
LESSON 9

REVISION AID

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NOTE: ALL MODEL ANSWERS HAVE BEEN PROVIDED BY THE STAFF OF THE DISTANCE LEARNING CENTRE.

KASNEB SYLLABUS

OBJECTIVE

To examine candidates' understanding of the legal principles relating to the nature and registration of companies. The ability to describe the various classes of companies and define the nature and contents of the Memorandum and Articles of Association. To appreciate the legal principles that govern the raising of capital for companies and to understand the principles relating to accounts, auditors and payment of dividends.

CONTENT

Nature and Classification of Registered Companies

- Definition of a company
- Procedure for registration of a company
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- Companies Limited by guarantee
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- Public and Private companies
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- Investor protection; Insider dealing (Capital Markets Authority Act Cap. 485A)
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- Transaction involving directors; the rule in Turquand’s case
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- Accounts, Audit and Auditors: Books of account; Laying the Accounts before the company in general meeting and filing them with the Registrar; The annual accounts; Group accounts; Directors report; Auditors report; Appointment of Auditors; Qualification of Auditors; Vacation of office by Auditors; Remuneration of Auditors; Powers and duties of Auditors

MODEL ANSWERS TO REINFORCEMENT QUESTIONS

LESSON 1

ANSWER ONE

The initial steps that must be taken by promoters who are desirous of forming a private company limited by shares is the preparation of a document called the Memorandum of Association to which at least two of them will subscribe their names pursuant to Section 4 of the Companies Act.

The Memorandum of Association must state:

- (i) The name of the proposed company, with "Limited" as the last word thereof since the proposed company is to be limited by shares.
- (ii) That the registered office of the company is to be situate in Kenya.
- (iii) That the liability of the company's members is limited.
- (iv) The objects of the company.
- (v) The amount of capital with which the proposed company will be registered and the division thereof into shares of a fixed amount.

The Memorandum of Association must also contain a declaration by the promoters that they are desirous of being formed into a company pursuant thereto.

The second step that the promoters must take is the preparation of the following documents:

1. ARTICLES OF ASSOCIATION

This document will contain the regulations for the company's management. In the instant case it is not mandatory for the promoters to prepare it since their proposed company is to be limited by shares and can therefore adopt the provisions of Table A, Part I as modified by Part II thereof.

2. THE STATUTORY DECLARATION OF COMPLIANCE (FORM NO. 208)

This document is obtainable from the companies registry and having been obtained, must have the prescribed information filled or inserted therein so as to constitute it a declaration by an advocate engaged in the formation of the company (or a person named in the articles as a director or secretary of the company) that all the requirements of the Companies Act for the company's registration have been complied with.

3. STATEMENT OF NOMINAL SHARE CAPITAL

The promoters must obtain from the Companies registry a document called "Statement of Nominal Share Capital" and insert therein the prescribed information about the proposed share capital of the company. This is done for purposes of computing the stamp duty payable on the company's formation.

The final step that the promoters must take is the delivery of the above documents to the registrar of companies.

If the documents are prepared in accordance with the provisions of the Companies Act they will be registered and the Registrar will issue the company's certificate of incorporation.

The company will come into existence from the date written in the Certificate of Incorporation.

ANSWER TWO

I would explain to Otieno and his friends that the major contents of a Memorandum of Association are prescribed in Section 5 of the Companies Act which requires the memorandum to state:

1. The name of the company, with "LIMITED" as the last word thereof if the proposed company is to be registered with limited liability on the part of its members.

This requirement anticipates the eventual birth of the proposed company as a distinct legal entity which must have a name of its own. Professor Cower has stated that the mystic word "LIMITED" at the end of the company's name is intended to act as a red flag warning the public of the dangers which they run if they have dealings with a limited company.

2. That the registered office of the proposed company will be situated in Kenya. The purpose of this statement is to facilitate the identification of the company's domicile, primarily for taxation purposes.
3. The objects of the proposed company.

I will tell Otieno and his friends that in the case of *COTMAN v. BROUGHAM*, the court explained that the statement of the objects is intended to serve the following purposes:

- (i) To enable a company's members know the purpose to which their money invested in the company could be applied; and
- (ii) To protect company's potential creditors whom the law assumes will read the registered memorandum and be able to infer from the stated objects the extent of the company's powers.

I would also explain to Otieno and his friends that their proposed company shall not have power to transact any business that is neither expressly nor impliedly within the stated objects. Any attempt to enter into such contracts would be ultra vires and illegal: *ASHBURY RAIL CO. v. RICHE*.

4. If the proposed company is to be registered with limited liability on the part of its members, the memorandum shall contain:
 - (i) A statement that the liability of the members is limited and, if limited by guarantee, the maximum amount of money which each member can be expected to pay during the company's liquidation; and
 - (ii) A statement of the amount of share capital which the proposed company will be expected to raise after its incorporation, and the division thereof into shares of a fixed amount.

I will explain to Otieno and his friends that, in the case of *OOREGUM GOLD MINING CO. LTD. v. ROPER*, the judge stated that a company's capital "is fixed and certain, and every creditor of the company is entitled to look to that capital as his security". The statement of the company's authorised share capital is, therefore, an indication to the company's potential creditors of the potential maximum assets of the company which would constitute the security for any credit to the company.

LESSON 2**ANSWER 1**

- (a) The advice that I would give my clients regarding the problems they are likely to encounter if they wish to bring further members into the company would be as follows:

Availability of further shares

They would not be in a position to bring further members into the company if no further shares are available for issue to the proposed members. The proposed company, being limited by shares, would have its capita divided into a number of shares of a fixed amount. Once those shares are issued there would be no more shares to be issued, unless the company in general meeting passed an ordinary resolution altering its capita pursuant to s.63 of the Act by increasing its share capita by new shares of such nominal value as is thought to be expedient.

- (b) **Transfer of shares**

As a general rule, a member's shares in the company are items of property which he is legally entitled to dispose of at any time and to whoever he pleases. Consequently, he cannot be stopped from doing so unless the company's articles are suitably worded in order to confer on the director's power to refuse to register a proposed transfer of shares unless the consent of the rest of the members to the proposed transfer has been obtained. The restrictions would be within the principle enunciated by the court in *Re: Smith & Fawcett Ltd* that a shareholder's right to transfer his shares is not an absolute right, and that it can be restricted by articles which are clearly drafted to confer the restrictions on transfer. The shareholder would then be bound by the provisions of the articles, as illustrated by *Lyle & Scott Ltd v Scott's Trustees*.

- (c) **Finance and membership**

- (i) **Finances**

The Companies Act requires every company having a share capital to annex to its annual return to the registrar of companies a statement of its share capita and debentures, a copy of every balance sheet and profit and loss account laid before the company in general meeting during the accounting period to which the return relates, as well as the director's report and a copy of the auditor's report. These documents are available at the company's registry for public inspection, and the company's finances will become public knowledge to the extent that the documents reveal them.

- (ii) **Membership**

S.112 of the Act requires every company to keep a register of its members. S.115(1) of the Act provides that the register shall be open to the inspection of any members without charge and of any other person on payment of two shillings, or such less sum as the company may prescribe for each inspection.

- (d) It will not be possible for an outsider to sue a member for recovery of money owed to him by the company. This was explained in *Salomon v Salomon & Co. Ltd* and is the general rule. However, it would be possible for the outsider to sue a member under s.33 of the Act if the company's membership had fallen below the statutory minimum and the company continued to trade thereafter for a period exceeding six months. A member who was cognizant of the

membership having so fallen would be personally liable for the debts of the company contracted after the six months and could be sued personally to recover the said debts

ANSWER 2

The remedies available to Mwangi will depend on whether the untrue statement was an innocent or fraudulent misrepresentation, as was defined by the House of Lords in the case of Derry v. Peek. A.

A. If it was an **innocent misrepresentation**, i.e. it was made without any desire to mislead Mwangi and the maker believed it to be true, as explained in Derry v. Peek, then:-

1. AGAINST THE MAKAA CO. LTD

- (a) No damages can be awarded: DERRY v. PEEK.
- (b) Mwangi may be able to rescind the contract of allotment and recover his money. However, he will not be able to rescind if:-
 - (i) He has **affirmed** the contract after discovering the truth, e.g. by accepting dividends, attending or voting at any of the company's meetings or attempting to sell the shares.
 - (ii) Third parties have acquired rights to the shares in the meantime.
 - (iii) The company has gone into liquidation:
HOULDSWORTH v. CITY of GLASGOW BANK
 - (iv) He has delayed in taking rectification proceedings after discovering the truth: **RE: FIRST NATIONAL RE-INSURANCE CO. GREENFIELD**

2. AGAINST THE DIRECTORS AND PROMOTERS OF MAKAA CO. LTD.

Mwangi may institute an action for **compensation** under s.45(1) of the Companies Act. The directors and promoters are **prima facie liable** to him unless they can avail themselves of the defenses listed in Section 45(2) of the Companies Act. They will be liable though the statement was innocently made if it is proved that they had no reasonable grounds to believe that the untrue statement was true.

B. If the untrue statement was a **fraudulent misrepresentation**, that is, it was made knowingly, recklessly or without belief in its truth (DERRY v PEEK) then Mwangi may have the following remedies:-

1. AGAINST THE MAKAA CO. LTD.

He may institute an action for damages against the company provided that he is in a position to rescind the contract of allotment: **HOULDSWORTH v CITY OF GLASGOW BANK.**

2. AGAINST THE DIRECTORS AND PROMOTERS OF MAI(AA CO. LTD

He may institute an action for compensation as indicated in A(2) above. The defendants are prima facie liable to him unless they successfully plead the defenses under Section 45(2) of the Companies Act.

LESSON 3

ANSWER 1

A share certificate is a document issued by a company and which states the name of a shareholder in the company, the number and description of the shares held by him and the amount paid on the shares.

It has been judicially described as "a declaration by the company to al the world that the person in whose name the certificate is made out and to whom it is given is a shareholder of the company with the intention that it shall be acted upon in the sale and transfer of shares". **Re: Bahia & San Francisco Railway Co.** A company must therefore take great care when issuing share certificates so as to avoid stating therein what is incorrect. If a company negligently issues a certificate that is incorrect in some material particulars it may be **estopped** from denying the correctness of the stated facts if a third party bought the shares in reliance thereon. This may be illustrated by:-

- (i) **Re: Bahia & San Francisco Railway Co.** in which the company was estopped from denying the title of the person who had been named in the certificate as the registered holder of the specified shares.
- (ii) **Burkinshaw v. Nicolls** in which the company was estopped from denying that the specified shares had been **fully paid** as stated in the certificate.

ANSWER 2

The legal consequences for H. Ltd. will depend on whether G. has transferred the shares to a bona fide purchaser who had no notice of the company's mistake.

- (i) If G. has **not** transferred the shares, the company would be entitled to ask him to surrender the certificate for cancellation in order that a new certificate for 250 shares may be issued to him. This is because s.83 of the Companies Act provides that, between the company and G., the certificate is merely a **prima facie** evidence of his title. This means that G may be called upon to prove that he holds 2,500 shares in the company as stated in the certificate and if he fails to do so the company can cancel the certificate and issue a new one for 250 shares. G cannot plead estoppel against the company because he knew the true facts and was not prejudiced by the misstatement.
- (ii) If G. has transferred the shares, H. Ltd. will be estopped from denying that he held 2,500 shares. The company will therefore be compelled to compensate the purchaser by paying him the amount which he paid to G. for the 2,250 non-existent shares or buying other 2,250 shares in the market in order to register them in his name: **Re: Bahia & San Fransisco Railway Co.; Sheffield Corporation v. Barclay.**

LESSON 4**ANSWER 1**

The remedies which are available to an ultra vires lender were explained by Buckley, J in **Re: Birkbeck Permanent Benefit Building Society** as follows:

- i. If the result of the transaction is that the indebtedness of the borrowing company is not increased because the new loan was used to discharge an **old debt**, the ultra vires lender would be treated as standing in the place of those **intra vires** creditors whose debts have been paid off. In such a case the ultra vires loan is not regarded as a loan.
- ii. If the result of the transaction is that the indebtedness of the borrowing company is not increased because the new loan was used to discharge a **future debt** (i.e. an indebtedness which was incurred after the money was borrowed), the ultra vires lenders would again be treated as standing in the place of those intra vires creditors whose debts have been paid off.

The basis of this remedy is that, since the company could legally become indebted in respect of the future debt, the lender whose money discharged it would be subrogated to the rights of the discharged creditor. However, he would be entitled to rank as a creditor of the company only to the extent to which his money was applied in discharging the intra vires debt(s). He would also not obtain the benefit of any security which had been given to the **intra vires** creditor. He would however be entitled to enforce any security which was given to him.

- iii. If the ultra vires lender can identify his money or the investment of his money in the hands of the borrowing company, he can call for its return. This is because "a company or other statutory association cannot by itself or through an agent be party to an ultra vires act. If its directors or agents affecting to act on its behalf borrow money which it has no power to borrow, the money is in their hands the property of the lender": **Sinclair v Brougham (per Lord Parks)**.

An ultra vires lender who cannot avail himself of one of the aforesaid remedies would be entitled to participate in the division of the company's surplus assets, if any, which would be divisible among the **ultra vires** creditors rateably during the company's liquidation after all the company's members have received back their capita in full.

ANSWER 2**1. APPOINTMENT OF DIRECTORS**

The appointment of a company's directors is governed by the provisions of the company's articles of association. In the absence of such provisions the provisions of Table A be as follows:

Table A, Article 75 provides that the **number** of the directors and the **names** of the first directors shall be determined in writing by the subscribers of the memorandum of association, or a majority of them. The signatories to the memorandum of association shall be the first directors unless and until they appoint the first directors.

Article 89 provides that at the first annual general meeting of the company all the first directors shall retire from office. This is to enable the members of the company to elect directors of their choice.

At the annual general meeting in every subsequent years one-third of the directors for the time being, or, if their number is not three or a multiple of three, then the numbers nearest one-third, shall retire from office.

The directors to retire in every year shall be those who have been longest in office since their last election, but as between persons who became directors on the same day those to retire shall (unless they otherwise agree among themselves) be determined by lot.

Article 91 provides that a retiring director shall be eligible for re-election.

By Article 92, the company at the meeting at which a director retires may fill the vacated office by electing a person thereto. In default of such election the retiring director shall if offering himself for re-election be deemed to have been re-elected, unless at such meeting it is expressly resolved not to fill such vacated office or unless a resolution for the re-election of such director shall have been put to the meeting and lost.

Article 93 provides that no person other than a director retiring at the meeting shall, unless recommended by the directors, be eligible for election to the office of director at any general meeting unless not less than three nor more than twenty-one days before the date appointed for the meeting there shall have been left at the registered office of the company notice in writing signed by a member duly qualified to attend and vote at the meeting for which such notice is given, of his intention to propose such person for election, and also notice in writing signed by that person of his willingness to be elected.

Article 94 empowers the company from time to time by ordinary resolution to **increase** or **reduce** the number of directors and to determine in what rotation the increased or reduced number is to go out of office.

Article 95 empowers the directors at any time, and from time to time, to appoint any person to be a director either to fill a casual vacancy or as an addition to the existing directors provided that the total numbers of directors does not at any time exceed the total number of directors fixed by the general meeting.

2. **DISQUALIFICATION OF DIRECTORS**

The circumstances in which a director may be disqualified from holding office of director are, in the absence of other provisions in the company's articles, governed by Table A, Article 88 and are as follows:

- i. The director fails to obtain the share qualification (if any) within two months, or within two months, or within the shorter period prescribed by the company's articles of association. This provision incorporates Section 183(3) of the Companies Act.
- ii. The director attained the age of seventy. This provision incorporates the provisions of Section 186(2). This provision only applies to directors of a public company.
- iii. The director becomes bankrupt or makes any arrangement or composition with his creditors generally.
- iv. The director becomes of unsound mind.

3. REMOVAL OF DIRECTORS

Section 185(1) of the Companies Act provides that a company may by ordinary resolution remove a director before the expiration of his period of office, notwithstanding anything in its articles or in any agreement between it and him.

ANSWER 3

- (a) Since there was no clause in the memorandum of association regarding the paper manufacturing business, the company **had no expressed power** to undertake the business: **ASHBURY RAIL CO. v. RICHE** - where it was stated that a transaction which is beyond a company's objects in the memorandum is beyond the company's powers and illegal.

Although the company had no express power to undertake the paper manufacturing business it does not necessarily mean that the business was **ultra vires** the company. It could be **impliedly authorised** by the memorandum within the principles enunciated by the House of Lords in **A.G. v. G.E. Rly Co.** and other relevant cases. If it was incidental to, or consequential upon the company's objects and was done to effectuate them. If so, the legal position would be as follows:-

- (i) If the manufacture of the paper was reasonable incidental to the stated objects and was undertaken to effectuate them, the company had implied power to undertake it. The borrowing would be valid and security enforceable: **A.G. v. G.E. Rly Co.**
- (ii) If the manufacture of the paper was NOT reasonably incidental to the stated objects, the company had no implied power to undertake the business and, since it also had no express power to carry on the business, the transaction would be illegal and void. The security given would also be void and unenforceable: **RE INTRODUCTIONS LTD.**
- (b) If the ordinary resolution was not passed by the members, the transaction would be **intra vires**, the company and its borrowing valid and binding on the company notwithstanding the director's lack of authority to undertake it. The passing of an ordinary resolution was, according to **ROYAL BRITISH BANK v. TURQUAND**, an "indoor management" condition which the lender was entitled to assume that the directors had complied with. The security given is valid and enforceable against the company.
- (c) The passing of a special resolution is not an "indoor management" requirement but an essential condition which "A" Ltd. was bound to check whether it had been complied with. If the resolution had been passed it would have been delivered for registration under S.143 of the Companies Act and a copy thereof would have been available for "A" Ltd. to verify. A Ltd. is therefore presumed, under the constructive notice rule, to have been aware that the resolution had not been passed.

B Ltd. is therefore only liable to the extent of Shs.100,000 which is the amount which the directors were authorised to borrow without a special resolution: **IRVINE v. UNION BANK OF AUSTRALIA.**

LESSON 5**ANSWER 1**

In *Sharp v. Dawes* the judge stated that prima facie, the word "meeting" means "a coming together of more than one person". There is therefore, legally, no meeting if only one person attends a proposed meeting, or if all persons who attended the meeting leave and only one person is left.

The above rule will not apply if:

- (a) The meeting is an annual general meeting which is held pursuant to s.131(2) of the Act. The said section provides that if default is made in holding the annual general meeting of a company in accordance with s.131(1) the registrar may, on the application of any member of the company, call or direct the calling of a general meeting of the company and give such ancillary or consequential directions as the registrar thinks expedient. The directions which the registrar may give include "a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting".
- (b) The meeting is held pursuant to s.135(1) of the Act. The section provides that if for any reason it is impracticable to call a meeting of a company in any manner in which meetings of that company may be called, or to conduct the meeting of the company in manner prescribed by the article or the Act, the court may, either of its own motion or on the application of any director of the company or of any member of the company who would be entitled to vote at the meeting, order a meeting of the company to be called, held and conducted in such manner as the court thinks fit. Where any such order is made the court may give such ancillary or consequential directions as it thinks expedient, including a direction that "one member of the company present in person or proxy shall be deemed to constitute a meeting". The power of the court in this regard was exercised in the leading case of *Re: El Sombrero Ltd.*
- (c) If the meeting is a class meeting which is held to authorize a variation of some right(s) attached to a class of shares and it happens that all the shares of that class are held by one person. Such a person would constitute a meeting for purposes of giving the requisite authority to vary the relevant rights. This was explained in *East v Bennett Brothers Ltd.*
- (d) The meeting is an adjourned meeting and the articles provide that "a member or members present shall be deemed to constitute a quorum".

ANSWER 2

- a. The legal principle in the case of **Salomon v Salomon & Co. Ltd.** is that: " the company is at law a different person altogether from the subscriber to the Memorandum" (per Lord Macnaghten). It has rights and liabilities or obligations of its own which are distinct or separate from those of its members.

The exception to the principle in **Salomon v Salomon & Co. Ltd.** are the instances in which "the veil of incorporation is said to be lifted and this may occur under the provisions of the Companies Act or judicial interpretation".

1. Lifting of the veil under the Companies Act.

This will occur in the following instances:

- i. When a member or members are made personally liable for the company's debts incurred after six months of a company's trading with less than the statutory minimum membership. The debts are paid by the members as if they were his/theirs debts, contrary to the decision in *Salomon v Salomon*, in which Salomon, a member, was held not liable for the company's debts.
- ii. When a company's officer or agent is made personally liable for the company's debts incurred at a time when the identity of the company was not made known to the other party by the failure to publicise the company's name as required by the Act.
- iii. When the accounts of a holding company are combined with those of its subsidiaries to form group accounts, as if the holding company and its subsidiary were one entity.
- iv. When an inspector is appointed to investigate a company's affairs also investigates of any other related company as if the two companies were one entity.
- v. When an inspector appointed to investigate a company's membership also investigates the membership of any other related company as if the two companies were one entity.
- vi. When the courts regard a take over bid made by a company as being in substance made by the company's members, as is illustrated by the case of *RE: BUGLE PRESS LTD*.
- vii. When misfeasance proceedings are instituted during a company's winding up against persons who were responsible for conducting the company's trading affairs fraudulently.

2. Lifting the veil under judicial interpretation

The veil of incorporation have been lifted but the courts in the following instances:

- i. When an wholly owned subsidiary company carrying on the holding company's business was held in ***Smith, Stones & Knight v Birmingham Corporation*** to be the agent of the latter. This decision was an exception to the principle stated in *Salomon's* case that a company is not the agent of the subscribers.
- ii. When the residence of the majority shareholder(s) who is controlling the company's affairs is held for purposes of taxation to be the residence of the company also, as if the company and the shareholder(s) were one person. This may also govern enemy status or subjection to the jurisdiction of Kenya Courts (*Daimler v. Continental Tyre Co. Ltd.*).
- iii. When an informal decision of a company's members is also regarded as the decision of the company authorising payment of director's remuneration: *RE: DUOMATIC LTD*
- iv. When a breach of contract by a member was regarded in ***Jones v. Lipman*** as a breach of contract by the company and specific performance decreed against both the company and member.
- v. When a company was held to be an enemy on the ground of PUBLIC POLICY because

its members were Germans and legally enemies of England during the Second World War: **Daimler Ltd v Continental Tyre Co. Ltd.**

- vi. When a vehicle belonging to a Mutual Benefit Society Incorporated as a company was said to belong to its members to whom the coal was being delivered in the vehicle: **Trebanog Working Men's Club v Macdonald.** The Society was therefore NOT liable for presentation for a quasi-coime of contravening the terms of the vehicle's license.
- viii. When an employee of a holding company (Mr. Caddies) was also declared to be an employee of a subsidiary company to which his services had been transferred against his will: **Houdsworth Co. v Caddies.**

b. i. **ADVICE TO CLIPSE LTD.:**

The material facts of the case are substantially the same as the material facts of **Gildford Motors Co. v Horne** in which the veil was lifted and the defendant Horne and the company he had formed were restrained from soliciting the plaintiff's customers in breach of a clause in this contract of employment.

I would advise Clipse Ltd. to sue Walter and Desks Ltd. The company would be regarded as Walter's "alter ego" and restrained from committing a breach of the contract between Walter and Clipse Ltd.

ii. **ADVICE TO WILF:**

I would advice Wilf to sue Walter for breach of contract and ask the court to decree specific performance against Walter and Desks Ltd.

My advice would be based on **Lipman v Jones** case whose material facts are substantially the same as the given facts. The court would regard Walter and Desks Ltd. as one person and order the company to transfer the house to Wilf. The court would not allow Walter to evade a contractual obligation by incorporating a company for that purpose.

LESSON 6**ANSWER 1**

- (a) The Companies Act requires every company to appoint an auditor, who must normally be a member of a recognized professional accountancy body. The auditor must report to the members on the accounts examined by him, on every balance sheet and profit and loss account, and, where applicable, on group accounts. He should exercise reasonable care in discharging them: **RE CROWN BANK**. The primary duty of the auditor is to carry out such investigations as will enable him to form an opinion that the accounts have been properly prepared, and to state whether the accounts give a true and fair view.

According to case law, the auditor is not expected to be suspicious but reasonably careful. However, if his suspicion is aroused then he must investigate the matter exhaustively, i.e. he must "go to the bottom". The auditor, in the course of his work, must comply with the auditing procedures which have been recommended by the Institute of Certified and Public Accountants of Kenya. His failure to do so would be prima facie evidence of negligence and, hence, a breach of his duty to the company.

(b) **Duties to prospective investors**

The duties of the auditor to prospective investors have not been fully explained by the courts, either in Kenya or England. However, it is generally believed that an auditor owes a wider duty of care whenever there is a 'special relationship' between him and other persons who rely on the accuracy of his work. This belief is based on inferences from the House of Lords decision in Hedley Byrne & Co. Ltd v Heller & Partners Ltd.

The auditor might also be liable in negligence to third parties whom he was aware would rely on his report in making a decision on whether to invest money in the company. It is submitted that such liability would be in negligence under the "neighbour principle" in *Donoghue v Stevenson*.

ANSWER 2

- a. The advantages and disadvantages that a company enjoys in securing its debentures by way of a floating charge are:
- i. It enables the company to create a charge over assets over which the company would find it impracticable to create a fixed charge, i.e. assets which are constantly changing in the course of business.
 - ii. The company is allowed to deal with the assets charged in the course of its business as if they had not been charged. Accordingly, the company can dispose of the assets and in doing so free them from the charge; and incoming after-acquired assets will equally be subject to it.
- b. The general rule as to priorities between fixed and floating charges is that a later fixed charge will take priority over an earlier floating charge, because of floating charge does not attach to specific property until it crystallizes.

As between themselves, floating charges rank in order of creation except that a general floating charge on the whole undertaking may be deferred to a subsequent specific floating charge on a particular class of assets: **RE AUTOMATIC BOTTLE MAKERS**

- c. A floating charge crystallizes when some default occurs and the debenture holder takes steps to enforce his security-usually by appointing a receiver or by seeking an appointment by the court. Default occurs-
- i. In the circumstances specified in the debentures or the debenture trust deed for example, when the company fails to pay the principal or interest as they fall due, or when the company ceases trading.
 - ii. On winding-up. This event will normally be specified in the debenture or trust-deed as one which allows the lenders to appoint a receiver. It differs from (i) above in that the charge **automatically** crystallises on winding-up, even if the debenture holders have taken no steps to enforce their security.
- d. The provisions which ought to be included in a debenture trust deed for the benefit of a creditor that is to lend money to a company, on the security of a floating charge is a clause to the effect that the company shall not create a subsequent fixed charge over the same class of assets within the floating charge. If the holder of a later fixed charge **takes within notice of such restriction** he would probably be deferred to the floating charge but it is uncertain whether the mere registration of the debenture securing a floating charge under s.96 of the Companies Act, without specific mention of the above restriction, is constructive notice to the world at large, not only of the existence of the debenture but of all its clauses including the restriction: RE: VALLETORT SANITARY CO. LTD.-in which it was held that registration of the charge constituted constructive notice of its existence but not of its contents.

LESSON 7**ANSWER 1**

Section 211(1) of the Companies Act provides that any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself), may make an application to the court by petition for an order under the section. S.211(1) further provides that if on any such petition the court is of opinion -

- (a) that the company's affairs **are being conducted** as aforesaid; and
- (b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound, the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

The order which the court makes may be for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company.

No Kenya cases appear to have been contested under the section. However, numerous cases that were instituted by minorities in English courts were all dismissed except two cases only, namely—

- (i) Scottish Wholesale Co-operative Society Ltd v Meyer, and Another
- (ii) Re: H.R. Harmer.

- (c) that the petitioner and others were being oppressed as members qua member.
- (d) that the oppressive conduct was continuous.

The English courts dismissed the other cases on highly technical grounds such as -

- (a) there was no "oppression" established: **Re: Five Minute Car Wash Ltd**—the oppression envisaged by the section being some "visible departure from the standards of fair play";
- (b) the petitioner had not been "oppressed" as a member but in some other capacity: **Elder v Elder & Watson**
- (c) what was complained of was an isolated act of impropriety rather than a continuing process of wrongdoing or oppression; and
- (d) the petitioner had failed to establish that the facts complained of justified a winding up of the company on the grounds that it was "justified and equitable" to do so.

This judicial interpretation of the section rendered it ineffective as a minority protection section in English. The same would be the case in Kenya if Kenyan courts were to adopt the same restrictive and literal interpretation of the English Courts.

However, the existence of the section may act as a deterrent by restraining majorities in companies from acting unfairly towards the minority. For the section gives some hope of going to court to obtain relief from oppression—although the success of the petition is not guaranteed. To that extent, Professor Gower's statement that the section "will probably always prove more potent when brandished in terrorem than when actually used to strike" seems to be justified.

ANSWER 2

The veil of incorporation has been disregarded, or lifted, by the courts in numerous instances. The following are some of the instances:

1. Agency or trustee or nominee

In **Salomon v Salomon and Co. Ltd.** Lord Cairns stated that ..."the company is **not** at law the agent of its members."

This statement constitutes the other aspect of the basic legal principle known as "the veil of incorporation". In this context, the principle would be disregarded -and 'the veil lifted'-if a company were to be regarded as an agent of its members. For example, in **Firestone Tyre & Rubber Co. Ltd v Lewellin** a wholly - owned subsidiary company was regarded, on the basis of the trading arrangements between the two companies, as the agent of an American holding company which had incorporated it in England to manufacture and sell in Europe the holding company's brand of tyres.

2. Determination of Character

In **Salomon v Salomon & Co. Ltd** Lord Macnaghten stated that "the company is at law a different person altogether from the subscribers to the memorandum". This means, inter alia, that the subscribers residence will not be the company's residence.

In **Daimler Co. Ltd v Continental Tyre and Rubber Co. Ltd** the House of Lords held that the plaintiff company was **resident** in Germany because:

- (i) all except one of its shares were held by persons resident in Germany, and
- (ii) all the directors resided in Germany.

By regarding the subscribers' residence as the company's residence the court "lifted the veil" and treated the subscribers to the memorandum and the company as one entity.

3. Ratification of Corporate Acts

Because of the legal separation between a company and its members, a decision made by the company's members **as individuals** is not generally regarded as the company's decision.

In **Re Express Engineering Works Ltd.** the court held that a transaction which had been unanimously assented to by all the shareholders of the company was binding on the company although the assent had not been given at a members' general meeting. The court thereby "lifted the veil" of incorporation by equating an informal assent of the members with an assent of the company itself.

4. Fraud and Improper Conduct

The courts have intervened on numerous occasions and 'lifted the veil' of incorporation in order to prevent something fraudulent or improper from taking place.

In **Jones v Lipman** the defendant had attempted to avoid having to complete a sale of his house to the plaintiff by transferring it to a company formed for the purpose. Both the defendant and the company were ordered to specifically perform the contract with the plaintiff.

The court thereby "lifted the veil" by regarding a breach of contract by the subscriber as a breach of contract by the company itself.

5. **Group Enterprises**

Numerous instances of lifting the veil have occurred in transactions or arrangements involving a number of companies within a group.

In **Holdsworth & Co Ltd. v Caddies** the court held that there had been no breach of Mr Caddies' contract as managing director when the directors of the appellant company resolved that he should confine his attention to one of the subsidiary companies within the group and cease to act as the group's managing director.

This decision constitutes an instance of lifting the veil because the court regarded a company (i.e. the subsidiary company) as being the same entity as the subscribers (i.e. the holding company). In effect, Mr Caddies would be working for the holding company at the time he was working in the subsidiary company.

Another instance of lifting the veil in the case of group enterprises is **The Roberta** where a holding company was held liable on a bill of exchange signed on behalf of its wholly owned subsidiary. The court stated that the subsidiary was "a separate entity ... in name alone, and probably for the purposes of taxation."

6. **Determination of residence**

Judicial authority has it that a company resides in the country in which its affairs are controlled and managed from since companies are managed by human beings, to ascertain a company's residence therefore, it is necessary to pierce the shell. As was the case in **De Beers Consolidated mines Ltd V. Howe (1906)**

LESSON 8**ANSWER 1****Voluntary winding up:**

It is voluntary because the company in general meeting, usually by a three quarters majority of votes to pass a special resolution, decides to go into liquidation: Companies Act s.271 (there is also a little used procedure for winding up by passing an ordinary resolution).

The winding up is deemed to commence at the passing of the resolution. A voluntary winding up is a creditors' voluntary winding up unless the directors make and file at the Companies Registry a statutory declaration of solvency: s.276. The declaration is made by all the directors, or if there are more than two directors, by a majority of them. It states that after proper enquiry the directors are satisfied that the company will be able to pay its debts in full within a specified period of not more than 12 months. It has a statement of assets and liabilities attached.

The declaration should be made not more than 30 days before the meeting at which the resolution to wind up is passed and not later than just before the meeting. It must be delivered to the Companies Registry before the meeting: s.276(2)(a).

If it later appears that the company is unable to pay its debts in full the directors may be punished by fine or imprisonment unless they can show that they had reasonable grounds for making their declaration. The liquidator calls a meeting of creditors to report that the company is insolvent.

When a declaration of solvency is duly made the liquidator proceeds as a members' voluntary winding up. The members in general meeting resolve by special resolution to wind up and to appoint a liquidator. When the liquidator needs approval for the exercise of statutory powers he convenes a general meeting for the purpose. The liquidator assumes many of the functions of the directors but they retain some powers and continue in office.

In a creditors' voluntary liquidation the directors convene a general meeting to pass an extraordinary resolution to wind up on the grounds that the company cannot pay its debts. The meeting also nominates a liquidator.

It is the duty of the directors to convene a meeting of creditors to be held after the general meeting of members and in any event not later than the following day. Although members may ordinarily waive the period of notice for a general meeting, there is a minimum period of seven days notice in this case.

The creditors' meeting is presided over by a director who lays before it a financial statement. The meeting nominates a liquidator. If the two meetings nominate different liquidators, the liquidator chosen by the creditors is appointed unless the members appeal to the court and the court upholds their objections.

The meetings of members and creditors may each appoint up to five of their number to be members of a committee of inspection to work with the liquidator.

In a creditors' voluntary winding up whenever the liquidator calls a meeting of contributories (past or present members) he also calls a meeting of creditors.

Compulsory winding up:

It is compulsory because the court makes an order that the company shall be wound up. The winding up is deemed to commence on the date when the petition to the court is first presented, i.e. the order is retrospective when made.

The petition to the court should specify one of the various grounds contained in s.219. There are seven grounds in all but almost all petitions are based on either

- (1) the company's inability to pay its debts, or
- (2) the 'just and equitable' ground.

In case (1) the petitioner is a creditor claiming a debt of more than Shs.1,000.

In case (2) the petitioner is a contributory. He must have been a registered shareholder for at least **six of the previous 18 months**, unless he acquired his shares direct from the company as an allottee or by inheritance from a deceased shareholder. s.221.

When the petition is presented to the court a copy is delivered to the company. The petition is also advertised so that any creditors or other interested parties may be aware of it.

After an interval of say three months the court hears the petitioner and any other interested persons and either makes an order or refuses to do so.

The order is retrospective to the presentation of the petition so that any disposition of the company's assets in the interval of any transfer of its shares is open to review. Such transactions are invalid unless approved by the court.

As soon as an order for compulsory liquidation is made the Official Receiver, who is an official of the High Court, becomes provisional liquidator (unless the court has already appointed a provisional liquidator at an earlier stage).

The Official Receiver convenes separate meetings of contributories and of creditors to obtain nominations of a permanent liquidator and members of a joint committee of inspection. He reports the nomination to the court which usually makes the appointments proposed. The Official Receiver continues as liquidator if no other liquidator is appointed.

The Official Receiver also receives a financial report, usually by the directors, in the form of a statement of affairs. He in turn reports to the court.

An order for compulsory liquidation terminates the appointment of the directors and any contracts of employments which they have with the company.

Comparison

The main difference is that in voluntary liquidation the court is not involved. The liquidator may however apply to the court for any order which it would make in a compulsory liquidation.

In a compulsory liquidation the liquidator (if not the Official Receiver) is an officer of the court (although he is usually an accountant in private practice who specialises in insolvency work).

A compulsory liquidation order is retrospective to the date of the petition. A resolution to wind up voluntarily takes effect only when passed and is not retrospective.

ANSWER 2

- (a) I would advise the supplier of oil that he may not sue Threads Ltd for the price of the oil.

My advise would be based on the decision of **Re Jon Beauforte Ltd** in which the material facts were substantially the same as those of the case before us. In the case of **Re Jon Beauforte Ltd** the judge stated that since the company had ordered the coke on a letter which also described it as "manufacturers of veneered panels", the supplier of the **coke had actual notice** that the company was manufacturing veneered panels and was ordering the coke for that purpose. As he had **constructive notice** of the company's objects, he had actual notice that the coke was being bought for an ultra vires purpose since the manufacture of veneered panels was not one of the company's objects. He had therefore entered into an ultra vires contract of sale **knowingly** and could not sue to enforce it.

Applying the above reasoning to the case before us, it can be said that since the **notepaper** describe Threads Ltd. as "paper manufacturers" the supplier of oil had actual notice that the oil was being ordered for use in the manufacture of paper. As he had **constructive notice** of the objects of threads and they knew that they did not include paper manufacturing, he had actual notice that the oil was being ordered for an ultra vires purpose. He had knowingly entered into an ultra vires contract and cannot sue to enforce it.

The alternative for the supplier of oil is to recover back oil itself as it still exists. The Sale of Goods Act defines a sale as a contract whereby the seller **transfers** the ownership of the goods to the buyer. If there is **no contract**, no sale can take place. If goods have been delivered on the mistaken belief that a contract exists the apparent seller retains the ownership of his goods while the apparent buyer merely acquires their possession. The seller is entitled to recover possession of the goods from the buyer as soon as he becomes aware of the actual position.

In this case Threads Ltd. merely acquired possession of the oil. The contract of sale, being ultra vires and void, did not vest ownership of the oil in them. The oil remained the property of the supplier who is entitled to recover it. This is the remedy of restitution and is available to a party to an ultra vires transaction: **Re Birkbeck Permanent Benefit Building Society Ltd.**

- (b) The general rule is that a minority shareholder cannot sue in respect of wrongs done by the company's directors; **Foss v Harbottle**. However, this rule is subject to certain exceptions. One of the exceptions is where the act complained of is **ultra vires and illegal**. In such a case a minority shareholder is entitled to institute proceedings in respect thereof since there is no chance of the wrong complained of being ratified by the company's general meeting.

Atieno may therefore sue to restrain the company from carrying on the business of paper manufacturers which is ultra vires.

PAST CPA EXAMINATION PAPERS

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATION BOARD

CPA PART III

LAW II

THURSDAY: 7 JUNE 2001

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks

QUESTION ONE

(a) To what extent does the doctrine of constructive notice operate negatively? (4 marks)

(b) Y Ltd. whose articles are similar to Table A, publish a weekly magazine. In one issue an article is critical of the policies of the city commission. A number of Commissioners who are also members of the company requisition a general meeting and secure the passing of an ordinary resolution ordering the company to publish in the next issue a withdrawal of the criticism. The directors of the company are adamant.

The angry commissioners approach you for the purpose of filing an action to compel the directors to publish a withdrawal.

Advise them. (12 marks)

(c) In what circumstances may a company accept shares surrendered by a member? (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) Explain the remedies that are available to an investor who has been induced to take shares by false statements made in a prospectus. (4 marks)

(b) Explain how the capital of a company may be:

(i) altered; (4 marks)

(ii) reduced (4 marks)

(iii) increased (8 marks)

(Total: 20 marks)

QUESTION THREE

(a) What are the salient duties and powers of the Chairman of a general meeting of a company? Illustrate your answer with reference to decided cases. (10 marks)

(b) Outline the classes of persons who may effectively demand for a poll during a general meeting. (5 marks)

(c) Section 143 (1) of the Companies Act Cap 486 provides that "A printed copy of every resolution or agreement to which this Section applies shall, within 30 days after the passing or making thereof, be delivered to the registrar for registration".

Identify five resolutions or agreements registrable under this section. (5 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) What books of account is a company required to keep and what provisions regulate group accounts? (8 marks)
- (b) Analyse the circumstances under which the group accounts of a company need not deal with a subsidiary of the company. (6 marks)
- (c) In what circumstances may a public company register a statement in lieu of prospectus with the registrar? (6 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) What are the advantages and disadvantages of a floating charge to a debenture holder? (8 marks)
- (b) Outline the exceptions to the general prohibition on financial assistance by a company for the purchase of its own shares. (6 marks)
- (c) Outline the circumstances under which a floating charge will crystallise (6 marks)
- (Total: 20 marks)**

QUESTION SIX

- (a) Explain five circumstances under which the veil of incorporated may be lifted by the court. (10 marks)
- (b) Name and briefly explain four classes of persons who may incur civil liability in respect of a false statement in a prospectus. (4 marks)
- (c)
- (i) Explain the doctrine of *ultra vires* with regard to the objects of a company. (2 marks)
 - (ii) State the effects of *ultra vires* transactions. (2 marks)
 - (iii) What are the purpose of the rule? (2 marks)
- (Total: 20 marks)**

QUESTION SEVEN

In the context of voluntary winding up, explain the statutory provisions regarding the powers of the liquidator which may be exercisable:

- (i) with the court sanction (10 marks)
- (ii) without the court sanction. (10 marks)
- (Total: 20 marks)**

QUESTION EIGHT

- (a) Detail the conditions that have to be satisfied before an applicant can bring an action successfully under the exception to the Rule in **Foss v Harbottle**. (10 marks)
- (b) Naliaka owns 10% of the issued shares in Pendo Limited. There are two directors Wanyonyi and Wafula who have an eccentric style of management. They own 45% of the issued shares. Naliaka understands that Wanyonyi and Wafula want to merge Pendo Ltd. with another more profitable company that the two directors wholly own.

If this plan goes ahead, Naliaka's shareholding will be reduced to 3% of the merged business. Naliaka is financially dependent on the dividends she gets from Pendo Limited and that future dividends may be much less.

Advise Naliaka of her legal position and protection under the law if any. (10 marks)

(Total: 20 marks)

KENYA ACCOUNTANTS AND SECRETARIES NATIONAL EXAMINATION BOARD**CPA PART III****LAW II****THURSDAY: 6 December 1996****Time Allowed: 3 hours.****Answer any FIVE questions.****ALL questions carry equal marks****QUESTION ONE**

Maneno and three of his friends recently retired from the Civil Service under the voluntary retirement scheme. They intend taking advantage of the on-going Structural Adjustment Programmes (SAPs) by going into business.

(a) Advise them on the procedures they have to follow in order to register a public company limited by shares. (16 marks)

(b) Explain to them how the procedure would differ from that for forming a private company limited by shares. (4 marks)

(Total: 20 marks)**QUESTION TWO**

(a) Define a foreign company and describe the documentary information which it must display at its place of business. (14 marks)

(b) A and B is a German company that established an office in Eldoret way back on 3 February 1962. Briefly discuss the validity of the following acts:

(i) a certified copy of its memorandum and articles of association was in both German and English.

(ii) the company's official documents were lodged with the registrar on the 28th day after establishment.

(iii) the principal place of business was switched from Eldoret to Mombasa and notice thereof given after 30 days. (6 marks)

(Total: 20 marks)**QUESTION THREE**

Write short notes on the following:

(a) Issued share capital; (5 marks)

(b) The difference between shares and debentures; (8 marks)

(c) Capitalisation of profits; (4 marks)

(d) A holding company. (3 marks)

(Total: 20 marks)**QUESTION FOUR**

(a) In what circumstances, if any, will a director be treated as an agent of the company? (14 marks)

(b) The directors of Ujenzi Ltd. diverted some funds meant for the extension of the commercial wing of the company's business premises to fund the expensive wedding of a son of one of the directors. At that particular time, Tony Lemata was the Secretary. He eventually became a director. At Lemata's very first board meeting, the earlier breach was ratified.

To what extent, if any, would Lemata be liable for the earlier breach? (6 marks)

(Total: 20 marks)**QUESTION FIVE**

Discuss in detail the rule and exceptions in *Royal British Bank v Turquand*

(20 marks)

QUESTION SIX

- (a) Do the majority of directors have a right to exclude an unpopular shareholder from attending the meetings of a company? (8 marks)
- (b) For three consecutive years, Kichwa Ngumu has been a member of Wazalendo Company Ltd., a company incorporated in Kenya in 1980 under the Companies act, Cap. 486. During this time, he has not received any notice of the company's meetings. Other members of the company have always excluded him from such meetings because he is "normally controversial". Kichwa Ngumu is now contemplating petitioning the High Court of Kenya for the compulsory winding up of Wazalendo Company Ltd. because of the treatment to which he has been subjected by the company.

As his lawyer, he seeks your advise on the following matters:

- (i) Does he have a *locus standi* to petition for winding up under Cap. 486? (2 marks)
- (ii) On what grounds can he advance under the provisions of the companies Act, Cap. 486? (10 marks)
- (Total: 20 marks)**

QUESTION SEVEN

- (a) Discuss the powers and limitations of raising loans by directors of public limited liability companies. (12 marks)
- (b) What remedies are available to the lender in circumstances where directors borrow loans outside the powers of the company with or without the knowledge of the lender? (8 marks)
- (Total: 20 marks)**

QUESTION EIGHT

Explain the grounds by which a company may be wound up by the court. (20 marks)

MODEL ANSWERS TO PAST CPA PAPERS

MODEL ANSWERS TO CPA IV LAW II EXAMINATION SET JUNE 2001.

Question 1

- (a) This doctrine is to the effect that persons who deal with the company are deemed to know the contents of its public documents, namely memorandum, articles special resolutions etc.

They are deemed to know the company's contractual capacity i.e. whether a transaction is intra or ultra vires the company.

This is because these documents are registrable with the registrar and are open for inspection by any person who cares to inspect them.

This doctrine protects the company from persons who do not inquire.

It is a modification to the doctrine of indoor management.

This doctrine operates negatively in that although parties are deemed to know the contents of the public documents, a party can only rely on those contents it has actual knowledge of their existence in the documents. It was so held in Rama Corporation v Proved Tins and General Investments where it was held that the plaintiff could not rely on the article permitting delegation since it had no notice of its existence. The company could not be held liable on the contract.

- (b) This problem is based on the division of powers between the general meeting and the board.

Under this principle, each organ has its own sphere of influence as dictated by the articles. An organ must as a general rule not interfere with the exercise of a power vested in the other.

In this case, since the articles of Y Ltd are similar to Table A, then under Article 80, the management of the company affairs is vested in the board except in those matters specifically allotted to the company at general meeting.

The directors are in charge of the publication hence the general meeting must not interfere. By passing the resolution, the general meeting is in fact interfering with the exercise of a power vested by the articles in the board.

My advice to the commissioners is that they have no actionable claim against the directors. They cannot sue since the directors are not abusing, exceeding or exercising their powers in contravention of the articles.

My advise is based on the decision in Scott v Scott where the general meeting purported to compel the directors of the company to pay an interim dividend, which was a power vested in the board. It was held that the resolution could not be given effect. A similar holding was made in Shaw v Shaw where the general meeting purported to interfere with the exercise of a power vested in the board of directors.

- (c) As a general rule, surrender of shares is not authorised by law. This is a situation whereby a member gives up his shares to the company. It is generally not provided for by the articles. However, a company may accept such shares in two circumstances:

- (i) to avoid the formalities of forfeiture
- (ii) fully paid up shares may be accepted in return for shares of the same nominal value.

Question 2

(a) The remedies available to a subscriber include:

- (i) Compensation for any loss or damage occasioned by the untrue statements i.e. Sec 45 of the Act.
- (ii) Damages for loss or liability arising. This remedy is available to the investor in the false statements were negligently or fraudulently misrepresented.
- (iii) Rescission of contract: The innocent party has the right to rescind the contract if the false statements were innocently, fraudulently or negligently made. The right is exercisable at the earliest possible instance.
- (iv) Indemnity: This remedy which entails monetary compensation is available if the false statements were innocently made. However, it is only available where the innocent misrepresentation occasion direct financial loss.

(b)

- (i) Under Section 63 (1) of the Companies Act, the capital of a company can be altered in various ways namely:
 - increase of capital
 - sub-division of shares
 - conversion of shares to stock
 - re-conversion of stock to shares
 - consolidation of shares
 - diminution of capital

To alter the company's capital in the afore-mentioned ways, the following conditions are necessary:

- the articles of the company must authorise the alteration
- the alteration must be authorised by an ordinary resolution of members in general meeting
- the registrar must be notified of the alteration within 30 days of the resolution.

- (ii) The Companies Act prescribes the circumstances in which a company may reduce its capital. The circumstances are prescribed in sections 68 to 71 of the Act. For a company to reduce its capital the following conditions/steps are necessary.

- Authority of the articles: Under Section 68 (1) of the Companies Act, the power to reduce a company's capital must be embodied in the articles.
- Special resolution: Under Section 68 (1) of the Act, a reduction of capital must be authorised by a special resolution of members in the general meeting. This resolution is referred to as resolution for reducing capital. A reduction of capital may take the form of:

- 1) extinguishing or reducing liability of unpaid capital
- 2) cancellation of any paid up capital which is lost or unrepresented by available assets
- 3) paying of any paid up capital which is in excess of the wants of the company.

- Application to court for confirmation: Under Section 69 (1) of the Act, an application must be made to the court for confirmation of the reduction. The court must generally satisfy itself that the reduction is not unfairly prejudicial to any class of members or creditors. In particular, it must satisfy itself that creditors entitled to object have objected or consented to the alteration. In the case of an objection, the courts must satisfy itself that the creditor's claim has been discharged, determined or secured. If satisfied that creditors' interests have been given the requisite attention, the court may confirm the reduction.

- Confirmation of the reduction: Under Section 70 (1) of the Act, if the court is satisfied that all creditors have consented and/or their claims have 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 and for a specified duration order the company to add the words "and

- reduced" to its name and for the duration of the order, the words and reduced form part of the company's name.
- Registration of the reduction: Under Section 71 (1) of the Act, upon production of a certified copy of the court order and the mincrite approving the reduction of capital, the registrar of companies registers the same and publishes the same in accordance with the direction of the court.
 - Under Section 71 (2) of the Act, a reduction of capital take effect when registered by the registrar.
- (iii) Under Section 63 (1) of the Companies Act, a company limited by shares may, if authorised by its articles, increase its capital by new shares of any amount. e increase must be authorised by an ordinary resolution of members in general meeting.

Under Section 65 (1) of the Act, the registrar must be notified of the increase within 30 days of the resolution whereupon he registers the same.

Question 3

(a)

Duties

- Satisfy himself that the meeting is duly constituted
- Inform himself the business of the meeting
- Satisfy himself that a quorum of members is present
- Call the meeting to order
- Frame issues for debate or discussion
- Make decisions on points of order
- Ensure that the sense of the meeting is kept and/or maintained by putting relevant questions
- Maintain order in the conduct of those present at the meeting
- Ensure that minutes of the meeting are taken
- Conduct voting and declare results.

Relevant Case Law

Powers:

- to adjourn the meeting at any time with consent of the members
- to stop discussion of any matter after reasonable debate
- to demand voting by poll
- close the meeting after its business is accomplished
- determine who to speak and for how long
- to declare results of any voting
- to cast a vote or a second vote in the event of a tie.

(b)

- The chairman of the meeting
- At least three members.
- A member or members representing not less than 1/10th of the issued shares, present in person or by proxy.
- A member or members representing not less than 1/10 of the total voting rights present in person or by proxy
- Specific resolutions

(c)

- Resolutions which have been agreed to by all members of the company which if not so agreed, would not be effective for their purpose unless passed as special resolutions.
- Resolutions which agreed to by holders of a particular class of shares, which if not so agreed, would not be effective for their purpose unless supported by a specified majority or passed in a particular manner.

- Resolutions which effectively binds all the holders of a particular class or shares whether or not agreed to by all.
- A resolution to wind up a company voluntarily on the ground of either lapse of time or occurrence of an event contemplated by the articles.

Question 4

- (a) Under Section 147 (1) of the Act, every company must keep certain books in the English language, namely:
- Assets and liabilities of the company
 - Sales and purchases of goods by the company
 - Receipts and expenses by the company

Under Section 150 (1) of the Act, if a company has subsidiaries, it must lay group accounts before a general meeting of the holding company.

Under Section 151 (1) of the Act, the group accounts laid before the general meeting must comprise:

- a consolidated balance sheet of the company and the subsidiaries dealt with
- a consolidated profit and loss account of the company and the subsidiaries.

These accounts must give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries dealt with as a whole.

However, in certain circumstances the accounts of a subsidiary need not be incorporated into the group accounts.

- (b)
- If the subsidiary is wholly owned by a company incorporated in Kenya.
 - If the directors of the holding company are of the opinion that doing so would:
 - i) be impracticable
 - ii) occasion delay or expense
 - iii) be misleading
 - iv) be harmful to the business of the company or any subsidiary
 - v) be of no real value to members
 - If directors are of the opinion that the business of the company and that of the subsidiary are so different that the enterprise cannot be treated as one.
- (c)
- When a private company goes public in accordance with the provisions of Section 32 (1) of the Companies Act, a copy of a statement ***in lieu***, if any, must be delivered within 14 days of the resolution effecting the change.
 - Under Section 50 (1) of the Act, if a public company having a share capital has not issued a prospectus with reference to its formation or has issued one but has not proceeded to allot any of the shares offered, no share should be allotted until at least after 3 days, after delivery to the registrar for registration, a statement ***in lieu*** of prospectus, signed by all persons who are named or proposed directors and containing the particulars of Part I and II of the 4th Schedule.
 - Under Section 111 (2) of the act, if a public company has failed to raise the minimum subscription to facilitate the issue of a certificate of trading, these must be delivered to the registrar for registration ***inter alia*** a statement ***in lieu*** of prospectus

Question 5

- (a) Advantages
- It enables companies without fixed assets to borrow.
 - It enhances the borrowing capacity of companies with fixed assets.
 - It does not prevent the company from disposing off and acquiring new stock
 - It charges both existing and future assets of the company

- Upon crystallisation, the chargee becomes entitled to sell the security.

Disadvantages

- The value of the security provided by the company remains uncertain until crystallisation
 - A fixed charge created subsequent to the floating charge has priority in the satisfaction of claims.
 - Other interests e.g. landlord's distress for rent have priority in the satisfaction of claims
 - A floating charge created within 6 months before the commencement of winding up is deemed to be a fraudulent preference and is void.
 - A floating charge created within 12 months before the commencement of winding up is invalid unless it is proved, that the company was solvent immediately after its creation.
- (b) The rule in **Trevor v Whitworth** prohibits the company from purchasing its shares. This rule is now embodied in Section 56 (1) of the Companies Act. However, there are several exception to this rule:
- If the lending of money is the ordinary business of the company and the same is lent in the ordinary course of such business
 - If the company has in force a scheme to advance loans to trustees to enable them purchase its fully paid up shares for the benefit of all employees including salaried directors.
 - If the company has in force a scheme to advance loans to all its ***bona fide*** employees other than directors to enable them purchase its fully paid up shares by way of beneficial ownership.
- (c)
- Default in payment of the principal or interest when due and payable provided the chargee takes some step to enforce the security
 - Commencement of recovery proceedings against the company.
 - Appointment of a receiver by a chargee or the court upon application.
 - Commencement of winding up
 - Occurrence of an event contemplated by the debenture
 - If the company ceases to carry on business

Question 6

- (a) In the Words of Lord Denning in **Littlewood Stores Ltd v Inland Revenue Commissioner**

"The courts can and often do draw aside the veil. They can and often do pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit"

- (i) Agency or trustee or nominee
In **Re: F. G. Films Ltd**
Firestone Tyre and Rubber Co. v Llewellyn
Smith Stone and Knight v Birmingham Corporation
- (ii) Determination of ascertainment of residence
Deebers Consolidated Mines Ltd. v Howe
- (iii) Ratification of corporate acts
In **Re: Duomatic Ltd**
In **Re: Express Engineering Co. Ltd.**
- (iv) Group Enterprises
Harold Holdsworth v Caddies
- (v) Fraud or improper conduct
In **Re: Buggle Press Ltd.**
Jones v Lipman and Another
Gilford Motor Co. Ltd v Horne and Another
- (vi) Determination of character

Daimler Ltd. v Continental Tyre and Rubber Co.

- (b)
- every person who was a promoter of the company
 - every person who was a director of the company at the time.
 - every person who authorised himself to be named by the prospectus as director and was so named.
 - every person who authorised the issue of the prospectus
 - every person who had agreed to become a director of the company either immediately or after an interval of time.

- (c)
- (i) **Ultra vires** literally means beyond the powers. It is a rule of capacity which delimits the contractual capacity of a company.

Under Section 5 (1) of the Acts, a company's memorandum must set out the objects of the company. This delimits the doctrine of **ultra vires** the company.

At common law, a company's capacity is restricted to the objects in the memorandum and those other transactions that are reasonably incidental to the pursuit or attainment of those objects. Other transactions are **ultra vires** the company

The doctrine of **ultra vires** in relation to the company's objects was formulated in **Ashbury Railway Carriage and Iron Co. v Riche** and **Attorney General v Great Eastern Railway co.**

- (ii) An **ultra vires** transaction is void since the company had no capacity to enter into it. Such a transaction is generally unenforceable. It cannot be rendered **intra vires** by estoppel acquiescence, lapse of time, delay or ratification. It was so held in the **Rolled Steel Products (Holdings) Ltd. v British Steel Corporation and Others (1986)**
Once **intra vires**, always **ultra vires**. It was so held in **Brady v Brady (1987)**
- (iii) In the words of Lord Parker of Waddington in **Cotman v Broughman** the doctrine of **ultra vires** serves a double purpose.
- It protects subscribers who learn from it in what spheres their investment can be applied by the company.
 - It protects persons who deal with the company's contractual capacity.

Question 7

- (i) In a compulsory winding up, the liquidator including a provisional liquidator exercises the following powers **with the sanction of the court or committee of inspection.**
- To bring or defend actions and legal proceedings in the name and on behalf of the company
 - To carry on the business of the company so far as may be necessary for beneficial winding up.
 - To appoint an advocate to assist him in the performance of his duties
 - To pay any classes of creditors in full
 - To make any compromise or arrangement with creditors
 - To compromise all calls and liabilities to calls, debts and other liabilities.
- (ii) On his own responsibility and **without obtaining any sanction** the liquidator can:
- Sell the property of the company by public auction or private contract.
 - Do all act as and execute, in the name and on behalf of the company all deeds and documents and use the company's seal therefore
 - Prove, rank and claim in the bankruptcy or insolvency or any contributory
 - Draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company.
 - Raise money on the security of the company's assets
 - Take out letters of administration to any deceased contributory and to do any other act necessary for obtaining payment of money from a contributory or his estate.
 - Appoint an agent to do any business which the liquidator cannot do himself.

- Do all such other things as are necessary for winding up the affairs of the company and distributing its assets.

Question 8

(a)

- the conduct complained of must of the lowest involve some fraud
- the fraudsters or wrong doers must be in control of the company
- the company must be made one of the dependants in the action
- the plaintiff shareholder must sue in a representative capacity on behalf of himself and other members other than the real defendants.
- the right to bring a derivative action is afforded to the individual member as a matter of grace.
- the plaintiff remains **dominus litis** until judgement and can discontinue or settle the action at his pleasure.

- (b) As a shareholder, Naliaka is protected by law in that at Common Law, though a majority shareholder is free to vote selfishly, he must always do so in the best interest of the company otherwise the decision is questionable in a court of law. As was the case in **Menier v Hooper Telegraph Wires**

In this case, since the proposed merger purports to benefit the majority shareholders at the expense of the minority, i.e. Naliaka, the decision to merge is challengeable in a court of law.

My advise to Naliaka is therefore to sue the majority shareholders and the company for disallowance of the merger. My advise is based on the decision in **Menier v Hooper Telegraph Wires** where the majority shareholders purported to benefit at the expense of the minority.

MODEL ANSWERS TO CPA IV LAW II EXAMINATION SET DECEMBER 1996.**Question 1**

- (a) Procedure
- i) Choice of suitable name which should be reserved
 - ii) Prepare the constitutive documents i.e.
 - Memorandum of Association,
 - Articles of Association,
 - Statements of Nominal Capital,
 - Declaration of Compliance,
 - List of Directors,
 - Written consent of directors,
 - Notice of Location of registered office
 - iii) The Memorandum of Association must indicate that the company is limited by shares.
 - iv) The Memorandum of Association must be signed by at least seven promoters
 - v) The Articles of Association must also be signed by at least seven people.
 - vi) After preparation of documents, they must be stamped (stamp duty)
 - vii) Presentation to the registrar of companies
 - viii) If the registrar is satisfied that all the documents are in order, he shall issue a certificate of incorporation
- (b)
- They are not required to write a list of directors on their consent.
 - The minimum number of signatures is two not seven

Question 2

- (a) A foreign company is one incorporated outside Kenya but having a place of business in Kenya

Documentary information displayed

- Certificate of incorporation: Exhibit on the outside of every office or place of business its name and country of its incorporation in English and in the original language.
 - State in every prospectus and on all publications and exhibit outside every office or place of business whether the liability of the members is limited.
- (b)
- (i) This is proper and valid. A foreign company is required to file a certified copy of its documents translated in English. This was complied with.
 - (ii) Such documents is required to be filed within 30 days. This was in order.
 - (iii) Any change of place of business must be done within 60 days. This was done. The act is valid.

Question 3

- (a) Issued Share Capital

- This is also known as the subscribed share capital
- It is the portion of the share capital which has been issued and taken up.
- It must be maintained at all times
- It need not be necessarily paid for
- It is the capital on which the company may make calls
- It can never exceed the nominal capital

- (b) Shares Debentures

- | | |
|---|--|
| - Constitutes membership to the company | - Constitutes creditors to the company |
| - Shares are irredeemable generally | - Are generally redeemable |
| - Attach voting rights | - Attaches no voting rights |
| - Entitled to dividends | - Entitled to interest on debentures |
| - Generally not secured | - Generally secured |
| - May not be issued on a discount | - May not be issued at a discount |

- A company cannot purchase its own shares.	- A company can purchase its own shares
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- (c) Capitalisation of profits is the converting profits available for distribution as dividends into capital by issuing bonus shares. It requires an ordinary resolution. When returns are made, they must be accompanied by a contract constituting the title of allottee in case the profits were issued as shares
- (d) A holding company
- It is a company which is a subsidiary of another.
 - It controls the directorship/management.
 - It must hold $\frac{1}{2}$ of the shares
 - Holding and subsidiaries are treated as one for purposes of accounts.

Question 4

- (a) A director may sometimes be regarded as an agent of the company. In **Farquison v Wilson**, it was held that directors are merely agents.
- the company cannot act on its own
 - it acts through directors
 - it is a case of principal and agent
 - where the agent is liable, the directors would be liable
 - this is only so if he acts within the powers/authority
- (b) A director is only an agent of the company and not of the other directors. Nothing done by the board can impose liability on a director who did not know of their action and did not participate in it even if he attended subsequent board meetings at which such wrongful acts are ratified. To be liable, he must have taken part of acquiesced in it.

Reference: **Re: Forest of Dean Coal Ltd.**

Where it was held that a director is not liable for any breach of trust that occurred before he became a director

Question 5

The rule states that every person associating with a company is deemed to have notice of its public documents but not having notice of the minute book of the Board of Directors and thus a party dealing with a company would not be bound by internal rules which might be adopted by the Board of Directors itself.

People dealing with registered companies are deemed to know the limits of the company's power and directors and other officers. A member of the public is thus expected to inspect such public documents i.e. the Memorandum of Association and Articles of Association.

Any person who enters into contracts with the company, which are ***ultra vires*** the company or the powers of the directors will not be entitled to any remedy.

The harshness of the rule was mitigated in the rule of **Royal British Bank v Turquand**.

Facts

Directors had powers to issue bonds provided they were authorised to do so by a general resolution of the company itself

The directors issued a bond to Turquand but no resolution had been passed authorising its issue. It was held that Turquand was entitled to assume that a resolution had been duly passed and was not bound to inquire in to the regularity of the internal proceedings.

Exceptions

- Where the person dealing with the company knows the internal regulations have not been complied with.
- Where the person purports to act as a director on behalf of the company in the transaction, it is his duty to see that the Articles are complied with
- Where the articles show that a liable resolution is required, he cannot ignore the irregularity.

- Where there are suspicious circumstances putting the outsider upon enquiry
- Where the document apparently issued by the company is a forgery.

Question 6

- (a) Majority directors don't have a right to exclude a minority shareholder. Right to attend a meeting is inalienable right of a shareholder. It is a primary right which cannot be taken away.
- (b) ...
- (i) He does not have capacity to petition for winding up if he is not a contributory. If he is a contributory, he has the ***locus standi*** to petition
 - (ii) He can petition for under just and equitable grounds. Because he has been disqualified from attending.
Lock v John Blackwood

Question 7

- (a)
- If it is a trading company, directors have powers to raise loans.
 - They should not borrow in excess of what has been resolved by the Board (Articles of Association)
 - They go hand in hand with powers to give securities for the loans.
 - They can create a charge or mortgage on the company's property.
 - There are some properties which cannot be given out as securities of reserve capital
 - They can only borrow from sanctified creditors.
- (b) Remedies
- Directors can be held personally liable
 - Training
 - Subrogation if it was used for legitimate debt
 - Injunction to stop company from utilising the funds
 - These are equitable remedies
 - Otherwise, ***ultra vires*** borrowing has no remedy in law.
- Reference: **Sinclair v Broudhem**

Question 8

This is done under Section 219 of the Companies Act if by special resolution the company has:

- Failure to submit statutory report to Registrar
- Default in holding the statutory meeting
- Failure to commence business within one or suspend business for one year
- Failure to pay debt/insolvency
- Where number of members fall below statutory minimum
- In case of foreign company, if winding up proceedings commence in that country

MOCK EXAMINATION

STRATHMORE COLLEGE

LAW II

Answer ANY FIVE questions

All questions carry equal marks

1. (a) "A promoter is not an agent for the company which he is forming because a company cannot have an agent before it comes into existence". Elucidate this statement showing very clearly who promoters are and what their duties are towards the company.

(b) Are there any remedies available to a company in case of breach of duties by a promoter towards the company?
2. What are the effects of the Articles of Association and Memorandum of Association to:
(a) The Company and the members;
(b) The members in relation to one another;
(c) The company and third parties?
3. Write short notes on the following in relation to a company:
(a) A share and the different types of shares.
(b) A debenture.
(c) A charge.
4. Who are members of a company according to the Companies Act (Cap.486)?
5. Outline the provisions of the Companies Act providing for Civil and Criminal liability in respect of non-compliance with provisions relating to prospectus.
6. Company X was unable to pursue its object of coal mining as a consequence of the nationalization of the coal industry. Consequent thereto, the company intended to go into voluntary liquidation on receipt of compensation due to it for its collieries. Pending the receipt of this compensation the company resolved to reduce its capital by returning the whole paid up capital to its 7% preference shareholders.

(a) What is the requirement for reduction of capital?

(b) What would be your opinion if the preference shareholders went to court to object to the reduction of the capital for inter alia that the reduction was unfair because as they would no longer be shareholders they would be unable to participate in the surplus assets remaining after the return of capital in the eventual liquidation?
7.
(a) What are the fiduciary duties of directors to the company?

(b) What are the duties of the Company Secretary under the Companies Act (Cap.486)?

8.

- (a) What is the distinction between voluntary winding up and compulsory winding up of a company?
- (b) What are the consequences of a resolution for voluntary winding up of a company?

END OF MOCK EXAMINATION

NOW SEND YOUR ANSWERS TO THE DISTANCE LEARNING CENTRE FOR MARKING