ADVANTAGES

1. Owner receives all profits and is in complete control of the business
2. It has no major legal and administrative formalities in starting as all one requires is a trading license
3. A sole trader is his own master and thus makes all decisions, he does not have to consult another person, which tends to delay decision making in other business entities.

DISADVANTAGES

1. Owner has to provide all the capital
2. Owner bears and suffers all the losses
3. Owner has to work for long hours to increase profits and this in the long run affects his health
4. There is no scope in sharing ideas for the improvement of the business

2. PARTNERSHIP

This is a business is owned by at least two people or more but not more than 20 people. Section 3 (1) of the Partnership Act defines a Partnership as the relationship, which subsists between persons carrying on a business in common with a view to make a profit.

Under Kenyan law there are two types of Partnerships, namely General and Limited. The General partnership operates quite similarly to a sole trader but in a Limited partnership the liability of the partners is limited. A partnership deed regulates the relationships among the partners.

ADVANTAGES

1. Partners provide capital on terms agreed. They share the net profit or bear the losses in proportions as set out in the partnership agreement
2. More capital is available and there is a scope of expanding business
3. Sharing of ideas by the partners leads to growth and improvement of business

DISADVANTAGES

1. Disagreement among partners sometimes can ruin the business
2. Business may stop temporarily after death of one of the partners.

3. COOPERATIVE SOCIETIES

This is an association of people who come together with a common objective. It is a form of self-help organisation. It's formed by at least 10 people and there is no maximum membership is open to any number of people required to start a cooperative society. Members hold shares in the society

of participation in the firm's management is, however not given to a partner who has limited his liability for the firm's debts.

(f) Agency

A member is not, *per se*, an agent of the company **(Salomon v Salomon & Co Ltd** (3). A partner is an agent of the firm because the business is carried on "in common" by the partners themselves. The Partnership Act, section 7 also expressly provides that every partner is an agent of the firm and his other partners for the purpose of the partnership.

(g) Liability of members

A company's member is not personally liable for the company's debts because, legally, they are not his debts.

A partner is personally liable for the firm's debts. This rule has been codified by section 11 of the Partnership Act, which provides that "every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner", unless the partner is a limited partner.

(h) Powers

The ultra vires doctrine limits a company's powers to the attainment of the company's objects under its memorandum of association. Partnerships are not affected by the ultra vires doctrine and partners enjoy relative freedom to diversify the firm's operations.

(i) Termination

A member's death, bankruptcy or insanity does not terminate the company's legal existence whereas a partner's death, bankruptcy or insanity may terminate the partnership unless the partnership agreement provides otherwise.

(j) Borrowing money

A company can borrow on the security of a "floating charge". A partnership cannot borrow on a "floating charge".

(k) Ownership of property

A company's property does not belong to the shareholders, either individually or collectively. Consequently, a member cannot insure the property since he has no insurable interest therein: **Macaura v Northern Assurance Co** (4). A firm's property is the property of the partners who can, therefore, insure it and, in the case of cash, make drawings from it.

1.3 LAW RELATING TO OTHER ORGANISATIONS

COOPERATIVES

Cooperatives in Kenya are governed by the Cooperative Societies Act Chapter 490 of the laws of Kenya enacted in 1966.They are also governed by the Cooperative Society Rules enacted in 1969.The rules provided for the following matters:

1. Registration of cooperatives and maintenance of related documents
2. Contents of by-laws and amendment procedures
3. Society membership
4. Maintenance of books
5. Services to be rendered by district cooperative unions
6. Financial control through meetings
7. Property and funds of the society
8. Arbitration

PARTNERSHIPS

The law relating to partnerships in Kenya is contained in the Partnership Act Chapter 29 of the laws of Kenya and the Limited Partnership Act chapter 30 of the laws of Kenya. The Partnership Act is based on the English Partnership Act 1890.These two statutes codify the law on partnerships in Kenya.

CHAPTER SUMMARY

There are four main forms of business associations in Kenya, though there may be others in existence, which are beyond the scope of this book. These forms are:

- Sole proprietorship/sole trader
- Partnership
- Companies
- Cooperative

i. It is too similar to the name of an existing company.

ii. It is misleading, for example, if the name of a company likely to have small resources suggests that it is going to trade on a great scale over a wide field.

iii. It suggests some connection with the crown or members of the Royal Family or royal patronage, including names containing such words as "Royal", "King", "Queen", "Princess" and "Crown".

iv. It suggests connection with a government department or any municipality or other local authority or any body incorporated by Royal Charter or by statute or with the government of any part of the Commonwealth or of any foreign country.

v. It contains the words "British", unless the undertaking is British-controlled and entirely or almost entirely British-owned and is also of substantial size and importance in its particular field of business.

vi. It includes "Imperial", "Commonwealth", "National", "International", "Corporation", "Co-operative", "Building Society", "Bank", "Bankers", "Banking", "Investment Trust", or "Trust", unless the circumstances justify the inclusion.

vii. It includes a surname, which is not that of a proposed director, unless the circumstances justify the inclusion.

viii. It includes words, which might be trade marks, unless a trade mark clearance has been obtained.

It is probable that the registrar of Companies in Kenya is guided by the above rules, modified *mutatis mutandis* when deciding on the desirability of any proposed name.

Reservation of Name

To obviate the risk of choosing a name that ultimately turns out to be undesirable, the promoters should enquire from the registrar whether the name they intend to give the company is "too like" that of a company already in the register of companies. After obtaining confirmation that the name is a registerable one they should immediately make a written application for its reservation under section 19 (1) (a) of the Act. Any such reservation shall remain in force for a period of 30 days or such longer period, not exceeding 60 days, as the registrar may, for special reasons, allow. No other company shall be entitled to be registered with the reserved name.

These statutory provisions regarding the choice of a company's name are intended to confer, on the company, legal monopoly of its name. Because it lacks physical attributes, which could assist its customers to differentiate it from another company with a similar name, a company can only rely on the legal monopoly of its name as its ultimate protection against what might constitute unfair instances of passing-off. They also avoid a situation in which two or more companies use one name with the resultant problem of identifying the company that is the contracting party in a commercial transaction.

Name to end with the word "Limited"

Section 5(1)(a) provides that the word "limited" must be the last word of the name of a company which is to be limited by shares or by guarantee. In **Durham Fancy Goods Ltd v Michael Jackson (Fancy Goods) Ltd** Donaldson, J, it is stated:

"The word "Limited" is included in a company's name by way of "description" and not identification. Accordingly, a generally accepted abbreviation will serve this purpose as well as the word in full. The rest of the name, by contrast, serves as a means of identification".

The use of the mystic word "limited' as the last word of a company's name is explicable only in the context of the historical evolution of English Company law. It was prescribed for the first time for English companies in 1856 by the Joint Stock Companies Act of that year and, in the words of Professor Gower, "was intended to act as a red flag warning the public of the dangers which they ran if they had dealings with the dangerous new invention". A member of the public dealing with a business organisation whose name ended with "ltd" was to be made aware that he was not dealing with a partnership and so could only blame himself if he burnt his fingers in the process. Its function may be likened to that of the ring on a married person's finger.

Power to dispense with the word "Limited"

Although section 5 provides that the last word of the name of a limited company must be "limited", this would not be so if the Minister empowers the company to dispense with it. The Minister would do so "by licence" if he is satisfied that an association about to be formed as a limited company is to be formed for promoting commerce, art, science, religion, charity or any other useful object, and it is intended that its profits, if any, or other income would be used in promoting its objects and the payment of any dividends to the association's members is prohibited.

An existing registered company may obtain a licence to make, by special resolution, a change in its name so as to omit the word "Limited". This can be done only after proving, *inter alia*, that the company is formed to promote charity and is prohibited from paying dividends to its members.

A licence may be granted on such conditions as the Minister thinks fit and may, upon the recommendation of the registrar, be revoked by him subject to the company's right to be heard in opposition to the revocation. A company granted exemption under section 21 of the Act is also exempt from the requirements of section.109 (1) which relate to the publication of the company's name.

Change of Name

A company's name may be changed voluntarily or compulsorily

(a) Voluntary Change

A company's name may be changed voluntarily:

i. Under section 20 (1) if a special resolution is passed by the company for that purpose after obtaining the written approval of the registrar. The registrar's approval is required to ensure that he does not later on reject the proposed name on the ground that it is undesirable.

THE REGISTERED OFFICE CLAUSE

Section 5(1) (b) provides that the Memorandum of Association shall state that "the registered office of the company is to be situate in Kenya". The situation of the registered office in Kenya fixes the company's nationality as Kenyan and its domicile as Kenya, though not its residence. Residence is decided by ascertaining where the company's centre of management and control is. Thus, a company may be resident in a number of countries where it has several centres of control in different countries. The residence of a company is important in connection with its liability to pay taxation to the Government of Kenya.

Function of the Registered Office

Section 107(1) provides that a company shall, as from the day on which it begins to carry on business or as from the fourteenth day after the date of its incorporation, whichever is the earlier, have a registered office and a registered postal address to which all communications and notices may be addressed. Section 108 (1) requires notice of the situation of the registered office and the registered postal address, and of any change therein, to be given within 14 days after the date of incorporation of the company or of the change, as the case may be, to the registrar for registration.

Failure to comply with the requirements of these sections renders the company, and every officer of the company who is in default, liable to a default fine.

The primary function of the registered office is to act as the company's official address. It provides a convenient place where legal documents, notices, and other communications can be served. Section 391(1) provides that a document may be served on a company by; *inter alia*, leaving it at the registered office of the company.

The following registers and documents are also kept at the company's registered office:

i. The register of members, and if the company has one, the index of members, unless the register is made up elsewhere, in which case they can be kept where they are made up. Where the register and index (if any) are made up by an agent, they may be kept at the agent's office (Section 112 - 113).
ii. The register of directors and secretaries (Section 201 (1).
iii. The company's register of charges (if the company is a limited company) (Section105 (1).
iv. A copy of any instrument creating any charge requiring registration under Part IV of the Act (Section 104).
v. The register of debenture holders (Section 88 (1).
vi. The register of directors' interests in shares in, or debentures of, the company or associated companies (Section 196 (1).
vii. The minute books of general meetings (Section 146 (1).

The registers and documents are then subject to the following rights of inspection:

(a) The company's members are entitled to inspect them, free of charge, during business hours for at least two hours each day.

(b) Debenture holders of the company are entitled to inspect, free of charge, the register of debenture holders and, during the period beginning 14 days before the date of the company's annual general meeting and ending three days after the date of its conclusion, the register of directors' shareholding.

(c) Any member of the public is entitled to inspect the register of directors and secretaries and the register of debenture holders on payment of a prescribed fee not exceeding two shillings for each inspection.

THE OBJECTS CLAUSE

Reasons for Stating Objects

Section 5 (1) (c) requires the Memorandum of Association to state the objects of the company. The section does not, however, indicate why a company's objects have to be stated in the company's Memorandum of Association. In **Cotman v Brougham** (21) Lord Parker stated that the statement of a company's objects in its Memorandum of Association is intended to serve the following purposes:

(a) To protect subscribers who learn from it the purpose to which their money can be applied.

(b) To protect persons who deal with the company and who can infer from it the extent of the company's powers.

These propositions will become clearer after a study of the doctrine of *Ultra Vires.*

The Doctrine of *'Ultra Vires'*

Fast forward

- **These are instances when the company acts beyond the powers in its objects clause**
- **The instances are either common law or judicial**

The doctrine of *Ultra Vires* is a legal rule that was articulated by the House of Lords in the case of **Ashbury Railway, Carriage and Iron Co Ltd v Riche (22)** to the effect that, where a contract made by a company (usually by the directors on its behalf) is beyond the objects of the company as written in the company's Memorandum of Association, it is beyond the powers of the company to make the contract. The contract is void, illegal and unenforceable. Lord Cairns stated in an

obiter dictum that such a contract cannot be ratified even by the unanimous consent of all the shareholders of the company. His Lordship observed that any purported ratification would mean that "the shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by Act of Parliament, they were prohibited from doing".

A company's objects are stated pursuant to the provisions of an Act of Parliament. It must therefore be deduced, for example, that a company whose object has been stated to be "gold mining" cannot engage in "fried fish" business. This is because: -

(a) Prospective investors who read the objects clause realised that the company was formed to mine gold. If they bought the company's shares they did so because they intended their money to be used in pursuance of the gold mining business. They did not give the money for any other business and the company does not have their consent to use it on any other business. If the company tries to use the money on a different venture, such as frying fish and chips, they can go to court for an injunction to restrain it from doing so.

(b) The statutory requirement that a company must state its objects in its Memorandum of Association would be rendered purposeless if, despite having stated the objects, the company was legally entitled to embark on any other activity. To prevent this happening, the courts concluded that the statement of objects would be taken to mean that what is not stated as an object cannot be pursued, or undertaken, by the company. In other words, the statutory requirement that the objects are to be stated implies that what has not been stated as an object cannot become a legitimate activity of the company.

IMPLIED POWERS

The statement of Lord Cairns in 1875 in **Ashbury Rail Co Ltd v Riche (22)** to the effect that a contract beyond the objects of the company "in the Memorandum of Association" is "beyond the powers" of the company gives the impression that a company has no legal power to do anything which is not written in the Memorandum of Association. That would be a startling proposition because, in practice, companies have to do so many things in the course of their business that if all those things were to be written down in the Memorandum of Association, the Memorandum would be such a gigantic document that nobody would print or read. It was, therefore, a welcome clarification of the legal position when, in 1880, Lord Selborne, L C, stated in **Attorney-General v Great Eastern Railway Co** that the doctrine of *Ultra Vires*, as explained in the **Ashbury** case, "ought to be reasonably, and not unreasonably, understood and applied". His Lordship then explained that it is not necessary for a company to write down in its memorandum everything that it would or could do in the course of its business because whatever may fairly be regarded as incidental to, or consequential upon, those things which have been stated in the memorandum ought not, and would not, be held by the courts to be *Ultra Vires*. The courts would regard such things as impliedly within the company's powers unless they are "expressly prohibited" by the memorandum. The range of transactions that could be encompassed within the "implied powers rule" was illustrated by Lord Buckley in 1907 when, in **Attorney - General v Mersey Railway Co**, he stated:

COMMON LAW OR JUDICIAL EXCEPTIONS

Numerous English cases have been variously classified by English writers as instances of "lifting the veil of incorporation". A few of these cases are summarised below. But it should be noted that the particular judges were merely ascertaining the facts of the case before them and making the appropriate decision rather than consciously or deliberately "lifting the veil of incorporation". It is the writers who have categorised the said cases as instances of lifting the veil because the decisions in those cases appeared to them to be a modification of the principle in Salomon's case. These cases may be explained under the following headings.

(a) Agency/Trustee/Nominee

One of the ratio decidendi in **Salomon's case** was stated by Lord Macnaghten that "the company is not in law the agent of the subscribers". This proposition was affirmed by the English Court of Appeal and extended to associated companies in **Ebbw Vale Urban District Council v South Wales Traffic Area Licensing Authority** when Lord Cohen stated:

"Under the ordinary rules of law, a parent company and a subsidiary company, even a 100% subsidiary company, are distinct legal entities, and in the absence of an agency contract between the two companies, one cannot be said to be the agent of the other. That seems to me to be clearly established by **Salomon v Salomon & Co Ltd** (3).

From this statement, it can be inferred that, if a court held that a company acted in a particular instance as an agent of its holding company, the veil of incorporation would have been lifted. This is illustrated by the decision in **Firestone Tyre & Rubber Co v Llewellyn** (12) in which it was held, on the basis of the trading arrangements between the holding company and its subsidiary, that the subsidiary was the agent of the holding company.

(b) Fraud or Improper Conduct

English courts have intervened on numerous occasions and lifted the veil of incorporation in order to circumvent a fraudulent or improper design by a bunch of scheming promoters or shareholders. This is illustrated by the decisions in **Jones and Another v Lipman and Another** (13) and **Gilford Motor Co Ltd v Horne** (14). The court's order in the latter case is usually cited as an instance of lifting the veil but it should be noted that the defendant (Horne) was not a member of the company and, in principle; no veil existed between him and the company, which would have been lifted by the court. It is rather an instance of the court regarding the company as Mr Horne in another form ("alter ego").

(c) Enemy Character

A company may be regarded as an enemy if, *inter alia*, all or substantially all of its shares are held by alien enemies. This is illustrated by **Daimler Co Ltd v Continental Tyre & Rubber Co (Great Britain) Ltd** (15). Since there appears to be no Kenya case on the point, the principles summarised by Lord Parker may be useful guidance to a Kenyan who might have to determine, in a given case, whether a particular company is to be regarded as a friend or enemy of Kenya.

CHAPTER QUIZ

1. Explain the expression “lifting the veil”
2. Who is a promoter?
3. Name the constitutive documents of a company
4. What is *Ultra Vires?*

ANSWERS TO QUIZ

1. This is an exception to the legal rule that a company has legal personality. This is where the company and its member's even subsidiaries are treated as one

2. A promoter is a person who undertakes to form a company with reference to a given purpose and to set it going

3. Articles and memorandum of association

4. This is a Latin term that literally means beyond the powers. They are those transactions that are outside the contracting capacity of the company.

A SAMPLE OF EXAM QUESTIONS

QUESTION ONE

Janet and Jackson Onyango are forming a Limited Liability Company. They are seeking your legal advice on the issues listed below. Respond to their enquiries by Janet and Jackson Onyango on:

a) What are the Memorandum and Articles of Association and is there a difference between the two? (5 marks)

b) What details would you expect the two documents in (a) above to contain and what other information might you be able to give about these details?

(15 marks)

QUESTION TWO

a) Outline the rules that govern pre-incorporation contracts.
Cite a relevant case law to support your answer. (12 marks)

b) Kioko, an Under Secretary in the Ministry of Viwandani was entrusted with the responsibility of selling the Ministry's boarded motor vehicles. He invited bids from members of the public to buy two Lorries. He also bid, through a nominee. Mwangangi, his own brother.

Subsequently, he sold the lorries to Mwangangi, at Ksh.80, 000 each. Kioko then formed Kima Company Ltd and instructed Mwangangi to sell the lorries to the company at Ksh.350, 000 each. A prospectus as issued to the public to subscribe for shares to Kima Company Ltd. The prospectus gave Mwangangi as the vendor of the lorries and did not disclose the profit Kioko was making. Musembi, a shareholder of the company,

▶ INDUSTRY CONTEXT

This is a very practical chapter in the industry. In the current year and even the previous year, many companies have made floatation for instance Safari Com, Eveready East Africa, Kengen just to mention but a few. Through this chapter one is able to understand the formalities and procedures to be followed in floating shares. The prospectus, for instance, is a vital document that brings to light many issues such as its contents and liability in respect of it.

3.1 RAISING AND MAINTENANCE OF CAPITAL

Fast forward

- Ø The ways in which a company raises capital
- Ø There are statutory rules relating to capital, bonus, discounts and premiums to ensure the company does not deplete its capital

RAISING OF CAPITAL

MEANING OF CAPITAL

In commercial speech, the word `capital' is generally used to denote the amount by which the assets of a business exceed its liabilities. However, in legal speech, the word "capital" is used to denote the amount of money which a company raises from a sale of its shares, or what represents that money.

TYPES OF CAPITAL

A company's capital at any given moment may consist of:

a) NOMINAL OR AUTHORISED CAPITAL

This is the capital that is stated in the Memorandum of Association pursuant to Section 5 (4) a) of the Act. It is called "nominal capital" because it is calculated on the basis of the "nominal" or book value of the shares into which it is divided. It is "authorized" in the sense that, once the Memorandum of Association is registered, the company can take immediate steps to raise the capital from the public without applying for a permit or license to collect the money.

1. The Matters

The matters to be stated in a prospectus are:

i) Directors' and Auditors of the company
   a) Directors' names, addresses and occupations.
   b) Directors' qualification shares, if any, and their remuneration (if there is a provision in the articles).
   c) Directors' interest in the company's promotion.
   d) Auditors' names and postal addresses.

ii) Formation expenses
   a) Preliminary expenses.
   b) Promoters' remuneration.
   c) Particulars of options on shares or debentures.
   d) Underwriting commission and brokerage.

iii) Investor information
   a) The minimum subscription.
   b) The time of the opening of the subscription lists.
   c) Amount payable on application and allotment.
   d) Voting and class rights
   e) Deferred shares.

iv) Company's property and business
   a) Particulars of shares and debentures issued otherwise than for cash.
   b) Particulars of material contracts.
   c) Vendors of property to the company.
   d) Amount paid for property to be bought by the company, stating the amount paid for goodwill.
   e) Length of time the business has been carried on, if less than three years.

2. The Reports

i) An auditor's report showing:
   a) Profits or losses in each of the last FIVE years.
   b) Rate of dividend during the last five years.
   c) Assets and liabilities at the date of the last accounts.
   d) Similar details with regard to subsidiary companies, if any.

ii) Where the proceeds of the issue are to be used to buy a business, a report by named accountants on the profits or losses of the business for the last five years, and its assets and liabilities at the date of the last accounts.

iii) Where the proceeds of the issue are to be used to buy shares in a subsidiary, a similar report as in (ii) above.

e) **The issue is sanctioned by the court.**
Although the grounds upon which the court is to exercise its discretion to sanction or reject the proposed issue are not spelt out, it appears that it would primarily be acting as the creditors' watchdog to protect their interests. This is so because creditors were not represented at the general meeting which passed, the resolution authorising the company to issue the shares at a discount and so the court steps in to protect their interests. If the issue of shares at a discount would adversely affect any creditor, the court would probably not sanction the issue.

f) **The issue is made within one month after the court's sanction.**
This provision acknowledges the fact that the stock exchange market is a highly fluid market. If a company's members pass a resolution authorising an issue at a discount because of the prevailing market conditions, the directors must act on the resolution before the market conditions change. The statutory assumption appears to be that the market conditions would have materially changed within one month after the court's confirmation. If the directors were to issue the shares at a discount despite the changed conditions, the issue could not be justified.

Another general meeting should be held to enable the members to reconsider their decision in the context of the changed conditions. However, the directors may ask the court to extend the time for issuing the shares at the prescribed discount if they are of the view, and the court concurs, that the market conditions have not materially changed. The flaw with this provision is that it does not provide a time limit for applying to the court for its sanction.

2. Payment of Underwriting Commission

Commission "is defined by Osborn's Concise Law Dictionary as, inter alia" an agent's remuneration. For purposes of company law, it denotes the amount of money paid by a company to a person "in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares in the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares in the company"

Section 55 (1) Companies Act allows a company to pay the commission if:-

a) The payment is authorised by the company's articles;
b) The commission paid or agreed to be paid does not exceed 10% of the price at which the shares are issued or the amount or rate authorised by the articles, whichever is the less; and
c) The amount or rate per cent of the commission paid or agreed to be paid is:
   i) In the case of shares offered to the public for subscription, disclosed in the prospectus; or
   ii) In the case of shares not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in Form No. 225 signed by all the directors or their agents authorised in writing; and
d) The number of shares which it has been agreed to subscribe absolutely is disclosed in manner aforesaid.

Section 55 (2) of the Companies Act provides that, except as provided by subsection (1), no company shall apply any of its shares or capital money, either directly or indirectly, in payment of any commission, discount or allowance to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, or procuring

"...Kshs 900, 000 divided into 100,000 Ordinary Shares of Kshs 9."

— Amount unpaid on each share is Kshs.5 (i.e. the liability on unpaid shares has not been reduced or extinguished).
— Amount paid per share becomes Kshs.4 (by consent of shareholders).

This mode of reduction is legally possible but may be questioned from a practical point of view. The truth is that it is the shareholders who have in fact lost their capital.
It should be noted that, despite the above reduction, the members will receive the same amount of dividend from the company as they would have received if, for psychological reasons, the directors did not ask them to reduce the capital so that the shares retained their Kshs.10 nominal value.

d. <u>By canceling any paid up share capital, which is lost or unrepresented by available assets and also reducing liability on any shares: Section 68 (1) (b)</u>.

<u>Example</u>:

The company's memorandum reads:

"...Kshs.1, 000,000/- divided into 100,000 Ordinary Shares of Kshs.10 each."

— Amount already paid per share is Kshs.5
— Amount unpaid per share is Kshs.5

Assume that the same type and quantity of goods are destroyed by fire in the same circumstances as in example (c) above.
The company passes a special resolution to reduce its capital by Kshs.200, 000. The resolution is confirmed by the court.

The amended memorandum will read:

"...Kshs. 800,000/- divided into 100,000 Ordinary Shares of Kshs.8 each."

— Amount already paid per share is Kshs.5
— Amount unpaid per share becomes Kshs.3

e. <u>By cancelling any paid-up share capital, which is lost or unrepresented by available assets and also extinguishing liability on any shares: Section 68 (1) (b)</u>

<u>Example</u>:

The company's memorandum reads:

"...Kshs.1, 000,000/- divided into 100,000/- Ordinary Shares of Kshs.10"

— Amount paid per share is Kshs.9
— Amount unpaid per share is Kshs.1

h. By paying off paid-up capital which is in excess of the company's needs and reducing liability on any shares

Example:

A company's authorised and issued capital is Kshs.10,000,000 divided into 1,000,000 Ordinary Shares of Kshs.10 each. Kshs.5 has been paid on each share.

The company can pass a special resolution to reduce the capital to Kshs.5 million paying to the shareholders Kshs.2.5 million out of the Kshs.5 million which they have already paid to the company if the directors tell the members that the paid up amount of shs.5m/- is in excess of the company's current needs.

The company's amended memorandum will read as follows:

"...Kshs.5,000,000 divided into 1,000,000 Ordinary Shares of Kshs.5 each." Amount paid on each share becomes Kshs.2.50 and the unpaid amount of Kshs.5 is reduced to Kshs.2.50".

THE FUNCTION OF THE COURT

In **Scottish Insurance Corporation Ltd v. Wilson's & Clyde Coal Co.** Lord Simmons stated:

"But important though its task is to see that the procedure by which a reduction of capital is carried through is formally correct and that creditors are not prejudiced, it has the further duty of satisfying itself that the scheme is fair and equitable between the different classes of shareholders". The court would therefore, not confirm a scheme of reduction if it is of the view that it is not "fair and equitable" to any of shareholders.

a) PROTECTION OF CREDITORS

Where the reduction of capital involves diminution of unpaid capital or repayment to shareholders of paid-up capital, creditors have a statutory right under Section 69 (2) to object to the proposed reduction and, upon objection; a list of creditors must be given to the court. The court will then confirm the reduction if satisfied that the creditors:

i) Have consented thereto;

ii) Have been secured (i.e. given alternative security so that they will no longer rely on the reduced capital as their security),

iii) Have been discharged or paid off (Section 70 (1).

ANSWERS TO QUIZ

1 Amount of money which a company raises from a sale of its shares.

2. (i) Nominal capital
(ii) Issued capital
(iii) Paid up capital
(iv) Called-up capital
(v) Uncalled capital

3
(i) Placing
(ii) Offer for sale
(iii) Prospectus issue

4. Prospectuses

A SAMPLE OF EXAM QUESTIONS

QUESTION ONE

a) Outline the contents of a register of members of a company. (6 marks)

b) Njoroge, a member of Tusonge Company Ltd., inspected the register of members of the company and noted that his name had been omitted therein.
Advise Njoroge on how he should proceed to have his name entered in the register. (4 marks)

c) It is a fundamental principle of company law that the share capital of a company must be maintained.
Discuss the legal consequences of this principle. (10 marks)
(Total: 20 marks)

QUESTION TWO

a) Explain three ways in which a company may raise capital. (6 marks)

b) Explain five circumstances when shares may be issued at a discount. (10 marks)

c) Explain two terms implied in a contract of sale of shares between a seller and purchaser. (4 marks)
(Total: 20 marks)

4.3 REGISTRATION OF CHARGES

Section 96(1) requires the prescribed particulars of specified charges on a company's property or undertaking to be delivered to the registrar for registration within 42 days after the date on which the charge was created. The specified charges are:

a) A charge to secure an issue of debentures;
b) A charge on uncalled share capital;
c) A charge created by an instrument, which, if executed by an individual, would require registration as an instrument under the Chattels Transfer Act (e.g. a Letter of hypothecation);
d) A charge on land;
e) A charge on book debts of the company;
f) A floating charge;
g) A charge on calls made but not paid;
h) A charge on a ship or any share in a ship;
i) A charge on goodwill, a patent, a copyright or a trademark.

THE PRESCRIBED PARTICULARS

The "prescribed particulars" of registered charges are enumerated in Form No 214 and are:

i. The date and description of the instrument creating or evidencing the mortgage or charge;
ii. The amount secured by the mortgage or charge;
iii. Short particulars of the property charged;
iv. Names, postal addresses and descriptions of the persons entitled to the charge; and
v. Amount of rate per cent of commission, allowance or discount (if any) paid.

GENERAL AIM

The purpose of registering the aforesaid particulars is to enable a would-be creditor to know the company's existing indebtedness and the assets available for their settlement.

CERTIFICATE OF REGISTRATION

Section 99 requires the registrar to give a certificate, under his hand, of the registration of any of the specified charges. The certificate shall be conclusive evidence that the statutory requirements, as to registration, have been complied with. Consequently, the charge would not be rendered void on the grounds that one of the prescribed particulars, such as the date of the creation of the charge, is later found to be incorrect: Re **C.L. NYE LTD** (66).

ANSWERS TO QUIZ

1. Redeemable and registered
2. Fixed and floating
3. TRUE
4. When a company ceases business.

A SAMPLE OF EXAM QUESTIONS

QUESTION ONE

Discuss the crystallisation of floating charges and the advantages of a floating charge. (20 marks)

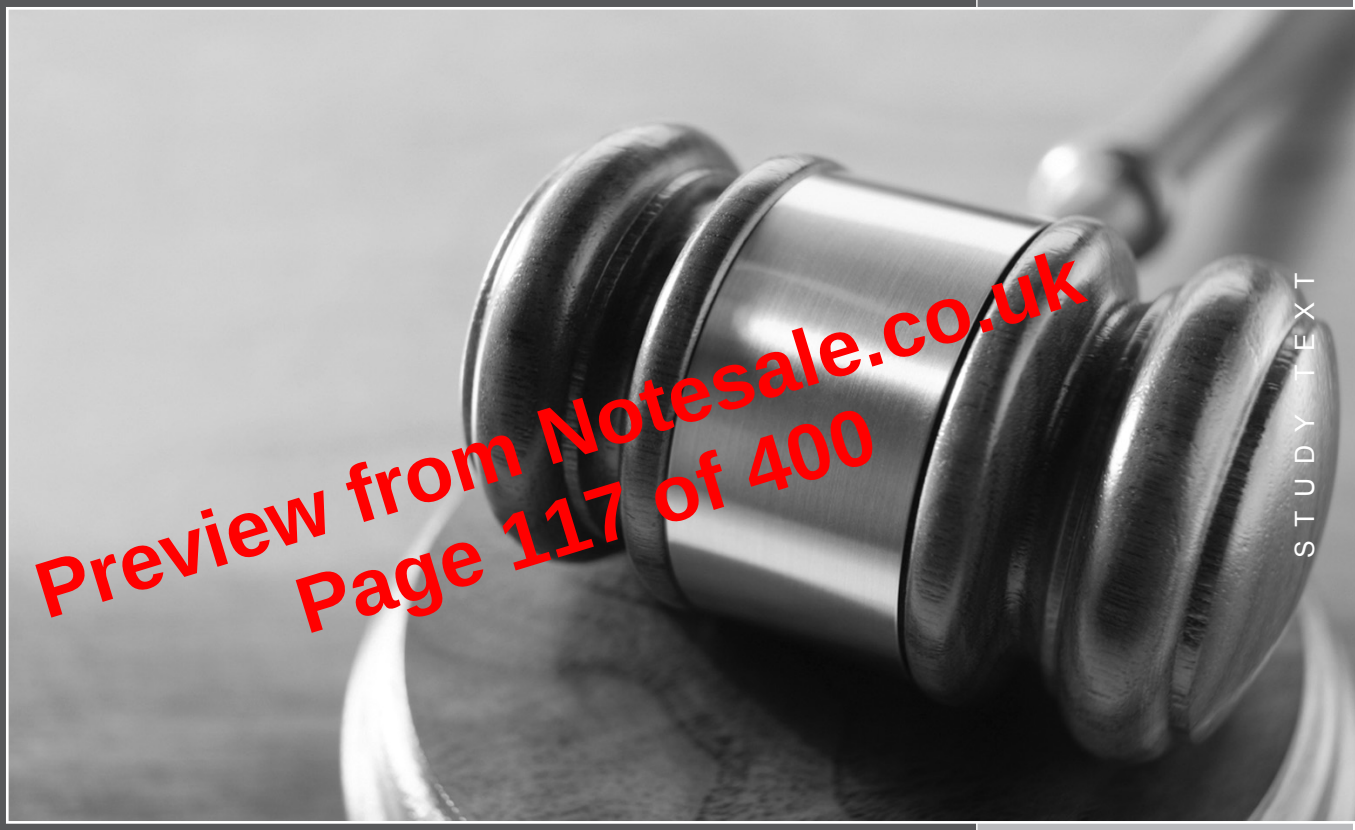
QUESTION TWO

What are trust deeds? (20 marks)

QUESTION THREE

Discuss the various types of debentures. How do they differ from shares? (20 marks)

CHAPTER FIVE



STUDY TEXT

MEMBERSHIP OF A COMPANY

Inspection of Register

Section 115(1) provides that the register and index of members shall during business hours be open to the inspection of any member without charge, and of any other person on payment of a fee, not exceeding two shillings for each inspection, as the company may prescribe. Any person may require a copy of the register or any part thereof, on payment of one shilling or such fewer sums as the company may provide, for 100 words or fractional part thereof required to be copied. The copy must be supplied within a period of 14 days commencing on the day next after the day on which the requirement is received by the company.

If a company officer refuses an inspection or fails to provide a required copy, the company and every officer of the company who is in default shall be liable in respect of each offence to a fine not exceeding Kshs.40 and further to a default fine of Kshs.40. The court may by order:

i. Compel an immediate inspection of the register and index, or
ii. Direct that the copies required shall be sent to the person requiring them.

The court order may also be made against the company's agent who keeps the company's register of members if the company's failure to provide a copy, or permit an inspection, is due to his default.

Section 117 permits a company, on giving notice by advertisement in some newspaper circulating in Kenya or in that area of Kenya in which the registered office of the company is situate, to close the register of members for any time or times not exceeding in the whole 30 days in each year. The purpose of this provision is to keep the register static so that members' holdings may be extracted as at a particular date for the purpose of computing dividends.

Rectification of the Register

Section 118(1) empowers the High Court to rectify the register of members in two cases, namely:

i. If the name of any person is, without sufficient cause, entered in or omitted from the company's register of members; or
ii. Default is made or unnecessary delay takes place in entering on the register the fact of any person having ceased to be a member.

The application to the court to rectify the register may be made by:

i. The aggrieved person;
ii. Any member;
iii. The company.

Where an application is made the court may:

i. Refuse the application;
ii. Order rectification of the register and payment by the company of any damages sustained by any party aggrieved.

An order rectifying the register can be made even when the company is being wound up: **Re Sussex Brick Co** (59).

The case of **Burns v Siemens Bros Dynamo Works Ltd** (60) shows that the circumstances set out in Section 118(1), above, are not the only ones in which the court can order rectification. It may also do so where a name stands on the register without sufficient cause.

The court may also order rectification of the register by deleting a reference to some only of the registered shareholder's shares. It need not delete his name entirely. This is illustrated by **Re Transatlantic Life Assurance Co Ltd (1979)** in which the court deleted an additional number of shares, which had been issued to the applicant in breach of the prevailing Exchange Control Regulations but left the register intact as regards his previous shareholding.

By Section 118(4), if an order is made in the case of a company required to send a list of its members to the registrar, the court, when making an order for rectification of the register, shall by its order direct notice of the rectification to be given to the registrar.

Notice of Trusts

Section 119 provides that no notice of any trust, expressed, implied or constructive, shall be entered on the register, or be receivable by the registrar. The consequences of this provision are as follows:

a. The company is entitled to treat every person whose name appears on the register as the beneficial owner of the shares even though he may, in fact, hold them in trust for another. In particular, if the company registers a transfer of shares held by a trustee, it is not liable to the beneficiaries under the trust even if the sale of the shares by the trustee was made in breach of the trust: **Simpson v Molson's Bank (61).**

b. The company is not a trustee for persons claiming the shares under equitable titles: Societe Generale de Paris v Walker (62). The owner of an equitable interest in shares, such as an equitable mortgagee or the recipient of a bequest of shares, may protect his interest by serving on the company a stop notice (or what is sometimes called a notice in *lieu of distringas*), informing the company that he is interested in the shares and requiring the company to notify him of a receipt of a transfer of the said shares to a transferee other than himself. When the company eventually informs him of the proposed transfer, he would then apply to the court for an injunction restraining the transfer.

CHAPTER SIX

SHARES

▶ OBJECTIVES

At the end of this chapter, the student should be able to:

- Explain the transfer and mortgage of shares
- Explain the various classes of shares
- Explain issue and allotment of shares
- Explain the mortgage, transfer and transmission of shares
- Explain pertinent issues to share warrants

▶ INTRODUCTION

The main security looked at is the share and all the formalities relating to its issue and allotment. The chapter also focuses on transfer and transmission of shares.

▶ KEY DEFINITIONS

- **Share:** A unit of ownership in a company
- **Stock:** Consolidation of many shares
- **Mortgage:** A transaction whereby shares are used as collateral security for loans
- **Lien**: An equitable charge on the shares of a member to secure sums owing by the member to the company.

▶ EXAM CONTEXT

In this chapter the examiner in this chapter is interested in knowing whether the student understands the various classes of shares, their issue and allotment. Mortgage of shares and share warrants are also often tested.

▶ INDUSTRY CONTEXT

Shares are growing in acceptance as more and more companies are using them as a form of raising funds.

A look at the financial markets shows an existence of other classes of shares as opposed to the common shares known to many. A share is an asset and thus many banks are accepting shares as security for the loans they issue.

STOCK

A company may, if authorised by its articles, convert its issued shares into stock (or reconvert stock into shares). But shares must be allotted as shares ranking *pari passu* and be made fully paid before they can be converted into stock. The effect of conversion is that, for example, one hundred one pound shares become a single block of 100 pound stock owned and transferable in units of defined value (usually the same amount as the value of the shares from which they are derived). It used to be common practice to convert fully paid shares to stock to dispense with use of identifying numbers for shares. But this result can now be achieved in other ways. It should be noted that reference to shares in the Companies Act includes stock unless otherwise indicated. (Companies Act Section 2)

6.3 MORTGAGE OF SHARES

This is a transaction whereby shares are used as collateral security for loans. The transaction is either legal or equitable.

Under a legal mortgage the borrower transfers his shares to the mortgagee who becomes the registered holder subject to a separate agreement by which he undertakes to re-transfer the shares to the mortgagor on repayment of the loan. The agreement also determines who is entitled to the dividends and gives the mortgagee the right to sell the shares if the mortgagor defaults on the loan. As registered holder, the mortgagee can transfer the shares to a purchaser who buys from him.

The essential feature of an equitable or informal mortgage is that the borrower deposits his share certificate with the mortgagee but remains the registered holder of the shares. There is again an agreement containing the terms of the loan and the mortgage. The mortgagee may protect himself by serving a "stop notice" on the company but his possession of the share certificate is an effectual bar to dealings with the shares by the borrower.

The equitable mortgagee's other potential difficulty is that since he is not a registered shareholder he has no direct means of transferring the shares to a purchaser if the borrower defaults and he decides to sell. He usually obtains from the mortgagor a "blank transfer", i.e. a transfer signed by the mortgagor as registered holder but without the name of a transferee inserted. This usually gives the mortgagee an implied power to insert his own name as transferee in case of default. He can then dispose of the shares after transferring them into his name. Alternatively, the mortgagee may obtain from the mortgagor a power of attorney giving him power to insert the name of a purchaser on the transfer.

SUMMARY OF THE CHAPTER

Mortgage of shares is a transaction whereby shares are used as collateral security for loans. The transaction is either legal or equitable

The following are the classes of shares generally issued by registered companies:

7. Ordinary shares
8. Preference shares
9. Participating preference shares
10. Redeemable preference shares
11. Deferred or founders or management shares
12. Employee shares

A share certificate is a document on which is printed the name of the shareholder and the number of shares held (with any particulars such as "1 pound ordinary") is written (or typed).

A share is by its nature transferable but to obtain transfer, a proper instrument (of transfer) must be delivered to the company and the directors must authorise the transfer

A mortgage may either be legal or equittable. In a legal mortgage the borrower transfers his ownership but for an equitable mortgage, the shareholder remains the registered holder.

iii. The election of directors in the place of those retiring, and

iv. The appointment of, and the fixing of the remuneration of, the auditors.

Subsection 5 makes it a criminal offence punishable with a fine not exceeding two thousand shillings for the company and every officer of the company to fail to hold the annual general meeting or comply with any directions of the registrar regarding the calling and conduct of the meeting.

Extraordinary General Meetings

Section132 (1) provides for the convening of "extraordinary" general meeting but does not define it. Neither is the word "extraordinary" defined in any other section of the Act. However, Table A, Article 48 provides that all general meetings other than annual general meetings shall be called extraordinary general meetings.

Table A, Article 49 further provides that the directors may, whenever they think fit, convene an extraordinary general meeting. Further, by Section 132 (1), despite anything in the articles of a company, the directors are bound to convene an extraordinary general meeting of the company on the requisition of the holders of not less than one-tenth of the paid-up capital of the company carrying the right of voting at general meetings of the company, or, if the company has no share capital, of members representing not less than one-tenth of the total voting rights. Section 132 (2) provides that the requisition must state the objects of the meeting, and must be signed by the requisitions and deposited at the registered office of the company. Section132 (3) provides that if the directors do not within 21 days from the date of the deposit of the requisition proceed to convene a meeting, the requisitions, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene a meeting, so long as they do so within three months of the requisition.

Section 32(5) entitles the requisitions to recover any reasonable expenses incurred in convening the meeting from the company, and the company may in turn recover these from the fees or other remuneration of the defaulting directors.

The company's articles cannot deprive the members of the right to requisition a meeting under Section 132 because the section requires the directors to proceed to convene a meeting on requisition "notwithstanding anything" in the company's articles. However, the section is defective in the sense that, although the directors are required to **convene** the meeting, they need not **hold** it within any particular limit of time. They may therefore defeat the purposes of the section by calling the meeting for a date, say, six months ahead, provided they do so within the 21-day period. In the event of their doing so the requisitions cannot convene another meeting, as illustrated by Re: Windward Islands Enterprises (U.K) Ltd (1982). The Jenkins Committee recommended that the requisitions should be empowered to call the meeting themselves if the directors call the meeting to be held **later than** 28 days after the notice convening it was sent out. The company's articles may also contain such a provision although the current Table A lacks one.

Case: RE CARATAL (NEW) MINES LTD (1902)

A special resolution was put to the vote on show of hands. The chairman counted the hands raised "for" and "against" and said "6 for and 23 against but there were 200 voting by proxy and I declare the resolution carried". This declaration was later challenged in court.

Held:

The declaration invalid since on the chairman's own figures there was no majority on a show of hands. Proxies may vote on a poll (which had not been held) but not on show of hands and should have been disregarded.

(d) Any provision in the articles is void insofar as its effect is:

(a) To exclude the right to demand a poll on any question other than the election of a chairman by the meeting or an adjournment;

(b) To make ineffective a demand for a poll:
   i. By not less than five members
   ii. By member(s) representing not less than one-tenth of the total voting rights:
   iii. By member(s) holding shares which represent not less than one-tenth of the paid-up capital;

   I.e., the articles may well say that three people may demand a poll but cannot validly say that at least six people are required - such a rule would be void and five people could demand a poll. (Section 137)

(e) When a poll is held, it is usual to appoint "scrutinisers" and to ask members and proxies to sign voting cards or lists. The votes cast are checked against the register of members and the chairman declares the result.

(f) In voting, either by show of hands or on a poll, it is the number of votes cast which determines the result. Votes which are not cast, whether the member who does not use them is present or absent are simply disregarded. Hence the majority vote may be much less than half or three quarters) of the total votes which could be cast.

7.7 RESOLUTIONS

A meeting reaches a decision by passing a resolution. There are three kinds of resolutions:

i. **An ordinary resolution,** which is carried by a simple majority of votes cast. Where no other kind of resolution is specified "resolution" means an ordinary resolution;

▶ INDUSTRY CONTEXT

Directors are charged with the responsibility of managing company affairs. In recent times, directors have been taken to court for breach of their duties. Therefore, it is vital that directors exercise their duties with care and skill. In this chapter, various powers and duties of certain officers, including directors, and qualifications that are used in the industry today are given.

8.1 APPOINTMENT OF DIRECTORS

NUMBER OF DIRECTORS

Section.177Companies Act provides that every company (other than a private company) shall have at least two directors. Every private company shall have at least one director. Under Table A, Article 75, the actual number of directors would initially be decided upon by the subscribers of the Memorandum, or a majority of them, and until so determined, the signatories to the Memorandum of Association shall be the first directors. Table A, Article 94 empowers the company from time to time by an ordinary resolution to increase or reduce the number of its directors.

APPOINTMENT OF DIRECTORS

In the absence of other provisions in a company's articles, the directors of the company would be appointed in accordance with the following provisions of Table A.

FIRST DIRECTORS

The names of the first directors shall be decided in writing by the subscribers of the Memorandum of Association or a majority of them. If there is a deadlock, all the signatories to the Memorandum of Association shall be the company's first directors.

SUBSEQUENT DIRECTORS

The subsequent directors are appointed by the members at a general meeting beginning from the first annual general meeting at which all the first directors retire from office and the members are given the first opportunity to elect directors of their own choice. The retiring directors are, however, eligible for election under Article 89. At the second annual general meeting, one-third of

the directors are to retire from office, the ones to retire being the ones who have been longest in office since their last election. As between persons who became directors on the same day, those to retire shall (unless they otherwise agree among themselves) be determined by lot. One-third of the board shall thereafter retire annually.

CASUAL APPOINTMENTS

Article 95 permits the board of directors to fill a vacancy in the board or to get an additional director to join the board for practical reasons provided that the appointment does not cause the number of directors to exceed the limit imposed by the articles. The person appointed director in this way shall hold office until the next annual general meeting. He will then be eligible for re-election, but his appointment will not be taken into account when deciding on the directors who shall retire from office.

RESTRICTIONS ON APPOINTMENT

The following are the restrictions which the Act imposes on appointment of directors:

1. **Section 182 (1): Appointment by the Articles**
   Section 182(1) provides that a person shall not be capable of being appointed director of a company by the articles unless, before the registration of the articles, he has by himself or by his agent authorized in writing:
   i. Signed and delivered to the registrar for registration a consent in writing to act as such director; and
   ii. Either:
      a) Signed the memorandum for a number of shares not less than his qualification, if any;
      b) Taken and paid or agreed to pay for his qualification shares, if any;
      c) Signed or made and delivered to the registrar for registration an undertaking to take and pay for his qualification shares, if any, or the statutory declaration that a number of shares not less than his qualification, if any, are registered in his name.

2. **Section 183: Qualification Shares**
   Section 83(1) provides that it shall be the duty of every director who is by the articles of the company required to hold a specified qualification, and who is not already qualified, to obtain his qualification within two months after his appointment, or within the shorter time (if any) fixed by the articles.

   Subsection (3) further provides that if the director fails to obtain his share qualification, or ceases to hold the required number of shares, he shall vacate his office. If he does not actually do so but continues to act as director he becomes a de facto director: **Rv Ivan Arthur Camps** (67).

3. **Section 186: Age Limit**
Section 186 provides that no person shall be capable of being appointed a director of a public company or a private company which is a subsidiary of a public company if at the time of his appointment:-

(a) He has not attained the age of twenty-one years or is more than 70 years.

This provision does not apply if:

(a) The company's articles provide otherwise or
(b) A "Special notice" of the resolution to appoint the director was given to the company.

The company must also have given notice of it (i.e. the special notice) to its members and stated the age of the proposed director.

Section 142 defines "special notice" as a notice given to the company not less than 28 days, before the meeting at which the relevant resolution is to be moved.

4. **Section 188: Undischarged Bankrupts**
Section 188 provides that if an undischarged bankrupt acts as director of any company without leave of the court he shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding Kshs.10,000 or both.

5. **Section 189: Fraudulent Persons**
Section 189(1) empowers the court to make an order restraining a person from being appointed or acting, as a company's director for a period not exceeding five years if—

i. The person is convicted of any offence in connection with the promotion, formation or management of a company;
ii. In the course of a winding up, it appears that the person has been guilty of fraudulent trading (under Section 323) or has otherwise been guilty, while an officer of the company, of any fraud or breach of duty to the company.

6. **Section 184: Individual Voting**
Section 184(1) provides that appointment of directors is to be voted on individually unless a motion for the appointment of two or more persons as directors by a single resolution was agreed upon by the meeting without any vote being given against it.

A resolution moved in contravention of this provision is void {Section 184 (2)}.

DEFECTS IN APPOINTMENT

Section 181 provides that a director's acts shall be valid despite any defect that may afterwards be discovered in his appointment or qualification. This provision applies to technical defects in appointment or qualification, such as a failure to obtain the director's share qualification within the prescribed time. An example is **R v Camps (67)**.

corporate, to a fine not exceeding Kshs 500,000 or to imprisonment for a term not exceeding five years or to both;

(b) On any subsequent conviction:
   (i) In the case of a person being a body corporate, to a fine not exceeding Kshs.3 million or
   (ii) In the case of any other person, including a director or officer of a body corporate, to a fine not exceeding Kshs.1 million or to imprisonment for a term not exceeding seven years or to both.

(13) An action under this section for the recovery of a loss shall not be commenced after the expiration of six years after the date of completion of the transaction in which the loss occurred.

(14) Nothing in subsection (12) affects any liability that a person may incur under any other section of this Act or any other law.

SUMMARY OF THE CHAPTER

Insider trading occurs when a person buys or sells company securities uses information that is not available to the public to trade in the company's securities or when the person has a relationship with the company and the extent that he is likely to have access to material information about the company.

The restriction on directors' appointments is as follows:

- Appointment by the articles.
- Qualification of shares.
- Age limit.
- Undischarged bankrupts.
- Persons disqualified by the court.
- Individual voting.

The office of the director shall be vacated if the director:

- Fails to obtain the share qualification
- Becomes bankrupt or makes any arrangement or composition with his directors
- Is prohibited by the court
- Is of unsound mind
- Resigns his office in writing
- Has been absent for more than six months without permission

It is unlawful for the company to issue a loan to its director unless:

- It's a private company.

9.1 APPOINTMENT OF THE SECRETARY

By section 178, every company must have a secretary. However, a sole director cannot be a secretary as well (Section 179). Section 179also provides that a corporation cannot be a secretary if its sole director is also the sole director of the company.

Section 178A (1) states that every company secretary shall hold a qualification prescribed by Section 20 of the Certified Public Secretaries Act. However, subsection 2 provides that the Minister may on the advice of the Council and the Registration Board; exempt certain classes of companies, non-profit organisations and charitable organisations from the provisions of that section. All public companies, all private companies with a nominal capital of at least Kshs.100,000 and all companies of public nature registered as limited by guarantee are supposed to comply with the provision of Section 178.

Table A, Article 110, provides that the secretary shall be appointed by the directors on such terms and conditions as they think fit and may be dismissed by them.

No person shall qualify for appointment as a company secretary unless he is registered under the Certified Public Secretaries Act. Section 20 of the Certified Public Secretaries Act provides that subject to this section, a person is qualified to be registered as a Certified Public Secretary if:

- He has been awarded by the Examinations Board a certificate designated the Final Certificate of the Certified Public Secretaries Examination.
- He holds a qualification approved by the Registration Board
- He is at the commencement of this Act, both a citizen of Kenya and a member of the professional body known as the Institute of Chartered Secretaries and Administrators
- He is at the commencement of this Act both ordinarily resident in Kenya, and a member of the professional body known as the Institute of Chartered Secretaries and Administrators
- He is at the commencement of this Act, registered as an accountant under Section 24(1) of the Accountants Act he is qualified as an advocate of the High Court of Kenya.

Section 21(1) provides for disqualification from being registered as a company secretary. The following are disqualified from being registered

- If convicted by a court of competent jurisdiction in Kenya or elsewhere of an offence involving fraud or dishonesty.
- If an undischarged bankrupt
- If he is of unsound mind, and has been certified to be so by a medical practitioner.
- If during the period when the Registration Board has determined under section 28(1)(d) that he shall not be registered or during any such period as varied by the High Court under Section 29.

5. Registration of Charges: Particulars of a charge created must be delivered within 42 days of creation.
6. Directors and Secretaries: Changes in the particulars of directors and secretaries must be submitted to the Registrar within 14 days from the happening thereof.

Responsibilities regarding meetings and minute books

Board and committee meetings

Board and committee meetings must be convened and conducted in accordance with the company's Articles of Association and the Companies Act. Failure to do so would entitle those entitled to attend or any other interested person to challenge the legitimacy or validity of the decisions made at such meetings. It is particularly important to observe the period of notice if this is prescribed in the Articles.

As Secretary of the Board, the Company Secretary should ensure that the agenda and the papers containing the business to be discussed are dispatched well before the date of the meeting. The secretary should also ensure that the agenda is properly drawn up and well arranged as this will facilitate smooth deliberations at the meeting.

The Secretary should also ensure that there is a quorum present at the commencement of the meeting. Only persons competent to take part in the business of a meeting should constitute a quorum. A quorum should be present throughout the duration of the meeting.

GENERAL MEETINGS

General meetings are either classified as annual general meetings or extraordinary general minutes.

In convening general meetings, it is also important to comply with requirements to serve notice to those entitled to attend as prescribed by the Act and the company's Memorandum and Articles of Association. While Table (Article 50) provides for waiver of notice, it is important to remember that the Act (Section 158) provides that a company's accounts must be dispatched to members at least 21 clear days before the date of the meeting. This requirement will not apply if it is so agreed by all the members entitled to attend and vote at the meeting. It is, however, difficult to achieve such unanimous agreement in the case of public companies with thousands of shareholders.

The Act also provides that special notice (i.e. not less than 28 days) is required in the following cases: -

1. To remove a director before the expiry of his period of office.
2. To appoint a director who is over 70.
3. To appoint an auditor, a person other than a retiring auditor; or fill a casual vacancy in the office of the auditor; or re-appoint an auditor who was appointed by the directors to fill a casual vacancy or remove an auditor before the expiration of his term in office.

ANSWERS TO QUIZ

1. Duties
2. TRUE
3. Common and Official
4. Three

SAMPLE OF EXAM QUESTIONS

QUESTION ONE

Discuss the position and duties of the Company Secretary

QUESTION TWO

What are the main qualifications of a secretary?

QUESTION THREE

Discuss the register of directors and secretaries.

Fast forward:

- Ø An auditor is an officer of the company who performs an audit of the financial statements of a company
- Ø An auditor owes a legal duty of care and the standard set is that of a competent auditor in the circumstances
- Ø An auditor is appointed by the board of directors, registrar or members at a general meeting

10.1 QUALIFICATION, APPOINTMENT AND REMOVAL

APPOINTMENT

Section 159 (1) of the Companies Act provides that "every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that, until the conclusion of the subsequent annual general meeting".

REAPPOINTMENT

By Section 159 (2) a retiring auditor shall be deemed to be reappointed without any resolution being passed unless:

a) He is not qualified for reappointment

b) A resolution has been passed at that meeting (i.e. annual general meeting) appointing somebody instead of him or providing expressly that he shall not be appointed

c) He has given the company notice in writing of his unwillingness to be reappointed.

APPOINTMENT BY REGISTRAR

"Where at an annual general meeting no auditors are appointed or are deemed to be reappointed, the Registrar may appoint a person to fill the vacancy" (Section 159 (3).

11.6 APPOINTMENT AND POWERS OF INSPECTORS

Where it appears to the registrar that there is good reason so to do, he may appoint one or more competent inspectors to investigate and report on the membership of any company and otherwise with respect to the company for the purpose of determining the true persons who are or have been financially interested in the success or failure (real or apparent) of the company or able to control or materially to influence the policy of the company.

The appointment of an inspector under this section may define the scope of his investigation, whether as respects the matter or the period to which it is to extend or otherwise and in particular may limit the investigation to matters connected with particular shares or debentures.

Where an application for an investigation under this section with respect to particular shares or debentures of a company is made to the registrar by members of the company and the number of applicants or the amount of shares held by them is not less than that required for an application for the appointment of an inspector, the registrar shall appoint an inspector to conduct the investigation unless he is satisfied that the application is vexatious, and the inspector's appointment shall not exclude from the scope of his investigation any matter which the application seeks to have included therein, except in so far as the registrar is satisfied that it is unreasonable for that matter to be investigated:

Provided that the registrar may refuse to appoint an inspector under this subsection unless, in any case in which he considers it reasonable so to require, the applicants give sufficient security for the payment of the costs of the investigation.
Subject to the terms of an inspector's appointment, his powers shall extend to the investigation of any circumstances suggesting the existence of an arrangement or understanding which, though not legally binding, is or was observed or likely to be observed in practice and which is relevant to the purposes of his investigation.

The AFORESAID shall apply in relation to all persons who are, or have been, or whom the inspector has reasonable cause to believe to be or have been financially interested in the success or failure, or the apparent success or failure, of the company or any other body corporate whose membership is investigated with that of the company, or able to control or materially to influence the policy thereof, including persons concerned only on behalf of others, as they apply in relation to officers and agents of the company or of the other body corporate, as the case may be; and

The registrar shall not be bound to furnish the company or any other person with a copy of any report by an inspector appointed under this section or with a complete copy thereof if he is of opinion that there is good reason for not divulging the contents of the report or of parts thereof, but shall keep a copy of any such report or, as the case may be, the parts of any such report, as respects which he is not of that opinion.

The expenses of any investigation under subsection (1) shall be defrayed by the registrar.
The expenses of any investigation under subsection (3) shall be defrayed by the applicants unless the registrar certifies that it is a case in which he might properly have acted under subsection (1).

In a members' voluntary winding up, the creditors play no part since the assumption is that their debts will be paid in full. There is no committee of inspection (on which creditors would be represented). The liquidator calls special and annual meetings of members to whom he reports:

(a) Within three months after each anniversary of the commencement of the winding up the liquidator must call a meeting and lay before it an account of his transactions during the year: Section 282.

(b) When the liquidation is complete, the liquidator calls a meeting to lay before it his final accounts.

After holding the final meeting, the liquidator sends a copy of his accounts to the registrar who dissolves the company three months later by removing its name from the register: Section 283(4).

CREDITORS' VOLUNTARY WINDING UP

If no declaration of solvency is made and delivered to the registrar, the liquidation process is a **creditors' voluntary winding up** even if in the end the company pays its debts in full.

To commence a creditors' voluntary winding up the directors convene a general meeting of member to pass a special resolution. They also convene a meeting of creditors, sending notices to creditors individually and advertising the meeting once in the Kenya Gazette and once at least in a newspaper circulating in Kenya: s.286 (2).

The meeting of members is held first and its business is:

(a) To resolve to wind up.
(b) To appoint a liquidator
(c) To nominate representatives to be members of **the committee of inspection**.

The creditors' meeting is convened for the same day at a later time than the members' meeting or it is held the following day. One of the directors presides at the creditors' meeting and lays before it a full statement of the company's affairs and a list of creditors with the amounts owing to them. The creditors' meeting nominates a liquidator and up to five representatives of creditors to be members of the committee of inspection. If the creditors nominate a different person to be liquidator, their choice prevails over the nomination by the members (subject to a right of appeal to the court).

It is no longer possible to prevent the creditors from appointing the first liquidator by failing to call a creditors' meeting after holding a members' meeting (to appoint a liquidator of their choice) on short notice. (This device was first developed in **Re Centrebind** (1966) and is colloquially called "centre binding"). Any meeting of members called to initiate a winding up must be convened with not less than seven days notice.

(a) If the shares which he holds or previously held are partly paid or if it is, found that the rules on consideration have been breached in the allotment of shares as fully paid.

(b) If the company is limited by guarantee.

(c) If the company is unlimited.

As explained below the persons who are members at the time when liquidation commences are primarily liable (when there is any liability). The liability of past members is very restricted.

If it is necessary to make calls on contributories, the liquidator draws up **a list "A"** of contributories who were members at the commencement of the winding up and **a list "B"** of contributories who were members within the year preceding the commencement of winding up. A list B contributory has liability limited by the following principles:

(a) He is only liable to pay what is due on the shares which he previously held and only so much of the amount due on those shares as the present holder (a list A contributory) is unable to pay.

(b) He can only be required to contribute (within the limits stated in (a) above) in order to pay those debts of the company incurred before he ceased to be a member which are still owing.

As stated above, a past member ceases to be liable altogether (on partly paid shares) if the company continues (without going into liquidation) for a year.

TRANSACTIONS ARISING IN LIQUIDATION

In collection in and realisation of assets in order to pay the company's debts and then to distribute any surplus to members the liquidator will have dealings with creditors, secured and unsecured, with members and others. He may have to enforce claims on behalf of the company against those who previously managed its business. He has also to consider whether the charges on the company's assets on which secured creditors rely are still valid. This topic is concerned with the legal aspects of these problems and transactions of the liquidator.

ASSETS IN THE POSSESSION OF CREDITORS

If the creditor has seized assets in the course of executing a judgment for debt against the company and at the commencement of the winding up or on receiving notice that it is about to begin the creditor has not completed the process of recovering what is owed to him, the liquidator may compel him to return the asset to the company.

DISCLAIMER OF ASSETS

The liquidator has a statutory right of disclaimer of assets: Section 135. The rules are:

(a) He must obtain leave of the court.

(b) The right of disclaimer is limited to property of the following kinds:

(i) Land burdened with onerous covenants.
(ii) Shares.
(iii) Unprofitable contracts.
(iv) Other property which is difficult to sell because of the burdens attached to it.

(c) The liquidator must disclaim within a period of 12 months (unless the court extends the period). The period is reckoned from commencement of winding up or the data when the liquidator became aware of the property if this was more than one month after that commencement. Moreover, the other party may serve on the liquidator a notice requiring him within 28 days, to state whether he intends to disclaim. If the liquidator does not within that period declare an intention of disclaimer, he losses the right to do so.

(d) Any person who suffers loss by the disclaimer becomes a creditor of the company for the amount of his loss. If the property disclaimed is a lease which has been mortgaged or sub-let the court may vest the property disclaimed in the mortgagee or sub-lessee.

PROOF OF DEBTS

Many of the rules of bankruptcy apply to the discharge of the company's debts: Section 310. The liquidator must obviously require satisfactory evidence that a creditor's claim is properly admissible as a liability. This is done (where necessary) by a procedure for "proof of debts".

If the company is solvent, every kind of debt which is legally enforceable may be admitted. If it is insolvent, unliquidated claims in tort are not admissible. But the injured party may be permitted to bring an action against the company in tort so that his claim may be converted by the award of damage into a liquidated sum so long as it is liquidated when the claimant comes into prove.

A statute-barred debt should be rejected since it is not legally enforceable. But in a members' voluntary winding up, the liquidator may with the consent of all contributories pay such a debt. The general rules on statute-barred debts are:

(a) In a normal case, a debt becomes statute-barred (i.e. the creditor may no longer take legal proceedings to enforce payment) if it remains unpaid for six years and the creditor does not within that time commence legal proceedings to recover it.

(b) The company becomes liable again to pay a statute-barred debt (after six years) if it

(b) Does not deliver up to the liquidator, or as he directs, all such part of the movable and immovable property of the company as is in his custody or under his control, and which he is required by law to deliver up

(c) Does not deliver up to the liquidator, or as he directs, all books and papers belonging to the company and which he is required by law to deliver up.

(d) Within 12 months before the commencement of the winding up or at any time thereafter conceals any part of the property of the company to the value of Kshs.200 or upwards, or conceals any debt due to or from the company.

(e) Within 12 months next before the commencement of the winding up or at any time thereafter fraudulently removes any part of the property of the company to the value of Kshs 200 or upwards.

(f) Makes any material omission in any statement relating to the affairs of the company.

(g) Knowing or believing that a false debt has been proved by any person under the winding up, fails for the period of a month to inform the liquidator thereof.

(h) After the commencement of the winding up prevents the production of any book or paper affecting or relating to the property or affairs of the company.

(i) Within twelve months next before the commencement of the winding up or at any time thereafter, conceals, destroys, mutilates or falsifies or is privy to the concealment, destruction, mutilation or falsification of any book or paper affecting or relating to the property or affairs of the company.

(j) Within 12 months next before the commencement of the winding up or at any time thereafter makes or is privy to the making of any false entry in any book or paper affecting or relating to the property or affairs of the company.

(k) Within 12 months next before the commencement of the winding up or at any time thereafter fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with altering or making any omission in, any document affecting or relating to the property or affairs of the company.

(l) After the commencement of the winding up or at any meeting of the creditors of the company within twelve months next before the commencement of the winding up attempts to account for any part of the property of the company by fictitious losses or expenses.

(m) Has within 12 months next before the commencement of the winding up or at any time thereafter, by any false representation or other fraud, obtained any property for or on behalf of the company on credit which the company does not subsequently pay for.

(n) Within 12 months next before the commencement of the winding up or at any time thereafter, under the false pretence that the company is carrying on its business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for.

SUMMARY OF CHAPTER

Winding up or dissolution is the dissolution of a company i.e. it ceases to exist.

The three main forms of liquidation are:

- Compulsory winding up.
- Members' voluntary winding up of an insolvent company.
- Creditors' voluntary winding up of a solvent company and winding up subject to the supervision of the company.

Once winding up proceedings have been commenced:

- Official receiver becomes provisional liquidator.
- Director's powers become *functus officio.*
- Servants of the company are *ipso facto* dismissed.
- Any disposition of the company's property and transfer of its shares become void.
- The company ceases to carry on business

The main difference between a members' voluntary winding up and creditors winding up is that a member's winding up is characterised by a declaration of solvency but in a creditor's voluntary winding up there is no declaration of solvency

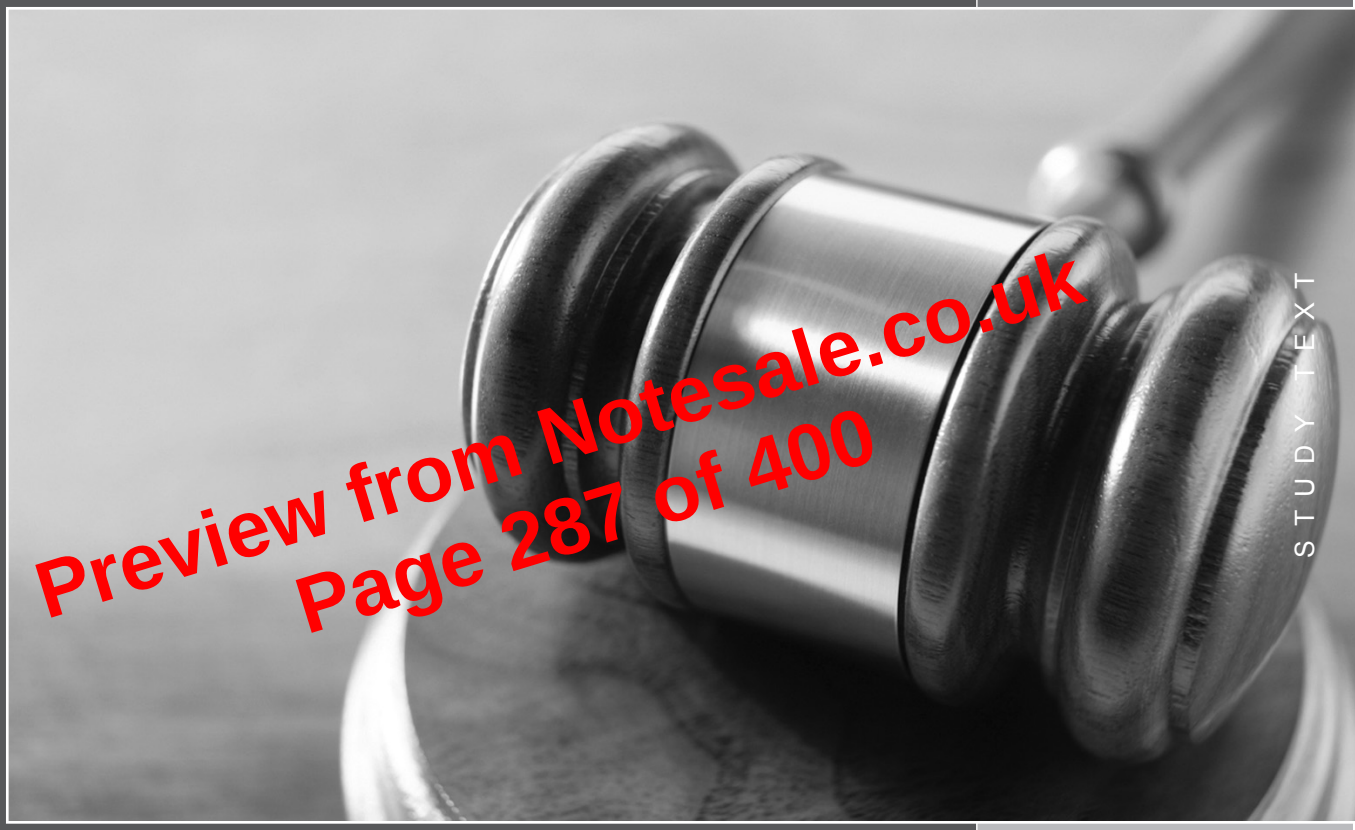
Powers of a liquidator:

- To conduct legal proceedings in the name of and on behalf of the company
- To carry on the business of the company for beneficial winding up
- Appoint an advocate to assist him
- To pay any class of creditors in full
- To make any compromise with creditors
- To comprise all calls
- A liquidator is appointed by the court whereas a receiver is a representative of secured creditors appointed by them.

Under Section 221 of the Act, a winding up petition may be presented to court by any of the following persons:

- The company
- Creditors

CHAPTER THIRTEEN



STUDY TEXT

ALTERNATIVES TO WINDING UP

▶ INDUSTRY CONTEXT

In the industry today, liquidation is always taken as a last resort as it has many procedures and thus very expensive. Many companies are opting for the alternatives that will be discussed in this chapter. A very good example is Uchumi Supermarket, which instead of being wound up was placed under receivership.

INTRODUCTION

Schemes involving reconstruction, amalgamation, take-overs, arrangements, and other forms of reorganisation are carried out for the following reasons:

1. To overcome the company's financial difficulties
2. To make arrangements with creditors
3. To reorganise the company's capital structure
4. To extend the company's objects.

Reconstructions, mergers and takeovers are not defined terms. A reconstruction may be an alternative of the structure of a group of companies or an alteration of the capital structure of a single company.

The conventional meaning of **"take-over"** is the acquisition by one company (the bidder) of sufficient shares in another company (the target) to give the purchaser control of that other company.

"Merger", on the other hand, means the uniting of two companies but, as this is possibly done through an acquisition by one company of a controlling holding of shares in another. Merger and takeover have almost become synonymous.

A merger (also called an amalgamation) is a transaction whereby two or more companies are combined in some way in united ownership. The simplest method is a takeover bid whereby Company A acquires the issued share capital of Company B so that they form a single group in which A is the holding company and B is the subsidiary. A more complex type of merger entails the transfer of a business (and the assets employed in it) from one company to another. If the acquiring company (in either a take-over bid for shares or a purchase of assets) allots its own shares as consideration for the acquisition the members of the company whose business or share capital is acquired will become additional members of the acquiring company.

A company may absorb a minority shareholding in its partly owned subsidiary in exchange for cash or shares.

A company may seek to alter the rights of its creditors, e.g. by variation of the rights of debenture holders or by mutual agreement.

In these transactions, it is first necessary to select the only available (or if more than one) the most convenient method to effect the proposed change. The advantages and disadvantages of each method are explained below in connection with the method itself. The essential elements of every method are that if a decisive majority of members or creditors can be obtained by the correct procedure, the minority (if any) who dissent will be bound by the majority decision. But in each case the minority is given safeguards or rights of objection to the court to balance the element of compulsion. Although a minority cannot frustrate the change by their opposition, they are entitled to a fair deal.

There are three statutory methods to be considered

Where one company offers to acquire the shares of another company and its offer is accepted by holders of 90 per cent or more of the shares for which the offer is made the acquiring company may compel the non-accepting minority to transfer their shares on the same terms. This is the standard procedure for "mopping up a minority" and achieving complete success in a **take-over bid**. It is no objection that the acquiring company already owns (directly or through subsidiaries) some shares of the other company. Accordingly this method is also available to acquire the outstanding minority shareholding of a partly owned subsidiary (Section 210).

Where one company transfers its undertaking (and assets) to another company in exchange for shares to be allotted direct or distributed to the members of the company, the company which makes the transfer must go into voluntary liquidation and the transfer must be approved by special resolution passed in general meeting. The acquiring company may be a new company formed for the purpose. There is then a change of company but the same shareholders as a group own the same business (through a company). It is a form of **reconstruction**. If however the acquiring company already has a business and a different group of members this method effects an amalgamation so that the two groups of shareholders join together in holding the shares of a single company which owns both businesses, Section 280.

A **scheme of arrangement** may be used in many different situations. Essentially, it is suitable for making a change in the rights of shareholders or creditors of an existing and continuing company. But it can also be used to effect a take-over (as described in (a) above) or to carry out a reconstruction involving changes of company structure (Section 207).

It will be seen that methods (a) and (b) relate to specific types of transaction. They can only be used in those transactions. The flexibility of a scheme of arrangement has led to its extended use though there is some doubt whether it is correct to use it in a situation where company law affords some other and more specific procedures.

Where there is a choice of method, the choice is usually between a scheme of arrangement and some more specific alternative method. The considerations affecting the choice are explained overleaf.

Section 207 refers to a "class" of members or of creditors. Obviously if two or more companies are involved or if one company has two classes of shares, e.g. preference and ordinary, or is proposing a compromise with different classes of creditors, e.g. debenture holders and unsecured trade creditors, it must ask the court to order that separate meetings be held of each group and it must obtain the required majority approval at each meeting. But the principle is carried even further. If within say one class of shareholders there are groups whose interests in the proposed scheme are clearly different, the court must be asked to order that separate meetings be called of each group. It has been said that each meeting "must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest" (***Sovereign Life Assurance Co v Dodd***).

If those who propose the scheme do not, in their application to the court, distinguish each such group (to be consulted separately) the court will at the final decision stage withhold its approval on the ground that there has not been fair and proper consultation.

In Re: Hellenic and General Trust (1976), a scheme of arrangement was agreed between Hambros and Hellenic whereby the shareholders of Hellenic were to have their shares in the company cancelled in return for cash compensation. Hambros was to pay the compensation and then receive the same number of shares in Hellenic. The scheme was approved at a meeting of Hellenic by a majority in number of the shareholders holding three quarters in value of the shares involved. But a wholly owned subsidiary of Hambros (MIT) held 53% of the shares in Hellenic and voted for the scheme. Hellenic applied for approval of the scheme and was opposed by a Greek Bank, a 14% shareholder in Hellenic. Its objections were that it wished to retain its membership and also that the cash received for its shares would be subject to heavy capital gains tax liability in Greece.

The Greek bank opposed the approval of the scheme before the court on two grounds. First, MIT as a subsidiary of Hambros had a different interest in the scheme from the other shareholders of Hellenic. MIT was Hambros indirectly; it was seeking to acquire the 47% of Hellenic, which it did not (through MIT) already own. There should therefore have been a separate meeting of the holders of the 47% of Hellenic shares not already under the Hambros' control through MIT. At such a meeting, the Greek bank (with 14% out of 47%) could have prevented approval by the required three quarters majority.

Secondly, the purpose of the scheme was to enable Hambros to acquire 47% of the shares of Hellenic. (The device of canceling the shares for cash and issuing new ones to Hambros was to save the stamp duty payable on a straightforward transfer of the shares - an example of the advantages of a scheme of arrangement.)

It was argued that a scheme of arrangement should not be used in a situation for which the take-over bid procedure was appropriate. Under take-over bid rules, the required 90% acceptance (from the independent shareholders) would not have been obtained since the Greek bank held more than one-tenth of the outstanding 47% minority shareholdings.

Covered by part X of the Companies Act cap 486 of the Laws of Kenya

14.1 PROVISIONS AS TO ESTABLISHMENT OF PLACE OF BUSINESS IN KENYA

The sections in part X shall apply to all foreign companies, that is to say, companies incorporated outside Kenya which, after the appointed day, establish a place of business within Kenya and companies incorporated outside Kenya which have, before the appointed day established a place of business within Kenya and continue to have a place of business within Kenya on and after the appointed day: A foreign company shall not be deemed to have a place of business in Kenya solely on account of its doing business through an agent in Kenya at the place of business of the agent.

14.2 DOCUMENTS TO BE PRESENTED TO THE REGISTRAR

Foreign companies which, after the appointed day establish a place of business within Kenya shall, within 30days of the establishment of the place of business deliver to the registrar for registration: -

(a) A certified copy of the charter, statutes or memorandum and articles of the company or other instrument constituting or defining the constitution of the company, and, if the instrument is not written in the English language, a certified translation thereof;
(b) A list of the directors and secretary of the company containing the particulars mentioned in subsection (2);
(c) A statement of all subsisting charges created by the company, being charges of the kinds set out in subsection (2) of Section 96 and not being charges comprising solely property situate outside Kenya;
(d) the names and postal addresses of some one or more persons resident in Kenya authorised to accept on behalf of the company service of process and any notices required to be served on the company; and
(e) The full address of the registered or principal office of the company.

capital is wasted or returned to members.

4. Creditors and other persons who deal with companies are aware that the companies have an amount of capital and are entitled to insist no part thereof is returned to members without due compliance with law.
5. It is, therefore, a fundamental principle of company law that capital be maintained.
6. Company Law has evolved both statutory provisions and prepositions of common law to facilitate the raising and maintenance of capital. One of these provisions is that the company should only reduce capital in accordance with the provisions of the Companies Act. These provisions of the Companies Act prescribe the circumstances and conditions under which a company may reduce capital.

i) Authority of the Articles
Under Section 68 (1) of the Companies Act, a company limited by shares or guarantee and having a share capital may reduce its capital of authorised by its articles.

ii) Special Resolutions
Under Section 68(1) of the Act reduction of capital of capital by a company must be authorised by a special, resolution of members in general meeting. This resolution is referred to as "resolution for reducing share capital". The reduction of capital may take the form of:
Reducing or extinguishing liability on any unpaid up capital.

Cancellation of any paid up capital, which is lost or unrepresented by available assets.
Paying off any paid up capital, which is in excess of the wants of the company.

iii) Application to court for confirmation
Under Section 67(1) of the Act, after the special resolution is passed, an application must be made to the High Court for confirmation of the reduction. The essence of the application is for the court to satisfy itself that the reduction does not unfairly prejudice the position of any class of members or creditors. In particular the court must settle a list of all creditors and must satisfy itself that any creditor entitled to object to the reduction has either objected or consented to the same. In the case of an objection, the court must be satisfied that the creditors claim or debt has been discharged, determined or secured. If the court is so satisfied, it may confirm the reduction.

iv) Confirmation of the reduction
Under Section 71 (1) of the Act, if the court is satisfied that creditors entitled to object to have consented or in the case of an objection, the creditors claim or debt has been discharged, determined or secured it may make an order confirming the reduction on such terms and conditions as it deems fit. The court may for any special reason if it deems fit order the company to add the words "and reduced" to it's name for a specified duration. Such words form part of the company's name for the duration of the order.

v) Registration of the reduction
Under Section 71 (1) of the Act, upon production of a certified court order approving the reduction and the minute of the same the registrar registers the

reduction and issues a certificate of registration, which is conclusive evidence that the requirements of the act relating to reduction of capital have been complied with. A reduction of capital by a company take effect when registered and notice of registration must be published in accordance with the courts direction

Underwriting Commission

This is the amount or sum paid by the company to a person who agrees to underwrite the company's shares i.e. take up all the shares or a specified number of the shares not taken up by the public. It's payable whether the person (Underwriter) takes up the shares or not. It must be disclosed in the company's prospectus.

Brokerage

This is an amount paid by the company to a person (or persons) who agrees to place the company's shares i.e. exhibits the company's prospectus in their premises or send copies to their clients, but without incurring any liability on the shares.

It is an amount only payable to brokers.

It must be disclosed in the company's prospectus.

CHAPTER FOUR

QUESTION ONE

Crystallization of Floating Charges

A floating charge is a charge on a class of assets of a company. The actual assets in that class owned by the company change from time to time. The assets that the chargee is entitled to utilise for payment of the secured debt are the assets in the class that the company owns at the time when the charge crystallises. On crystallisation a floating charge becomes a fixed or specific equitable charge.

A floating charge crystallises:

(i) When the chargee appoints an administrative receiver.
The power to do so exists only by virtue of the charge contract, which must, therefore, specify the circumstances in which the power is exercisable. e.g.

1 Liquidation or winding up
2 Appointment of a receiver
3 Levy of execution or distress
4 Insolvency
5 Cessation of business

a sale. Table A, Article 23, permits members to transfer all or any of their shares. A member, therefore, ceases to be a member only if he transfers ALL of his shares.

ii. Forfeiture

Where a company's articles authorise the directors to forfeit a member's shares and the director's forfeit ALL of the shares held by a member, the member will cease to be a member from the date specified in the articles as the effective date for forfeiture.

Table A, Article 38 provides that "a statutory declaration in writing that the declaring is a director or the secretary of the company, and that a share in the company has been duly forfeited on a date stated in the declaration, shall be conclusive evidence of the facts therein stated."

Article 37 provides that a person whose shares have been forfeited shall cease to be a member in respect of the forfeited shares.

He therefore ceases to be a member of the company only if all of the shares previously held by him are forfeited.

iii. Surrender of Shares

The precise nature of surrender and the machinery by which it is effected are not clear since it is not provided for by the Companies Act or Table A. However, in Trevor v Whitworth, the judge stated that a surrender "does not involve any payment out of the funds of the company," and that "if it were accepted in a case where the company were in a position to forfeit the shares the transaction would seem to me perfectly valid," presumably even if not expressly authorised by the articles.

A person's membership will therefore come to an end if he surrenders all his shares to the company with the approval of the directors.

iv. Death

When a person dies, his membership of a company will come to an automatic end by virtue of the provisions of the Law of Succession. The shares previously held by him become, legally, the property of his personal representative. (See Table A, Article 29)

v. Bankruptcy

When a person becomes bankrupt, his membership of a company will come to an end under the provisions of the Bankruptcy Act, which vest a bankrupt's property in his trustee in bankruptcy (see Table A, Article 32).

vi. Sale by a company in exercise of lien

A company, like an unpaid seller under the Sale of Goods Act, has a right of lien on its shares as security for the balance of their price. For example, Table A Article 11 gives the company "a first and paramount lien" on every unpaid share.

If the company sells ALL the shares held by a member, the membership will come to an end from the moment the buyer's name is entered in the register. Table A, Article 12 gives the company power to sell "any shares on which the company has a lien".

order that the transfers should be entered in the register. On 18th December 1967 a second director was appointed and there was a board meeting at which the two directors refused to register the transfers (4 months, 14 days).

Held:

The attempt to exercise the power of refusal on December 18,1967 was invalid since, in the interval of 4 1/2 months (since the transfers were presented), the power had expired (as regards those transfers). Since the power of refusal had not been exercised, the transfers must be entered in the register.

The articles may also restrict the right to transfer shares by giving to members a right of first refusal of the shares, which other members may wish to transfer. Any such rights are strictly construed, i.e. a member who wishes to accept must observe the terms of the articles and a member will not be permitted to evade his obligation to make the offer.

In LYLE & SCOTT v SCOTT'S TRUSTEES

The articles required any member who might be "desirous of transferring" his shares to give notice to the company secretary so that the shares could be offered to other members. Certain members agreed to sell their shares to an outsider and, while remaining the registered holders, gave the purchaser their proxies so that he could secure control of the company.

Held:

These members were indeed "desirous of transferring" their shares and must give formal notice as the articles required.

The cases cited above show that when there is a dispute over refusal to register the proper remedy is to apply to the court for rectification. A member who applied for an order for compulsory winding up of the company on the just and equitable ground was refused (Charles Forte {Investments} v Amanda) as "a winding up petition is not a proper remedy" in such a case because to liquidate the company would be unfair to other members not involved in the dispute.

CHAPTER SEVEN

QUESTION ONE

The Annual General Meeting

Section 131(1) provides that "every company shall in each year hold a general meeting as its annual general meeting in addition to any other meetings in that year, and shall specify the meeting as such in the notices calling it".

Not more than 15 months must elapse between the date of one annual general meeting and the next. The word "year" was defined in Gibson v Barton as "calendar year", i.e. the period January 1 to December 31.

tried servants of the company and are undetected for years by the directors. So to hold would make the position of an auditor intolerable...

KAY, LJ. ".... The words of the section are "any misfeasance or breach of trust in relation to the company.... misfeasance means something other than a breach of trust... it does not mean mere non-feasance: RE WEDGWOOD COAL AND IRON CO.... I think the only safe interpretation to adopt is that it includes all cases other than breaches of trust in which an officer of the company has been guilty of a breach of his duty as such officer which has caused pecuniary loss to the company by misapplication of its assets, and for which he might have been made liable in an action..."

2. RE LONDON AND GENERAL BANK

An auditor represented a confidential report to the directors calling their attention to the insufficiency of the securities in which the capital of the company was invested, and the difficulty of realizing them, but in his report to the shareholders merely stated that the value of the assets was dependent on realization, and in the result the shareholders were deceived as to the condition of the company, and a dividend was declared out of capital and not out of income.

HELD:

The auditors had been guilty of misfeasance under S.10 of the Companies (winding-up) Act, 1890, and was liable to make good the amount of dividend paid (amounting to $14,433.3s).

LINDLEY, LJ.: "... it is the duty of the directors, and not of the auditors, to recommend to the shareholders the amounts to be appropriated for dividends and it is the duty of the directors to have proper accounts kept, so as to show the true state and condition of the company... It is for the shareholders, but only on the recommendation of the directors, to declare a dividend. It is impossible to read the section of the Companies Act without being struck with the importance of the enactment that the auditors are **to be appointed by the shareholders, and are to report to them directly**, and not to or through the directors. The object of this enactment is obvious. It evidently is to secure to the shareholders **independent** and **reliable** information respecting the true financial position of the company at the time of the audit... It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is **to ascertain and state the true financial position of the company** at the time of the audit, and his duty is confined to that. But then comes the question, how is he to ascertain that position? The answer is, by examining the books of the company. But he does not discharge his duty by doing this without inquiry and without taking any trouble to see that the books themselves show the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this, his audit would be worse than idle farce. Assuming the books to be so kept as to show the company's true financial position, the auditor has to frame a balance showing that position **according to the**

of Company B the bidder (Company A) must arrange for a cash alternative to be provided since that was part of the terms (although it came from a third party) which induced a high level of acceptance: **Re Carlton Holdings** (1971)

A non-accepting shareholder who applies to the court to set aside the proposed compulsory acquisition of his shares under Section 210 will fail unless he can make out a very strong case. Acceptance by holders of 90 per cent or more of the shares indicates that the terms offered are fair. This is so even if the objector contends that he had need of more information in order to reach a decision or that Company A in acquiring control of Company B will obtain special advantages (e.g. elimination of a competitor) which are not reflected in the price offered for his shares. Objection on those grounds only are likely to fail.

But the court will not permit s.210 to be used in an artificial and oppressive manner.

Case: RE BUGLE PRESS (1900)

X, Y and Z held 4,500, 4,500 and 1,000 one-pound shares respectively, of Company B. They were the only shareholders and X and Y were the directors. X and Y wished to eliminate Z. Section 210 however is not available to individuals. So X and Y formed a new company (Company A) in which they were the only two shareholders. Company A then offered to acquire all the shares of Company B. X and Y accepted the offer but Z did not. Company A served notice on Z that it has secured 90 per cent acceptance (the shares of X and Y) and intended to acquire Z's 1,000 shares under Section 210. Z applied to court.

Held:

Company A was a sham since (lifting the veil of incorporation) it was merely the majority shareholders (X and Y) in Company B seeking to expropriate the shares of the minority (Z). Section 210 could not be used in these circumstances. Z's objections were upheld.

The alternative to acquisition under Section 210 (in a take-over bid) is a scheme of arrangement under Section 207. The choice may be determined by comparative costs (see paragraphs 8.3.7(c) and 8.3.8). Stamp duty is payable (at the two per cent ad valorem rate) on transfers of shares of Company B in a transaction to which s.210 applies. It can be avoided under Section 207. But under Section 210 procedure there is usually no expense of court proceeds as few minority shareholders persist in their objections to the point of making application to the court (at some expense to themselves).

On the other hand if there is uncertainty about obtaining 90 per cent acceptance and a scheme of arrangement is not excessive in costs it is an easier route to the intended result. It is particularly useful when Company A is seeking to acquire those shares of a partly-owned subsidiary (Company B) which it does not own. In such cases some minority shareholders of B may be indifferent or passively opposed; Company A cannot count on their acceptances (to achieve 90 per cent) but reckons that they cannot or will not deny it a three quarters majority at a meeting. There is often a delicate balance of conflicting risks and considerations in choosing between Section 207 and Section210 in such situations.

QUESTION THREE

The sections in part X shall apply to all foreign companies, that is to say, companies incorporated outside Kenya which, after the appointed day, establish a place of business within Kenya and companies incorporated outside Kenya which have, before the appointed day established a place of business within Kenya and continue to have a place of business within Kenya on and after the appointed day: A foreign company shall not be deemed to have a place of business in Kenya solely on account of its doing business through an agent in Kenya at the place of business of the agent.

CERTIFICATE OF REGISTRATION AND POWER TO HOLD LAND

Where a foreign company has delivered to the registrar the documents, the registrar shall, if such documents and particulars are so delivered after the appointed day, certify under his hand that the company has complied with the requirements; and such certificate, and any certificate given by the registrar of companies before the appointed day that a foreign company has delivered to him the documents and particulars required by any provision of any of the repealed Ordinances corresponding to the said section and to the like effect, shall be conclusive evidence that the company is registered as a foreign company for the purposes of this Act.

Where a foreign company has, after the appointed day, delivered to the registrar the documents and particulars mentioned in Section 366, it shall have the same power to hold land in Kenya as if it were a company incorporated under this Act.

Where a foreign company has, before the appointed day, delivered to the registrar of companies the documents and particulars required by any provision of any of the repealed Ordinances corresponding to section 366 of this Act and to the like effect, it shall, subject to the provisions of that one of the repealed Ordinances in accordance with which such documents and particulars were so delivered and of this Act, have the same power to hold land in Kenya as if it were a company incorporated under this Act.

REGISTRATION OF CHARGES CREATED

369.

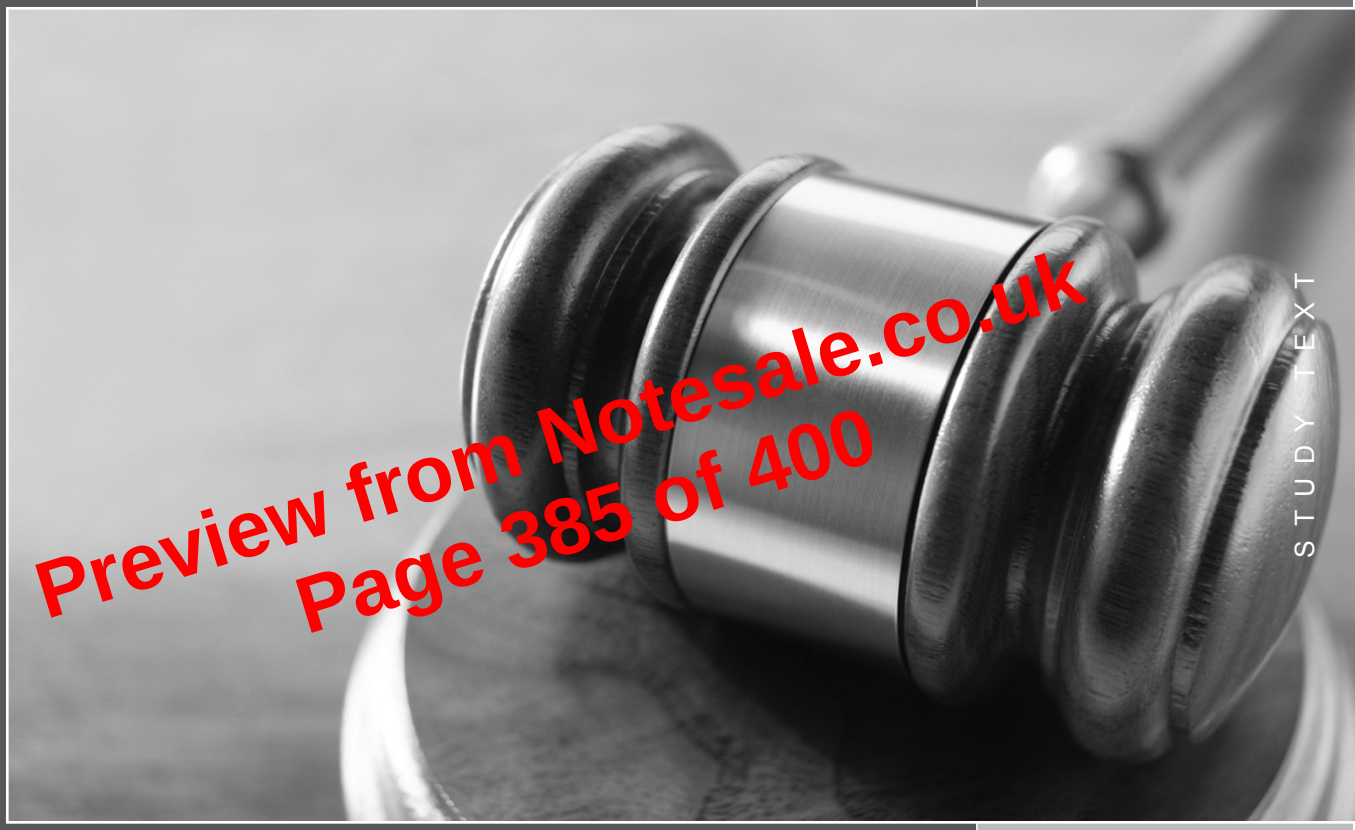
The provisions of Part IV shall extend to charges on property in Kenya which are created, and to charges on property in Kenya which is acquired, after the commencement of this Act, by a foreign company which has an established place of business in Kenya:

Provided that in the case of a charge executed by a foreign company out of Kenya comprising property situate both within and outside Kenya:-

(i) it shall not be necessary to produce to the registrar the instrument creating the charge if the prescribed particulars of it and a copy of it, verified in the prescribed manner, are delivered to the registrar for registration; and

(ii) the time within which such particulars and copy are to be delivered to the registrar shall be 60 days after the date of execution of the charge by the company or, in the case of a deposit of title deeds, the date of the deposit.

GLOSSARY



GLOSSARY

A

Annexture: Attachments or documents fixed to another

Auditor: This a person appointed by the company to carry out an audit

Audit: This is an independent examination of the final statements as to whether they show a true and fair view

Allotment: It: It is, legally speaking, the company's acceptance of an offer to buy its shares

Articles of association: A document which regulates the internal affairs of a company

Artificial person: A person recognised by law in the form of companies

B

Balance sheet: This is a financial statement that shows the company's state of affairs

Bankrupt: This is a person adjudicated by a court as unable to pay his debts

Bearer: This is a person in possession of a particular thing

Body corporate: This is an artificial which comes into existence through incorporation

Brokerage: This is the commission paid to a broker

C

Capital: amount of money which a company raises from issuing shares

Central depository system: A computerised ledger that enables the transfer and holding of securities without need for physical movement

Caveat emptor: A Latin term that means buyer beware

Class: refers to people whose rights are so similar that it is hard to separate

Cessation: This refers to loss of company membership or to share entitlement

D

Discount: The difference between the nominal value and the issue price; it's normally lower than the nominal value

Derivative action: A suit brought by a person in the name of and behalf of the **company** to remedy a wrong

Director: This is a person with running of the day to day affairs of the company

Compensation: These is the total payments that are made to a person

Debenture: A long term loan

Q

Quorum: The requisite number of members to be present for a meeting to take place

Qualification shares: These are the shares that are prescribed in the articles for the director to take up before e he can qualify as one

R

Receiver: A representative of secured creditors to enforce their security

Reconstruction: Recreation of a company building it a new

Redeemable preference shares: these are shares that rank above ordinary shares and are bought back by the company during its existence

S

Share: The basic unit of ownership in a company

Secured creditor: This is a creditor whose debt is secured on a fixed or floating asset of the company

Stock: This is a block of shares

T

Transfer: Occurs when shares are bought from a member rather than the company

U

Ultra vires*:* A Latin term which means beyond the contracting powers of a company

V

Void: Means the contract cannot be enforced it confers no rights and imposes no obligations

Voidable: A contract that can be enforced at the option of the innocent party

W

Warrant: This is a warranty that the bearer is the owner of the shares specified there insurance

Winding up:- Process by which a company is dissolved and ceases to exist

REFERENCES