division of powers between the general meeting and the board of directors depends entirely on the construction of the Articles of Association and generally where powers of management are vested in the Board of Directors, the general meeting cannot interfere with the exercise of those powers.

The division of the power to manage the company's affairs is embodied in Article 80 of Table A which states that the business of the company shall be managed by directors who may exercise all such powers of a company as are not by the Act or by the regulations required to be exercised by the company at the general meeting. Where this article is adopted as it is invariably done in practice, the general meting cannot interfere with a decision of the directors unless they are acting contrary to the provisions of the Companies Act or the particular company's Articles of Association.

Duties of Directors

The duties of directors fall into two categories;

a) Duties of care and skill
b) Fiduciary duties of loyalty and good faith

a) Duties of Care and Skill

The degree of care and skill required is determined objectively by considering how a reasonable person with similar knowledge and experience would have acted, and then comparing this to the director's actions. Each case is considered individually taking into account the nature of the business and the director's specific obligations. As indicated earlier, no distinction is made between executive and non-executive directors.

The duties of care and skill were summed up by Romer J in the ***Re City Equitable Fire Insurance Co.***[39] In this case the directors of an insurance company left the management of the company's affairs almost entirely to the Managing Director. Owing to the Managing Director's fraud, a large amount of the company's funds disappeared. Certain terms appeared in the balance sheet under the heading "loans at call or short notice" and "cash in bank or in hand". The Directors did not inquire how these items were made up. If they had inquired that would have found that the loans were chiefly to the Managing Director himself and to the company's General Manager and the cash at bank or in hand included some £ 13,000 in the hands of a firm of stockbrokers at which the Managing Director was a partner. On winding up, an investigation of affairs of the company showed a shortage of funds of more than £1.2 million incurred mainly due to the fraud of the Managing Director for which he was convicted and sentenced. The other directors had all along acted in good faith and honestly but the liquidator sought to make them liable for the damages. It was held that the directors were negligent and Justice Romer reduced the duties of care and skill as follows;

> "*A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience*"

This proposition prescribes the standard of skill to be exhibited in actions undertaken by directors. The test is partly objective and partly subjective because a reasonable man would be expected to have the knowledge of a director with his experienc

[39] [1925] Ch. D 447

Neville J in ***Re Brazilian Rubber & Plantations Estates Ltd***[40] opined;

> *"It has been laid down that so long as they act honestly, directors cannot be made responsible in damages unless they are guilty of gross negligence. A director's duty requires him to act with such care as is reasonably expected from him having regard to his knowledge and experience. He is not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of anything connected with rubber without incurring responsibility for the mistakes which may result from such ignorance. While if he acquainted himself with the rubber business, he must give the company the advantage of his knowledge when transacting the company's business. He is not bound to take any definite part in the conduct of the company's business but insofar as he undertakes it he must use reasonable care. Such reasonable care must be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf."*

The other duties of directors are to attend board of directors meetings, but the courts have held that a director is not bound to give continuous attention to the affairs of his company.[41] His duties are of an intermittent nature to be performed at periodical board meetings and at meetings of any committee of the board on which he is placed. He is not bound to attend all such meetings though he ought to attend whenever in the circumstances he is reasonably able to do so.

c) Fiduciary Duties

Fiduciary duties of directors were first elaborated by common law judges, operating without any guidance from the formal written law. The fiduciary duties of directors are continuing to evolve, again without formal written law. A director's fiduciary duty arises

[40] [1911] 1 Ch. D 405
[41] *Re Denham & Co. Ltd* [1883] 25 Ch. D 752

out of the board's fiduciary relationship with the corporation and shareholders. Through corporate law, a board is given power to manage the company, and with that power comes the duty to use that power to benefit the company and the shareholders. Directors act as fiduciaries to the corporation, and once elected must serve the best interests of both the corporation and all of the corporation's shareholders, not just those shareholders who the director was elected by.

Every director is bound at common law by a separate and distinct fiduciary duty to the company. The term 'fiduciary' is derived from the Latin ***'fiduciarius'*** meaning ***'of trust'***. Directors owe their fiduciary duty to the company as a corporate being in its own right and not to the members individually, not even to a member who is a majority shareholder. Even if a director occupies his position on the board by virtue of another position he holds, for instance, where he is appointed by a major shareholder or is entitled to a seat on the board by virtue of an executive position in the company, a director's fiduciary duties rest upon him as an individual. The fiduciary duty is likewise not owed directly to creditors, employees or other stakeholders of the company, although there is a range of circumstances in which a director may, by virtue of the neglect of his fiduciary duty to the company, be held personally liable to the company's stakeholders

The fiduciary duties of directors are divided into four categories as follows:
Firstly, the directors must always act bona fide in what they consider and not what the courts consider to be in the best interest of the company. In this context, the term company means the present and future members of the company on the basis that the company will be continued as a going concern thereby balancing long-term interests against short-term interests of existing members.

Secondly, the directors must exercise their powers for that particular purpose for which they where conferred and not for extraneous purposes even if the latter are considered to be in the best interests of the company. For example directors are invariably empowered to issue capital and these powers should be exercised for only raising more funds when the company requires it. Hence it will be a breach of the of the directors' duties to issue company shares for the purposes of entrenching themselves in the control of the company's affairs.

Thirdly, directors must not fetter their displeasure to act for the company. For example, the directors cannot contract either among themselves or with third parties as to how they will vote at future board meetings. However, where there they have entered into a contract on behalf of the company, they may validly agree to take such further action at board meetings as maybe necessary to carry out such a contract.

Fourthly, as fiduciaries, the directors must not place themselves without consent of the company in a position in which there is a conflict between their duties to the company and their personal interests. Good faith must not only be done but it manifestly be seen to be done. The law will not allow the fiduciary to place himself in a position where he will have his judgments to be biased and then argue that he was not biased. This principle applies particularly when a director enters into a contract with his company or where he makes any secret profit by being a director. As far as contracts are concerned, a contract entered into by the board on behalf of the company and another director is governed by the equitable principle which ordains that a fiduciary relationship between the director and the company vitiates such contracts. Such a contract is therefore voidable at the instance of the company.

In ***Aberdeen Railway v Blaikie***[42], the defendant company entered into a contract to purchase chairs from the plaintiff partnership. At the time that the contract was entered into, a director of the company was also one of the partners. The issue was whether the company was entitled to avoid the contract. The court held that the company was entitled to avoid the contract. The judge said that as a body corporate, the company can only act by its agents and it is the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has a duty if fiduciary nature to discharge towards his principal. It is a rule of universal application that no one having such duties to discharge shall be allowed to enter into a contract or can have a

[42] [1854] 1 Macc 461

personal interest conflicting or which may possibly conflict with the interests of those whom he is bound to protect. This principle is strictly applied and no question is entertained as to the fairness or unfairness of the contract so entered into.

However it is possible for such contract to be given effect by the Articles of Association. At their narrowest, the articles might provide that a director who is interested in a company contract should disclose his interests and he will be not counted to decide and his vote will not be counted on the issue. At their widest, the articles might allow the director to be counted at the board meeting.

In order to create a balance between these two extremes and ensure that a minimum standard prevails, section 200 was incorporated into the Companies Act. Under this section, it is the duty of a director who is interested in any contract to disclose the nature and extent of his interest to the board of directors when the contract comes up for discussion. Failure to do so renders the defaulting director liable to a fine not exceeding Kshs. 2,000. In addition, the failure also brings in the equitable doctrine where the contract becomes voidable at the option of the company and any profits made by the director are recoverable by the company.

The shortcoming of this section is that the director has to disclose to the board of directors and not to the general meeting. It is not sufficient for a director to say that he is interested. He must also specify the nature and extent of his interests. If the company's articles take the form of Article 84 of Table A, then a director who is so interested is required to abstain from voting at the board meeting and his vote will not be taken in determining whether or not there is a quorum on the board. Once a director has complied with section 200 and Article 84 then he can escape liability.

Directors may often sit on the boards of several companies and conflicts may also arise between the divergent interests of these companies, thus presenting a problem to the individual who sits on the boards of both companies. It is important to note that where a director is simultaneously a director of a holding company and its subsidiary, he owes a separate and distinct fiduciary duty to both entities as legal individuals in their own right. A director must guard against a conflict of interests developing in a situation where he is a director of both the holding company and a subsidiary. Should a conflict arise which prevents him from discharging his duty to both companies properly, he should consider resigning from either or both boards.

However, there are situations in which directors may make use of opportunities originally offered to the company and thereby make profits provided that;

(i) The opportunity has been rejected by the company
(ii) If the directors acted in connection with that rejection, they must have acted bona fide in the best interests of the company.
(iii) The information about that opportunity should not have been given to them confidentially on behalf of the company.
(iv) Their subsequent use of that information must not relate to them as directors but as any other ordinary person.

7. Shareholding

A shareholder is a person, company or other institution that owns at least one share in a company. They maybe also be referred to as stockholders but the commonly used term in Kenya is share holder. Shareholders are the owners of a company. They have the potential to profit if the company does well, but that comes with the potential to lose if the company does poorly.

8. Share Capital

The authorized share capital of a Kenyan company can be divided into different classes of shares, the rights pertaining to which are set out in the articles of association. Share capital can be reduced by the shareholders through passing a special resolution and subject to confirmation by the court. A company is entitled under the Companies Act to issue preference shares.

Under the law, a company cannot give, directly or indirectly, financial assistance in any manner for the purchase of its own shares. There are no statutory pre-emption rights either on an issue or allotment of shares of a company, or on the transfer of shares by a shareholder. Such pre-emption rights, if required, must be incorporated in the articles of association and/or in the case of a transfer of shares, by way of shareholders agreement.

A company cannot issue shares to the public without complying with the prospectus rules. The prospectus provisions in the Companies Act have largely been superseded by the rules and regulations promulgated under the Capital Markets Act (Chapter 485A, Laws of Kenya). The Capital Markets Authority has published rules (some are still in draft form) relating to corporate bonds and commercial papers, a Takeover and Mergers Code and collective investment schemes. The authority has also issued guidelines for the approval and registration of credit rating agencies. The authority supervises all activities of the Nairobi Stock Exchange and all public issues of securities, as well as the licensing of dealers and brokers.

9. Controlling Shareholders

Controlling shareholders are those who hold the majority of the voting rights in a company. Such shareholders can always ensure control of the company's business by virtue of their voting power. To ensure that controlling shareholders do not use their voting power for exclusively selfish ends, the law requires that in exercise of their voting power, these shareholders must not defraud the minority. For example by endeavoring directly or indirectly to appropriate to themselves any money or property or advantage which either belongs to the company or in which the minority shareholders are entitled to participate.

Disputes between minority (non-controlling) shareholders and controlling shareholders and the boards of directors in listed and unlisted companies arise from time to time in Kenya. A recent example is the decision by the board of directors of Kakuzi Ltd and controlling shareholders to dispose of a major asset in the face of opposition by minority shareholders. Such situations of conflict occur between boards of directors and controlling shareholders, on one hand, and minority shareholders, on the other, do occur also in unlisted companies. The typical outcome of such conflicts is that minority shareholders lose because they are unable or unwilling to challenge decisions by the board and are also outvoted at general meetings.

There are various ways through which minority shareholders can protect their rights and interests from controlling shareholders. There are avenues for recourse offered by company law. These are available for companies listed under the Nairobi Stock Exchange and are supported by the Guidelines on Corporate Governance Practices by Public Listed Companies issued by the Capital Markets Authority (CMA)[43]. These remedies are:

1. A court action against the directors
2. A petition presented to the Court for winding up the Company
3. An application to the High Court ("the Court") for any order that it thinks fit

Firstly, a court action can be taken against the directors. The ***Companies Act (Chapter 486 of the Laws of Kenya)*** has provisions under which minority shareholders can conceivably find recourse by way of suing the directors. ***Section 22*** provides that the memorandum and articles of association shall constitute a contract binding the members to the terms of the memorandum and articles. Therefore the members, as parties to the contract, appear to have legal standing to bring actions on behalf of the company against directors for breach of provisions of the memorandum and articles of association or breach of the directors' duties as agents and fiduciaries of the company. The main directors' duties are: ***(a)*** to act in good faith in what they believe to be the best interests of the company, ***(b)*** not to exercise the powers conferred upon them for purposes different from those for which they were conferred, ***(c)*** not, without the informed consent of the company, to place themselves in a position in which their personal interests or duties to

[43] Kiboi, Elijah *Protection of the Rights and Interests of Minority Shareholders.* The author of this article is an Advocate of the High Court of Kenya practising in the firm of Ameli Inyangu and Partners Advocates, Nairobi.

other persons are liable to conflict with their duties to the company, and (d) to exercise reasonable care and skill in the conduct of their affairs as directors.

The major disadvantage of this remedy is that actions alleging damage to the company should, as a general rule, be brought by the company itself, not by individual shareholders. The power to bring an action on behalf of the company is bestowed upon the members in general meeting and is obviously unavailable where dominant shareholders act against the wishes of minority shareholders and force proposals through. The dominant shareholders and the board would also reject any attempt to bring an action against themselves.

Furthermore, there are stringent requirements to be met before a shareholder can bring an action on behalf of the company, as developed in the English case of ***Foss-v-Harbottle***. However where the memorandum and articles of association confer rights upon the shareholders, these rights are enforceable by the shareholders directly as explained below.

Secondly, winding up of the company is another remedy. Section 219 of the Companies Act provides various grounds for which the Court may wind up a company. Two of these grounds conceivably available to minority shareholders are, (a) the company has by special resolution resolved that the company be wound up by the court and (b) the court is of the opinion that is just and equitable that the company should be wound up.

Minority shareholders cannot easily arrange and affect the passage of a special resolution to wind up the company. ***Section 141 of the Companies Act*** requires that special resolutions be passed by a majority of at least seventy five percent of members present (in person or by proxy) and voting at a general meeting of which appropriate notice has been given. It may be difficult for minority shareholders give notice and to marshal such numbers. Further, voting by individual members in attendance can be overridden by a poll.

The second ground can be availed by a shareholder presenting a petition to the Court to wind up the company. Courts, however, rarely grant this remedy due to its drastic nature. Even where a company is being run in a manner that is oppressive to some shareholders, the alternative remedy to winding up is likely to be applied. If the Court finds that there is an alternative remedy available to a petitioner and he is acting unreasonably is seeking a winding up order, the petitioner is not entitled to a winding up order. ***Section 222*** of the Companies Act provides sets out this position and has been applied numerous times by the courts.

Generally, winding up is not readily available to minority shareholders. It may also be unsuitable for them if they seek continued investment in the company.

Thirdly, the other alternative will be an application to the High Court for any order that the court deems fit in the circumstance. The members as individuals have legal standing to sue where the directors, who are also fiduciaries vis-à-vis the shareholders, owe the shareholders certain duties. An example of such a situation is where directors propose to act in a manner oppressive to, discriminatory of or detrimental to certain shareholders.

Under such circumstances, the shareholder(s) can bring an action against the directors and the company. ***Section 211*** of the Companies Act enables a member who considers that the affairs of a company are being conducted in a manner oppressive to some part of the members (including him), to make an application for an order by the court such as it thinks fit. The order may be for regulating the affairs of the company, or for the purchase of the shares of any members by other members or by the company.

Specific remedies may include injunctions or declarations, damages or compensation, restoration of the company's property, rescission of contracts, account of profits, and summary dismissal of directors.

10. General Meetings

These are provided for under the First Schedule, Table A Regulation 47 of the Companies Act. It provides that every company shall hold an annual general meeting every year in addition to any other meeting that may be held that year. That section provides that not more than fifteen months shall elapse between the date of one annual general meeting of the company and that of the next provided that so long as the company holds its first annual general meeting within eighteen months of its incorporation, it need not hold it in the year of its incorporation or in the following year. The annual general meeting shall be held at such time and place as the directors may appoint.

Regulation 48 provides that all other general meetings other than the annual general meeting shall be called extraordinary general meetings. Regulation 49 gives the directors powers to convene extraordinary general meetings. That section also provides for the requisite quorum for an extraordinary general meeting to take place. It provides that if at any time there are not within Kenya sufficient directors capable of acting to form a quorum, any director or any two members of the company may convene an extraordinary general meeting in the same manner as nearly as possible at that in which meetings may be convened by the directors.

11. Notice of General Meeting

Regulation 50 of Table A requires that a notice of a general meeting be issued in writing at least 21 days before the proposed meeting. Under that section the notice shall be exclusive of the day on which it is served or deemed to be served and of the day for which it is given. The notice shall also specify the time and place of the meeting and the nature of the meeting. Under regulation 51, the accidental omission to give notice of a meeting to, or the non-receipt of notice of a meeting by, any person entitled to receive notice shall not invalidate the proceedings at that meeting.

12. Proceedings at General Meetings

***Regulation** 52* provides that all business that is deemed special shall be conducted at an extraordinary general meeting. It shall also be special business all that is carried out at an annual general meeting with the exception of declaring a dividend, the consideration of the accounts, balance sheets, and the reports of the directors and auditors, the election of directors in the place of those retiring and the appointment of, and the fixing of the remuneration of, the auditors.

No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business unless it is provided that three persons shall be deemed to be sufficient quorum. Regulation 54 provides that If within half an hour from the time appointed for the meeting a quorum is not present, the meeting, if convened upon the requisition of members, shall be dissolved; in any other case it shall stand adjourned to the same day in the next week, at the same time and place or to such other day and at such other time and place as the directors may determine, and if at me adjourned meeting a quorum is not present within half an hour from the time appointed for the meeting, the members present shall be a quorum. The regulations also provide for the mode of appointing a chairman for the purpose of the meeting if the chairman is absent.

Table A also contains regulations that govern the voting of members in person or by proxy. A proxy could be general or limited.

CHAPTER FOUR

Corporate Law in East Africa: A Comparative Analysis of the Legal Framework Tanzania and Uganda).

Tanzania

The corporate law regime in Tanzania is governed by the Companies Act 2002 which came into force on 1st March 2006. Prior to that, company law in that country was regulated by the Companies Act CAP 212, an archaic piece of legislation based on the English Companies Act 1929. This legislation regulated trading companies and other associations including the imposition tax on nominal capital, regulation of dividends and surpluses and related matters.

This legislation was in force for over 77 years which period covered not only the tail end of the colonial period but also the period of state-planned economy through to liberalization in the 1990s. The law was reformed to cover an increasingly sophisticated market and the dramatic changes to the Tanzanian economy. The new reforms are contained in the Companies Act 2002, an act which was on the shelf for almost three years before it came into force on the 1st of March, 2006. The new law aims to put in place a relevant and modern legal framework.

The Companies Act 2002 introduced significant reforms to Tanzanian company law. Its full title alone imparts some of the significance of the act, stating that it is an act to repeal and replace law relating to companies and other associations, to provide for more comprehensive provisions for regulation and control of companies, associations and related matters. The question then is how far reaching are these reforms, and how difficult compliance. The short answer is that the new legislation introduces substantial changes but is intended primarily to clarify existing legislation regarded by many as unclear. Given that the intention of the new legislation is simply clarification, compliance should be relatively straightforward. However, brevity is not a feature of this Act, which contains 490 sections, 140 more than its predecessor.

The new Act brought reforms in various aspects of company law including directors, capacity of the company to act, investigation into a company's affairs, arrangements, compromise, reconstruction and amalgamation of companies, minority shareholders, insolvency, accounts and audit among others as shall be discusses below.

1. Directors.

The Companies Act 2002 was drafted and enacted in order to take into consideration developments in corporate governance and directors' duties. Directors previously had various common law duties which have now been enshrined in the Companies Act 2002, and are now statutory duties. These duties include a duty to act in good faith and in the best interests of the company. Given that these were previously common law duties, the practical impact on directors will be minimal though courts will have a greater degree of guidance from the Companies Act 2002 in determining whether directors have breached any of their duties. These provisions are contained in Chapter VII sections 181 to 185 of the Act.

Section 181 (1) provides that;

> ***"… a director of a company, when exercising powers or performing duties must act honestly and in good faith and in what the director believes to be the best interests of the company."***

Section 185 provides that;

> ***"A director owes the company a duty to exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person having both –***
>
> ***(a) the knowledge and experience that may reasonably be expected of a person in the same position as the director, and***
>
> ***(b) any special knowledge and experience which the director has."***

This was meant to increase the accountability of directors by amplifying their duties and clearly documenting them.

In addition, the Companies Act 2002 also imposes a new duty to have regard to the interests of employees, to exercise powers for proper purpose, a duty of care and a minimum age of 21 years for appointment as a director coupled with a duty to disclose one's age.

Section 183 (1) provides that;

> ***"The matters to which the directors of the company are to have regard in their performance of their functions include, in addition to the interests of the members, the interests of the company's employees."***

A director may also find himself personally liable for a company's debt if he is disqualified from being a director. The Companies Act 2002 also introduces certain prohibitions, including on the making of tax-free payments to directors and/or loans to directors of the company or its holdings company or any connected persons. The Companies Act 2002 also introduced a statutory procedure for the removal of a director and the requirement that directors' service contracts be made available for inspection at the company's registered office.

Under section 192, the appointment of the directors of a public company is to be voted on individually. Under ***section 193***, a director can now be removed by an ordinary resolution notwithstanding provisions to the contrary in the memorandum and articles or in any agreement with him.

The reforms also brought under ***sections 203 to 212*** the requirement that there be significant disclosure with regard to directors' shareholdings in the company, emoluments, and loans, interests in contracts, service contracts, pensions and compensation for loss of office. Under the new law, private companies are also concerned with the requirement for public disclosure of confidential information relating to individual director's emoluments as opposed to the total directors' emoluments as was required to be disclosed in the previous Companies Act.

2. Capacity of the Company to Act

The capacity of a company to act is governed by its memorandum. Previously a company could claim an act was invalid if ultra vires (i.e. outside its authority as stated in its memorandum) and thus would not be liable for such act). The Companies Act 2002 stipulates that it shall no longer be a defense that an act is invalid by reason of limitation of capacity by its memorandum, and this concept is rolled out to acts of directors, for instance, a company will be unable to disclaim liability by reason of a director's act being ultra vires.

Further protection is offered to persons dealing with the company in that they need not enquire into the capacity of the company or authority of its directors and the company would nevertheless be bound by its action. This new legal aspect is aimed at defeating the unscrupulous directors who dealt with the interests of the company at the expense of bona fide third parties. Further, there is a new development in the since that any person dealing with the company has no duty to enquire as to the capacity of company or authority of directors in a certain transaction.

3. Investigation into a Company's Affairs

The Act has now provided for much more extensive powers of investigation and mechanisms for monitoring the affairs of a company. These are provided for under ***sections 215 to 228***. Under ***section 215*** the Registrar of companies has the powers to call for information from the company further to which the company has the duty to furnish to the Registrar all the information required by him. On application by its members or the company itself, or on recommendation by a Minister, under the Companies Act 2002 a court may order the investigation of a company if it appears that the company's affairs have been mismanaged or the law has not complied with in full. This applies equally to local and foreign registered companies. The investigation would be conducted by court appointed inspectors and can potentially be far reaching, depending on the grounds for the order.

Under ***section 219***, the inspectors have been given more powers to carry out investigations into the affairs of related companies. ***Section 225*** also empowers the inspectors to carry out investigations as to the true ownership of a company. There are also provisions under ***section 226*** in relation to punishment for destruction of documentary evidence and to save advocates and banks from disclosing client/ customer confidential information under ***section 227.***

4. Minority Shareholders

Minority shareholders are granted additional new protections under the Companies Act 2002, including procedures for orders in cases of unfair prejudice and the institution of derivative actions. This deals with the right of a person to apply to court to prosecute, defend or bring an action in the name of and on behalf of the company or any of its subsidiaries.

Any member of a company can now make an application to the court for its intervention or for permission to start a derivative action on behalf of the company if the affairs of the company are being conducted in a manner which is unfairly prejudicial to the interests of the members in general or the minority in particular. This is provided for in ***sections 233 and 234 of the Act.***

5. Arrangements, Compromise, Reconstructions& Amalgamations.

The Companies Act 2002 introduces the concept of arrangements and reconstruction, which allow a company and its creditors or the company and its members to apply to the court for an arrangement, compromise or reconstruction and amalgamation. In the latter case the new law also provides for how to deal with shares of shareholders dissenting.

6. Insolvency

Prior to the Companies Act 2002, when a company became insolvent it went directly to the Court for winding up proceedings. There were three grounds for a winding-up order, including voluntary winding-up, winding-up by the court and winding-up under the supervision of the court.

Under the Companies Act 2002 there are only two grounds for winding-up, including voluntary winding-up and winding-up by the Court. Further, under the Companies Act 2002 in the event a company becomes insolvent, it will be able to seek shelter under the new protective insolvency provisions which speak to the proceedings related to company voluntary arrangements with creditors (rescue based approach empowering directors to make proposals), putting a company into administration (court appointed administrators manages the affairs of the company, alternative to liquidation) and receivership (managing the liquidation of a company). The crux of the Companies Act 2002 in this respect is that it affords an orderly and fair process for insolvent companies and their creditors.

The new provisions introduced in relation to companies which are insolvent or approaching insolvency are as follows:

Firstly, directors of an insolvent company may either under section 240 enter into voluntary arrangements with its creditors for satisfaction of its debts or may apply to court under section 247 for the court to make orders for its management to forestall a possible creditor petition for winding up.

Secondly, the new act has provided under section 236 for the affairs of an insolvent company to be managed by only by a qualified insolvency practitioner, administrator, liquidator or administrative receiver.

Thirdly, under section 239 during the insolvency procedures the supply of utilities like gas, water and electricity may not be interrupted. The overall focus of these improvements is to prioritize a rescue-based approach and make winding up the last resort.

7. Accounts and Audit

The Companies Act 2002 provides under ***section 151*** that books of accounts are required to be preserved for six years from the date on which they were made. This requirement is a year longer than the record keeping requirement in terms of the income tax and VAT legislation in Tanzania.

Directors are now required under ***section 154 of the Act*** to prepare individual company accounts as well as consolidated group accounts, both of which will show a true and fair view in accordance with the generally accepted accounting practices. ***Section 159*** requires the Directors' report to include a fair review of the changes and development of the business of the company and its subsidiaries.

The auditor's report is required to cover each component of individual accounts as a well as group accounts which include the balance sheet, profit and loss account and cash flow statement. The auditors are also required under ***section 161*** to report whether the contents of the directors' report are consistent with those in the accounts.

The scope of the auditor's report has been expanded to include specific disclosures required on noncompliance with certain matters under ***section 163***. These include confirmation on the following: whether proper accounting records have been kept and proper returns received from the branches, whether the accounts are in agreement with the accounting records and branch returns, whether auditors have obtained all the required information and explanations, and whether accounts include disclosures on emoluments and benefits of directors as required under ***section 206***.

Under ***section 166*** the time limit within which the directors are required to lay the company's audited accounts before the company in general meeting is now 7 months from the end of the company's accounting period in case of a public company, and 10 months in case of a private company. ***Section 171*** exempts certain companies from audit but only dormant companies are likely to qualify in view of a ridiculously low threshold: annual turnover below Tshs 1.5 million and gross assets below Tshs 750,000. A certified copy of the audited accounts, directors' report and auditor's report is now required under ***section 167*** to be delivered to the Registrar except where the company is exempt ***(under S171)*** from the requirement to appoint an auditor.

Every director of the company shall be liable to a daily fine for any delay in laying the accounts before the general meeting and delivering a copy to the Registrar. In case of non-compliance with this requirement any member, creditor or the Registrar may serve a notice on the directors to make good the default within 14 days, failing which they may approach the court who may issue an order with costs specifying the deadline for compliance. This is provided for under ***section 167***. ***Section 176*** provides that any officer of the company giving false information to the auditor is liable to imprisonment or fine or both.

The Companies Act also has new provisions on dividends which were not included in the previous Act. ***Section 180(3)*** contains the relevant provisions for payment of dividends and provides that dividends can be paid out of realized profits less realizes losses or out of realized revenue profits less realized revenue losses. These dividends can only be paid provided the directors reasonably believe that immediately after the dividend has been paid the company will be able to discharge its liabilities as they fall due, and the realizable value of the company's assets will not be less than the amount of its liabilities".[44]

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[44] Section 180 Tanzania's Company Act 2002

Uganda

The Government of Uganda has committed itself to revising the commercial laws of the country in order to support private sector development and encourage private investment. Commercial law reforms in this country begun in about 1996 as a sub-component under the legal component of the Uganda Institutional Capacity building.[45] The project engaged American and British Consultants who reviewed the laws under their terms of reference and produced draft bills.

The Companies Act[46] in Uganda is a comprehensive law which governs the formation, capitalization and management of corporate entities as well as their dissolution. As currently written the Companies Act reflects an older jurisprudence. It is a re-enactment of the 1948 English Companies Act which has been revised in a comprehensive fashion since its passage [47] The Act has not been revised in a comprehensive manner since its enactment save for a few isolated amendments.

In Uganda, there are various laws applicable to companies. The Ugandan Constitution is the supreme law in the country and therefore most of its provisions are applicable to companies. However, the substantive law is the Companies Act, CAP 110 which governs the incorporation, management and winding up of companies. Other laws that are applicable to companies in Uganda are the Capital Markets Authority Act CAP 84, the Income Tax Act CAP 340 and the Public Enterprises Reform and Divestiture Act CAP 98 among others. Courts in Uganda have developed their own jurisprudence in company law matters and where there are not clear statutory provisions, they are guided by English Common Law principles.

The Companies Act CAP 110 is the principle legislation governing private and public companies in Uganda. The Act is divided into thirteen parts that cover incorporation,

[45] A Study Report on Company Law, Kampala, Uganda 2004 (Uganda Law Reform Commission) Law Com Pub. No. 5 of 2004 page 13
[46] CAP 110
[47] *supra*

share capital, registration of charges, debentures, winding up, management and administration of companies, appointment and duties of directors and the registration of foreign companies among other things.

The Act provides for the registration of various types of companies. Under the Act, companies can either be registered as private or public companies limited by shares. Companies can also be private limited by guarantee with or without share capital. Finally, under the Act a company can be registered as unlimited without a share capital.

The Companies (Government and Public Bodies Participation) Act CAP 111 provides for the acquisition of shares of companies incorporated under the Companies Act by government or public bodies. Under this Act, the Government is empowered to acquire any class of shares not exceeding 60 percent which could be issued by the companies that were listed in the Schedule to the Act.

1. Formation of a Company

The process is referred to as incorporation and the process involves a number of steps from the initial meeting of promoters, then drafting of the relevant documents, organizing and payment of the relevant fees and then actual registration of the company.

It should be ascertained whether the proposed company is to be a private or a public company .The law specifically states that any association, either partnership or a company, for the purposes of carrying out any business with an object of gain has to be registered in accordance with the company's act.

2. Membership

According to ***Section 3(1) of the Companies Act***, for a private company, the membership is fixed to a minimum of 2 persons whereas for a public company, the minimum membership is 7 members. There is no limit for the membership of a public company but for a private company, the maximum membership is limited to 50 members .It must be noted however that the limitation of membership of a private limited liability company does not include its employees and does not apply where two or more persons hold shares jointly se sect 29 of the Companies Act.

In private companies ,transferability of shares and raising of company capital has some restrictions and the law prohibits inviting the public to subscribe for shares, as provided for in ***section 29(1)(c)*** For a public company ,the presumption is that one is free to transfer the shares subscribed at any time without any restrictions. The restrictions on private companies is meant to avoid a situation where an individual or a new shareholder joins the company may disturb the operations of the company.

The commencement of business is effective from the date of issuance of a certificate of incorporation by the registrar for a private company ***(Section 15 CA)***

For public companies, incorporation and registration per say is not sufficient as one should satisfy other processes. Before commencement of business you must, as a public company, issue a prospectus inviting the public to subscribe for shares and must obtain from the registrar of companies a certificate of commencement of business.

Before issuing the certificate, the registrar has to ascertain first that specific issues have been fulfilled. There is a statutory meeting every public company must hold within three months from the date it is supposed to commence business and 14 days before the meeting must be given a statutory report which must be signed by at least 3 directors giving the details of the status of the company ***(Section 130 CA).***

Failure to comply with the requirement of the statutory meeting makes one liable to payment of a fine .For a private company, the statutory meeting may not be held and the statutory report may not be issued. A private company must have at least one director but for a public company, the minimum is 2 directors ***Section 177 CA***. For a private company, if it has only one director, he cannot act as the secretary at the same time

(Section 179 CA).For public companies, there are fixed qualifications for one too be a director and they must be contained in the articles of association for instance a provision may be that of holding shares or having substantial shareholding in the company.

For public companies, members must sign and deliver for registration consent in writing an undertaking to act as a director and showing that the director has either signed the memorandum of association undertaking to pay the qualification shares or has actually paid the qualification shares. These provisions however do not apply to private companies. It's also important that after determining whether the company is to either be private or public, it should be determined whether the company should have limited or unlimited liability of its members .As a general requirement, members of a limited liability company are not liable for the company debts beyond the amount which is still unpaid on the share he or she holds.

Once that amount is paid, he cannot be called upon by the creditors to meet company debts. There are situations where a company can have unlimited liability and in such situations ,such members become liable for the company debts if its assets cannot sufficiently pay off the creditors liabilities Section 3 (2)

3. Memorandum of Association

Section 4 CA provides that every company must have a memorandum of association which must state the name of the company and also whether the company is limited by share or by guarantee and the word limited must appear at the end of the name of all limited companies. However this requirement may be dispensed with if the minister is satisfied upon application that the company is being promoted for promoting commerce ,art, science education ,religion, charity or any other essential object which that company intends to promote and apply its profits to promote such plans and to prohibit payment of any dividends to its members .Such companied also enjoy such privileges and rights of limited companies and are also subject to the obligations of limited companies. It is an offence for any company to omit the word limited at the end without any prior exemption by the minister.

The memorandum must state the share capital and the nominal value of the share in their fixed amount .It must be dated and signed by all the share holders indicating their full names, occupations and addresses and it must be witnessed and such witness must state their occupation and address

4. Articles of Association

Section 14 CA states that companies limited by guarantee or companies with unlimited liability must register a document called the articles of association but for private companies limited by share, there is no mandatory requirement to register the articles of association. Articles of association must be in English and signed by all the subscribers of the memorandum of association and they must indicate their postal addresses and occupations .It must be attested by a witness who must indicate their address and occupation.

5. Membership of the Company

Section 27 CA Provides that all persons who may have subscribed to the memorandum of the company shall be members of the company and when the company is registered, the names shall be entered on the register of the members.

This provision therefore indicates that subscribers to the memorandum are members of the company and even if a member is not entered on the register of members, he is still a member of the company automatically but only makes one entitled to be a shareholder. Apart from subscribers to the memorandum, the Companies Act provides for two categories of people who can be deemed members of the company, the first category includes directors of the company who are supposed to take up qualification shares

(Section 182 CA) and the other category is that of individuals who have paid up for share and upon allotment and upon subscription.

It must be noted that courts have been a little bit relaxed when it comes to enforcement of *S.27 CA*, ***In Mawogola Farmers vs.Kayan***[48]; in the trial and appellate court, the company sought to rely on S.27 that for one to be a member of a company there must have been an agreement to that effect and his name must have been an agreement to that effect and his name must have been entered on the company register and that these two were cumulative. Court unanimously held for the respondent and they quoted '***Buckley on the Company Act' that 'the register of the company is most important but not conclusive'***

6. Corporate Personality

Section 15(2) CA provides that from the date of incorporation ,the subscribers to the memorandum and all such other persons as may become members shall be a body corporate capable of exercising all the powers of an incorporated company with the powers to own property ,perpetual succession and a common seal but with such liability on the part of the members to contribute to the assets in case of winding up .The effect of the section is to summaries the consequence of incorporation .It should also be noted that the section in a way establishes the principle of corporate personality. Once all the formalities have been complied with, a certificate of incorporation is issued and the conclusive evidence of incorporation. In ***Salomon vs. Salomon and Co. Limited***[49], court observed that once the statutory requirements have been complied with ,the company has been incorporated; such a company becomes a legal person separate from those who formed it court further held that;

> ***'At Law a company is a different person all together from the subscribes and ...... The company is not an agent of its subscribers or a trustee for***

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48 [1969] EA 595
49 [1897] AC 22 HL

them and nor are the subscribers as members liable in any shape or form except to the extent and in the manner provided in the Act.'

Consequences of Legal personality

Liability; the company being a distinct legal persona is liable for all its debts and obligations .The liability of the members or shareholders of the company is limited to the amount remaining unpaid on the shares. ***Ssentamu v UCB***[50]***, it*** was held that individual members of the company are not liable for the companies' debts. Even a managing of the company cannot be liable for its debts. An exception exists in respect of an unlimited company. Members in such liable for its obligations without any limitation on the amount payable .With regard to a company limited by guarantee ,each member is liable to contribute a specified amount of assets of the company in the event of its being wound up while he is a member or within one year after ceasing to be a member

Property; an incorporated is able to own property separately from its members .he advantage of it's that members cannot directly interfere with the company's property. It is also settled that a company can occupy business premises as a tenant.

Legal Proceedings; as a legal person a company can take action t enforce its legal rights or be sued for breach of its duties .However, the action for or against the company should be instituted in the company's registered name. Thus in ***Dennis Njemanze vs. Shell B.P Port Harcourt***[51]**,** the plaintiff sued shell B.P Port Harcourt for the defendant objected that here was no company known as Shell B.P Harcourt .Counsel for the defendant objected that there was no company known as shell B.P Port Harcourt .Counsel for the plaintiff asked for leave to amend the writ, but the court refused leave and struck out the claim. Upon appeal from the refusal, it was held;

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[50] [1966]EA 17
[51] [1969] EA 557

i) That putting in an appearance did not prevent the company from objecting that the defendant sued was no a legal person

ii) the plaintiff had a duty to show that there were reasonable grounds of excuse in naming the defendant wrongly and that the misnomer could not have given rise to any reasonable doubt as to which company was being sued ,but he did not do so

Additionally, it is not enough to institute the action in he name of an officer of an officer of the company on behalf of the company, except where he has been expressly authorized so to defend. The only advantage about this consequence is that the limited company when suing may be required to give security for costs

Perpetual Succession; limited liability company is endowed with perpetual succession; consequently changes in membership arising from the bankruptcy or death thereof do not affect the company's existence. The life of the company can only be ended either by winding up, tricking off the register of companies or through amalgamation and reconstruction as provided by the companies Act.

Transfer of shares; A Share constitutes an item of property, which is freely transferable, except in the case of private companies, the transfer of shares may be restricted to the existing members of the company.

Borrowing; A company can borrow and provide security in the form of a floating charge. A floating charge is said to float like a cloud over the whole assets of the company at any given time. However, the disadvantage of this to the company is that the charge does not prevent the company as mortgagor from disposing of the assets in the usual course of business. It is when something happens that the charge becomes crystallized or fixed over the existing assets of the company. The charge is also beneficial to the company especially when its business has no fixed assets such as land, which can be used in a normal mortgage, but has on the other hand, a large and valuable stock in trade. Since stock in trade has to be turned over in the course of business a fixed charge is convenient because the consent of the mortgagee would be needed every time anything was sold and a new charge would have to be entered into whenever anything was bought and added to the stock.

A floating charge takes care of these difficulties by enabling the stock to be turned over but attaching to whatever it is converted into and whatever stock is acquired. It's further notable that a floating charge is mostly restricted to companies and is not used by sole traders or partnership because of the complicated procedure of registering mortgaged chattels under the Bills of Sale Act which are applicable to charges by incorporated companies.

Apart from the advantages mentioned above which accompany incorporation, certain disadvantages attend that exercise. These are formalities have to be followed, there is publicity and therefore loss of privacy and the exercise is expensive.

The veil of incorporation can be lifted if;

a) ***Where the number of members is below legal minimum:*** Under ***section 32*** of the CA, if the company carries on business for more than six months after its membership has fallen below the statutory minimum (7 for public and two for private companies) every member during the time the business is carried o after the six months and who knows that the company is carrying on business with less than the required minimum membership is severally liable for the companies debts incurred during that time.

b) ***Where the company is not mentioned in the bill of exchange:*** by section 109 of cap 85 an officer of the company is personally liable if he signs a bill of exchange, cheque, etc on behalf of company without mentioning the companies name on it in legible characters.

c) ***Holding and subsidiary companies:*** According to section 150 of Cap 85 where companies are in relationship of holding and subsidiary companies, group accounts should be represented before the holding company in general meeting .In this regard the holding and subsidiary company is ignored.

d) ***Reckless or fraudulent trading;*** It is provided under Section 327 of Cap 85 that if during the winding up of a company it appears that any business of the company has been conducted recklessly or fraudulently, those responsible for such business may be held liable without limitation of liability for any of the company's debts or liabilities.

e) ***Investigation into related Companies:*** where an inspector has been appointed by the registrar to investigate the affairs of a company, he may if he thinks it fit also investigate into the affairs of any other related company and also report on the affairs of that other company so long as he feels that the results of his investigation of such related company are relevant to the main investigation. The related company may be a corporate body with a subsidiary or holding relationship to the company under primary investigation

f) ***Taxation:*** Under Income Tax Act 1997 the veil of incorporation may be lifted to ascertain where the control and management of the company is exercised in order to determine whether it is a Ugandan Company for income tax purposes.

CHAPTER FIVE

Shortcomings of the Current Law and Recommendations.

The law in Kenya governing corporate entities is an old piece of legislation that has been outdated by modern practices in the corporate world. It has been acknowledged that there is need for reforms in the law. There has emerged new trends in corporate governance and Kenya is yet to embrace these changes. Other countries in East Africa like Tanzania have enacted new legislation to govern corporate entities. Uganda has also begun the process of reforming their corporate law regime. Kenya is also on the path of reviewing and reforming its company and partnership laws but the pace of the reforms has been wanting.

There has been a call for the repeal or amendment of the obsolete 1948 Company Law. The amendments to the company law can bring changes which will bring Kenya at par with other common law countries. Weaknesses in the Company Law and Partnership Law have been used by land grabbers and schemers in cases like Goldenberg and Anglo Leasing to exploit Kenyans under what is termed the 'veil of incorporation'. Law enforcement agencies must be given wide powers to circumvent this veil where crime and fraud are suspected. It has also been suggested that in order to improve corporate governance in Kenya, there is need to have a sound legal system. There is increasing evidence that a country's legal system plays a significant role in determining the success of its corporate governance system. Research has shown that good corporate governance is more likely to be associated with countries with a strong legal system.[52]

Corporate governance in the country is hindered by the absence of a strong legal system, thus the need for reviewing the current legislation.

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[52] R. La Porta, F. Lopez-de-Silanes, A. Shleifer and R.W. Vishny, "Legal Determinants of External Finance" (1997) 52(3) *Journal of Finance* 1131.

A Review of the Law Affecting Corporate Governance in Kenya

The statutory law governing corporate governance in public listed companies in Kenya is embodied in the Companies Act CAP 486. Kenya, a former British colony, adopted the Companies Act almost in entirety from England's Companies Act 1948 upon attainment of independence in 1963. The Companies Act deals with directors' duties and shareholder protection among other matters pertaining to corporate governance in Kenya. Other regulations that govern Kenya's corporate governance are the Capital Markets Authority Act 2002, the Nairobi Stock Exchange (NSE) Regulations and the Penal Code CAP.63.

Directors' duties in Kenya are governed by Kenya's common law of companies. Traditionally, directors' duties in common law are divided into the duty of care and skill and the duty of loyalty. The duty of care and skill represents the courts' attempt to regulate the entrepreneurial side of directors' activities. The duty of loyalty, on the other hand, mainly encompasses the duty of good faith, the no conflicts rule and the rule against managerial opportunism. The duty of good faith requires that directors exercise their powers in the best interests of the company.[53] This means that in carrying out the business of the company, which involves dealing with the assets of the company; directors have a duty to preserve these assets.

Therefore all decisions taken on behalf of the company must be taken solely for the benefit of the company and not with a view to seeking a collateral advantage for directors.[54] The "no conflicts rule" requires directors not to put themselves in a position where their duties and interest conflict, for instance turning down the business offer of a third party with the intention of secretly taking up the same offer themselves and benefiting in a private capacity.[55] The rule against managerial opportunism requires directors to see business opportunities coming to the company as the property of the company and requires them to be treated as such. For instance, the taking of business

[53] *Flagship Carriers Ltd v Imperial Bank Ltd* (Civil Case No.1643 of 1999), unreported, High Court
[54] *ibid*
[55] *ibid*

contracts in the director's name instead of the company's name thereby creates an opportunity for self-interested behaviour.[56]

The directors' duty of loyalty has to be well protected by robust laws, if the directors' duty of care and skill that facilitates entrepreneurship is to be effective and in turn if good corporate governance is to be possible. This is because whether a director performs his duty with the required care and skill to a great extent depends on where the director's loyalty lies. The disloyalty of directors often manifests itself in managerial misbehavior which takes the form of misappropriation of company assets.

Standards of directors' behavior are enforced through both criminal and civil sanctions as charges against a director who misappropriates property can be brought under both civil and criminal law. To enforce a director's duty of loyalty and therefore secure their duty of care and skill, criminal sanctions are the key to providing the necessary standard of deterrence under which directors can be expected to refrain from misappropriation of company assets. However, an examination of Kenya's company law reveals a comprehensive legal framework that is difficult to enforce owing to underlying weaknesses in the drafting of legislation governing director liability. Director liability is dealt with under ***Section.45 of the Companies Act***.

Section 45(1) (a) of the Companies Act provides that directors are personally liable for misstatements in company prospectus but avails directors with an array of defences in ***s.45 (2). Section 45(2)*** provides that where a prospectus has been issued without his consent, where he withdrew his consent or relied on a public official document, a director is exempted from liability for misstatements in the company prospectus. ***Section 45 of the Companies Act*** consequently gives company directors no incentive to ensure that they exercise due diligence in the performance of their duties. Shareholders are left vulnerable and unprotected by this provision, in that where a shareholder has relied on incorrect information in the company's prospectus, they can only be compensated if it can be shown that the director was aware of the misstatements in the prospectus or that the

[56] This was the ruling the East Africa Court of Appeal in *Price v Kelsall* [1957] E.A. 752.

director consented to the issuing of the prospectus. The burden of proof here rests with the shareholder, who usually has access to little or no information on the activities of the company.

Section 46(1) of the Companies Act goes further in sealing the shareholder's fate by providing that directors will be liable for two years' imprisonment or a fine of KES 10,000 for misstatements in prospectus where they are unable to demonstrate that all they did was to consent to the issuing of a prospectus and therefore not be liable for its contents. This subjective standard of liability is further evident in ***section.318*** of the Companies Act which further exonerates directors by providing that directors can be exempted from liability for offences that are discovered during liquidation if they had no intention to defraud the company, or to conceal the company's state of affairs. In sections of the Act dealing with the appointment of directors, the same trend is evident.

Section 188 of the Companies Act provides that:

> ***"... If a person who has been declared bankrupt ... acts as a director of a company without leave of court, he shall be liable to imprisonment for a term not exceeding two years or a fine not exceeding Kshs. 10,000 or both"***

Section 188 of the Companies Act therefore implies that an undischarged bankrupt can act as a company director with leave of the court. ***Section 188(2) of the Companies Act*** confirms this by stating that for leave to be granted the bankrupt individual must show that he may safely be involved in the management of companies. It is important to review this section to prohibit undischarged bankrupts from acting as directors of companies. This would prevent bankrupt individuals from starting a business and raising credit using a limited liability company. The loopholes in this section have been used by bankrupt persons who have used companied as instruments of fraud to raise capital and credit.

Section 189 of the Companies Act empowers the court to make an order restraining the appointment of a person for a period not exceeding five years if the person has been convicted of any offence in connection with the company or if it appears that in the course of winding-up, the person has been guilty of fraudulent trading.

Section 189 of the Companies Act therefore implies that persons guilty of past frauds can act as company directors as long as the court allows them to do so and that a person cannot be barred from acting as a director of a company in Kenya on the grounds of fraud for more than five years. ***Section 189 of the Companies Act*** suffers from the same limitations as ***section.188 of the Companies Act*** as it does not prohibit management who commit fraud from acting as directors of public listed companies.

The potential presence of fraudulent management on company boards raises serious questions as to whether good corporate governance is an achievable goal in Kenya, insofar as there is nothing to deter management from acting against the interests of the company. The weakness of Kenya's laws is also reflected in ***section.402 (1) of the Companies Act*** which states that:

> *"...If in any proceeding for negligence, default, breach of duty or breach of trust against an officer of a company ... it appears to the court hearing the case that that officer ... is or may be liable ... but that he has acted honestly and reasonably ... he ought fairly to be excused ... "*

This suggests that it is possible for directors to go unpunished as a result of negligence arising from their ignorance or inexperience.

The Court in ***Flagship Carriers Ltd v Imperial Bank***[57] confirmed this. It held that directors are only required to exhibit a degree of skill and care that may reasonably be expected from a person of their knowledge or experience, but they are not liable for errors of business judgment.

[57]High Court Civil Case No.1643 of 1999 (unreported)

The ***Penal Code CAP.63 Section 329*** provides a penalty of imprisonment for seven years for directors who knowingly give false statements with the intention to deceive or defraud the corporation. However, prosecutions at the behest of shareholders, particularly minority shareholders, are difficult to bring since the legal rights of the company belong to the company and not its members and for that reason only the company may institute proceedings for redress._An exception to this ruling is allowed where a majority of shares are controlled by those against whom relief is sought in particular where they have acted fraudulently or ultra vires in excess of their powers. On the contrary, it appears that suits can only be brought on behalf of minority shareholders where a wrong is done to an individual; in all other cases, only the company can sue the delinquent director

Since wrongs are hardly done to a sole individual in a company, the decision to sue rests with the board of directors as it is only the board that can bring proceedings in the company's name. Unlike in countries like the United States where an attorney can bring proceedings on behalf of minority shareholders without the consent of the directors of the company,_an advocate in Kenya cannot bring proceedings against a company on behalf of the shareholder without the authority of the board.

There is a need to revise the law regarding derivative actions to provide shareholders, particularly minority shareholders, with an efficient dispute resolution mechanism which will encourage them to seek legal redress when directors breach their duties._At present, minority shareholders cannot sue for wrongs done to the company.

In addition, minority shareholders cannot sue the directors of the company in the company's name where a breach of directors' duties is rectifiable. Although this rule limits the rights of minority shareholders, it prevents wasteful litigation in the form of multiple actions by minority shareholders and protects the company from being held hostage by disgruntled minority shareholders where they do not agree with the decision of the company. In addition, it facilitates business and preserves the separate legal personality of the company. In spite of the advantages that follow from restricting suits by minority shareholders where acts are rectifiable, this rule exposes minority shareholders to exploitation by the majority particularly in companies where the ownership structure is concentrated.

The penalties within the Penal Code like those in the Companies Act effectively exonerate directors from liability by requiring shareholders to prove the director's dishonest intention. These penalties do not provide the deterrent effect that is necessary to ensure that directors exercise their duty of loyalty by acting in the best interests of the company. This is further compounded by the fact that action on corporate fraud cases in Kenya is highly selective and only seems to take place in high-profile cases where there is political interest, such as the Goldenberg case and the Anglo-leasing scandal.

There is a need to review Kenya's law on director liability to reflect a dual standard of liability with both objective and subjective elements of liability. The present subjective standard of director liability in Kenya is based on the 1925 decision of Romer J. **in** ***Re City Equitable Fire Insurance Co***[58] where it was held that:

> *"... A director need not exhibit in the performance of his duties a greater degree and skill than may reasonably be expected from a person of his knowledge and experience."*

By adopting a dual standard of liability for company directors, Kenya would greatly improve its competitiveness as an objective standard would be incorporated into the law and therefore provide an atmosphere in which good corporate governance can thrive.

Kenya ought to restrict foreign influences upon its legal system to those rules of corporate governance which have proved successful in other jurisdictions with similar market conditions and to be flexible enough to dismantle those legal traditions based on inappropriate market models. Adopting foreign corporate governance practice should be done with caution even in cases where market conditions are similar because not only are

[58] [1925] Ch. 407

the policies in these countries likely to differ from those in Kenya but the size and nature of the business transacted in these countries and the people that company law is seeking to protect may have different standards of sophistication and education. In general, the law must by definition keep pace with the needs and demands of a developing society.

Recommendations

Some of the recommendations that should be considered in reforming the company law in Kenya include;

1. Chairman/CEO Duality

The board is an important internal control mechanism in corporate governance and the position of the chairman and the CEO are often described in corporate governance theory as a company's board leadership structure. The manner in which directors are to exercise their powers in managing the company is not dealt with by the Companies Act, but by Table A of England's Companies Act 1948. It is worth pointing out that Table A is optional and may not be part of the constitution of the company.

The provisions of Table A are therefore discussed with the general assumption that they will be applicable to Kenyan companies. Article 101 Table A provides that, "the directors may elect a chairman to their meetings and determine the period for which he is to hold office". Section 3.2(iii) of the CMA Guidelines states that chairmanship of a public listed company should be held by an independent and non-executive director. This provision contradicts art.101 Table A which states that directors may choose "one of their number" to act as chairman if the elected chairman is not present within five minutes following appointment to hold a meeting. Under both the law and the CMA Guidelines, the chairman should be elected by the board.

Although both the CMA Guidelines and Table A are not mandatory, where a company has adopted Table A into its constitution, as Table A is part of England's Companies Act

1948, from which Kenya's Companies Act 1962 was adopted, it is the mandatory legislation upon which the appointment of chairman is likely to be based. There is a need to review art.101 Table A accordingly to prevent it from suppressing compliance with the requirement that the chairmanship of a public listed company should be held by an independent and non-executive director

2. One Man Companies

Currently, the law requires that a private company should have at least two members and a public company should at least have seven members. It is impossible in Kenya to incorporate a 'one man company' as is in other jurisdictions. In the United Kingdom for example, a private company can have at least one member or director and a public company must have at least two members. This is provided for under section 152 of Companies Act 2006.

Also under the current law, a person who is sixteen years or below cannot be a director of a company. In Kenya, only persons who have attained the age of can be members of a company.

3. Annual General Meetings

In Kenya, the law under section 131 requires companies to hold annual general meetings at least once every year. In Kenya, failure to comply with the requirement to hold such an Annual General Meeting, the company shall be liable to a fine not exceeding Kshs. 2000. Today, that amount is very minimal to deter companies from holding AGMs.

Again it has been argued that annual general meeting have become obsolete with new technologies where it is possible to conduct such meetings without having to converge at one meeting point. The costs of holding such meeting have also been held to be unreasonable given the economic circumstance today. The recent Safaricom Ltd's annual general meeting which was held last year is a case in point. Safaricom has the highest number of shareholders in Kenya and the cost that was incurred by the company in holding its AGM was quite high. It has been suggested that the provision requiring AGMs be done away with and other alternative methods of meeting be introduced. In other jurisdictions, AGMs are voluntary exercises that are not a must unlike in Kenya.

4. Protection of Shareholders

Research in developed countries has shown that shareholders as a group have an incentive to monitor the actions of management. However, recent research on compliance with the "comply or explain" principle in the United Kingdom has shown that market discipline through codes is having little effect on compliance. The probability of achieving collective action of shareholders and effecting market discipline in a developing country such as Kenya is quite small.

The common law of companies appears to provide better protection for shareholders by providing that a shareholder may exercise his own interest as he thinks fit except where he wants to perpetrate a "fraud on the minority"; the vote must be exercised bona fide for the benefit of the company as a whole when a proposed alteration of articles is under consideration. This implies that a large shareholder may not be able to vote against the interests of minority shareholders. However, demonstrating to the court that the majority shareholder had a fraudulent intention against minority shareholders is too high a threshold for minority shareholders, as the majority shareholder can always argue that they were exercising business judgment and acting in the interests of the company.

It worth noting that of particular importance for Kenya is the nature of the minority shareholders. It can be argued that a significant number of shareholders in Kenya are under-informed about their rights as shareholders of the company and are not sufficiently educated on corporate governance issues to discover that there is anything to complain about. In cases where shareholders may want to complain, they find it difficult to come up with better suggestions. Some shareholders are indifferent and do not see the company's under-performance as being their problem to complain about, as they see investing in stock as a gamble. A lack of good returns from investment is seen as a "bad investment" in the wrong company as opposed to poor firm performance, the emphasis being on the shareholder not being in luck as opposed to managerial ineffectiveness. When a large number of minority shareholders think in this way, this thinking can have a devastating effect on corporate governance, as shareholder activism will no longer be an effective internal control mechanism.

There have been efforts to address the issue of shareholder protection in the country; there is still a long way to go before shareholders in Kenya are educated in their rights. Shareholders in developed countries such as the United Kingdom get most of their information from business papers and this keeps the companies in check.

The recent increase in press freedom in Kenya is likely to play a substantial role in the attainment of good corporate governance as the role of a free and vibrant press is the reason why soft law, such as corporate governance, works so well in the United Kingdom. A free and vibrant press gives corporate governance the back-up it needs by providing a powerful investigative process which exposes dodgy dealings in companies, therefore keeping potential misuse of company powers in check. On the other hand, an inactive press in the area of corporate governance means that shareholders may not discover a fraud until much later when the damage is already done.

Conclusion

In conclusion therefore, following the adoption of the Companies Act 1962 to date, Kenya has witnessed the collapse of many of its corporations. Poor corporate governance led to the collapse of 33 banks in Kenya in 1985 and continues to be the cause of the collapse of many corporations to date. Companies in Kenya perform poorly not only because of the nature of the laws in place but also because of the political and regulatory environment in the country.

Although it is possible to argue that enforcing the law that is currently in place would improve corporate governance to an extent and that reviewing the current law without improving the environment in which it operates is likely to have a limited impact on corporate governance, implementing effective laws is a fundamental requirement for establishing a successful corporate governance system. A review of the current system of companies' legislation to reflect the market conditions in Kenya today is way overdue. The current standard of director liability needs to be revised to a dual standard of liability.

Adopting a dual standard of liability such as that of the United Kingdom would encourage entrepreneurship while facilitating accountability. For the dual standard of liability to be effective in achieving good corporate governance, it is necessary to increase the criminal sanctions within the Companies Act and the Penal Code to a level that reflects the business world today. Directors who are not willing to act in the best interests of the company are not going to be deterred by a sanction of imprisonment between two and seven years or a civil sanction of Kshs. 10,000 coupled with a high burden of proof for the prosecutor. The sanctions governing director liability need to be revised to reflect the benefits that are likely to be derived from engaging in financial crime.

In order to ensure good corporate governance, there is need of a strong legislative and regulatory framework in the company law regime in Kenya. It has to be built on a strong foundation, therefore necessitating the need for a review of the Companies Act 1962.

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