

COMPANY LAW

Introduction

The companies Act 2015 provides the basic legal framework for the regulation of companies in Kenya. The Act makes provisions for incorporation of companies, share capital and debentures, management and administration of company and dissolution.

Case law and company practice have developed many rules which are useful in filling gaps not provided for by the Companies Act.

Definition and nature

What is a company?

Section 3 of the Companies Act defines company as a company formed and registered under this Act or an existing company;

A clear definition is given by Lord Justice Lindley,

“A company is meant an association of many persons who contribute money or money’s worth to a common stock and employs it in some trade or business, and who share the profit and loss (as the case may be) arising there from”.

A company may therefore be defined as a incorporated association, an artificial person having an independent legal entity with perpetual succession, common seal and carrying limited liability.

Other business association which exist with the aim of carrying out business or trade in common include; Sole Proprietorship, Partnerships, State corporations and Cooperative society.

CHARACTERISTICS

OF

COMPANIES

1. An artificial person - a company is a creation the law, and enjoys all rights of a natural person upon incorporation.
2. Separate legal entity -a company is an artificial person and has a legal entity quite distinct from its members. It bears its own name, acts under corporate name, has a seal, its assets are separate from the members.
3. Perpetual succession - the life of a company is not related with the life of its members. A company continues to exist unless it is wound up under certain circumstances.
4. Common seal - official signature of the company for use on company documents
5. Limited liability- members liability is limited to the extent of shares they have purchased.
6. Transferability of shares - shareholder can transfer his shares to any person without the consent of the other members. A company can put restrictions but cannot put a stop to it.

7. Limitation of work – field of work of a company is fixed by the memorandum of association.
8. Voluntary association of profits – a company is a voluntary association of persons to earn profits.
9. Representative management – management of a company is by representatives i.e. Board of Directors
10. Termination of existence- can only be by law
11. Capacity to sue and to be sued – suits of the company are not of the shareholders.
12. Separate property- a company is capable of owing, enjoying and disposing property in its own name.

In the case of **Macaure Vs Northern Assurance Co. Ltd (1925) AC 619** Master J held that no shareholder has any right to any item of the property owned by the company for he has no legal or equitable interest therein. That he is only entitled to a share in the profits while the company continues to carry on business and a share in the distribution of surplus assets when the company is wound up, but not to the property.

Company

Registration

Procedures for registration of a company in Kenya

Section 11 states that: “one or more persons, who wish to form a company, may by subscribing their names to the Memorandum of Association and by complying with the provisions of the Act form a company”.

- ✓ Apply to the registrar to reserve your desired name. If accepted the registrar will reserve the name for 30 days.
- ✓ File the duly filled Application form CR1, Memorandum and Articles of Association CR2, directors particulars, registered office and stamp duty payable, with the Registrar of Companies who, upon satisfaction, issues the Certificate of Incorporation.

CLASSIFICATION OF COMPANIES

A.ON BASIS OF INCORPORATION

- **Registered companies** – formed and registered under the Companies Act
- **Statutory companies** – Is created by special acts of parliament. Has no shareholders and treasury provides initial capital e.g. parastatals
- **Foreign Company** – Is a company incorporated outside Kenya. For purposes of carrying out business the foreign company must be registered under the Act.

B. ON BASIS OF LIABILITY

- **Limited company** - Section 5 defines a limited company as a company limited by shares or by guarantee.
Companies limited by shares – Is a company whose liability is limited by the amount of unpaid shares. It may be public or private company.
Companies limited by guarantee – does not have share capital and

the liability of members is limited to amount which members undertake to contribute to assets of the company.

- **Unlimited companies** - Section 8 defines an unlimited company to one which has no limit on the liability of its members and its certificate of incorporation states so.

C. ON BASIS OF INDEPENDENCE

- **Independent unit** - performs all work independently it neither controls or is controlled by any other company
- **Subsidiary company** - Section 3 of the Companies Act states that a subsidiary company means a company of which another company is its holding company.
- **Holding Company** - Section 3 of the Companies Act states that a company shall be deemed to be another's holding company if that other is its subsidiary.
A holding company;
 - i. controls the composition of that other company's board of directors;
 - ii. controls more than half of the voting rights in that other company;
 - iii. holds more than half of that other company's issued share capital;
 - or
 - iv. is a holding company of a company that is that other company's holding company;

D. ON BASIS OF NUMBER OF MEMBERS

- **Private company** (section 9) - is a company formed by not more than fifty persons, prohibit invitations to the public to subscribe for shares or debentures of the company and articles of association restrict transfer of shares.
- **Public company** - (section 10) is a company that does not limit transfer of shares, number of members and does not prohibit invitations to the public to subscribe for shares or debentures of the company

- (a) **Distinction between a Public company and a Private company**
Minimum number of members:- For public company is seven whereas private company is one.
- (b) **Maximum number of members:-** There is no limit on the maximum number in case of public company, but a private company cannot have more than fifty members.
- (c) **Commencement of business:-** A private company can commence business as soon as it is incorporated, whereas a public company shall not commence its business immediately unless it has been granted the certificate of commencement of business.
- (d) **Invitation to public:-** A public company by issuing a prospectus may invite public to subscribe to its shares whereas a private company cannot extend such invitation to the public.

- (e) Transferability of shares:- There is no restriction on the transfer of shares in case of a public company whereas private company by its articles must restrict the right of members of transferring the shares.
- (f) Number of directors:- A public company must have at least two directors whereas private company may have one director. s.128
- (g) Statutory meeting:- A public company must hold a statutory meeting and file with the registrar a statutory report, but in case of a private company there are no such obligations.
- (h) Name:- The name of a private company must include the words "private ltd" at the end of its name, but a public company has to use the words "ltd" at the end of its name.

EFFECT OF REGISTRATION

- a) On registration the company becomes a body corporate by the name stated in the certificate of incorporation;
- b) the company can do all of the things that an incorporated company can do;
- c) the registered office of the company is as stated in the application for registration;
- d) the status of the company is as stated in its certificate of incorporation; in the case of a company having a share capital, the subscribers to the memorandum of association become holders of the shares specified in the statement of capital and initial shareholdings; and
- e) the persons named in the statement of proposed officers (i) as directors of the company; (ii) in the case of a public company, as secretary or as a joint secretary of company; or (iii) as an authorized signatory of the company, become holders of those offices.

The Principle of Corporate Veil

When a legal entity has been incorporated the liability of its members and directors is separate to that of the legal entity, because the entity has a separate legal personality.

The purpose of limited liability is to promote commerce and industrial growth by encouraging shareholders to make capital contributions without subjecting all of their personal wealth to the risks of the business.

This principle is regarded as a curtain, a veil or a shield between the company and its members and is established in the case of **Salomon Vs Salomon & Co Ltd (1897)**. *Salomon* incorporated his boot and shoe repair business, transferring it to a company. He took all the shares of the company except six, which were held by his wife, daughter and four sons.

Part of the payment for the transfer of the business was made in the form of debentures (a secured loan) issued by the company to *Salomon*. *Salomon* transferred the debentures to *Broderip* in exchange for a loan. *Salomon* defaulted on payment of interest on the loan and *Broderip* sought to enforce the security against the company. It was held that; "The company is at law a

different person altogether from the [shareholders] ...; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands received the profits, the company is not in law the agent of the [shareholders] or trustee for them. Nor are the [shareholders], as members, liable in any shape or form, except to the extent and in the manner provided for by the Act."

Thus lifting corporate veil means identification of a company with its members and when the corporate veil is lifted the individual members may be held liable for its acts or entitled to its property.

Exceptions to the Solomon Vs Solomon & Co Ltd principles

The various ways in which corporate veil has been lifted can be divided into two:

a) Lifting by the court

- **Prevention of fraud or improper conduct** - The veil may also be lifted if a company is formed for a fraudulent purpose or to avoid legal obligations.
- **Determine character of the company** - A company may be declared an enemy character when its directors are residents of an enemy country. Therefore courts may lift the veil to ascertain the nationality of persons controlling the company. This was done in *Daimler Co Ltd v Continental Tyre & Rubber Co (Great Britain) Ltd* [1916] 2 AC 307, HL where shares in an English company were held by German nationals, who were treated as an enemy concern in the First World War.
- **Protection of revenue** - This is especially the case when a company is formed to assist shareholders evade taxes. In such case the shareholders may be held liable to pay income tax.
- **Public policy** - Courts lift the corporate veil to protect the public policy and prevent transactions contrary to public policy. Where there is a conflict between the separate entity principle and public policy the courts ignore form and take into account the substance.
- **Company is a sham** - This refers to a situation where a company is formed and used for some illegal or improper purpose. In *Gilford Motor Co v Horne* [1933] Ch 935 (CA) the defendant was a former director of a company who signed an agreement that he would not solicit his former employer's customers. Instead, he and his wife incorporated another company which he used to breach the agreement. The court held that the second company was simply 'a cloak, or a sham' and held the defendant liable.
- **Company acting on behalf of shareholders** - When a company is acting as an agent of its shareholders or of another company, it will be liable for its acts. There may be express agreement to the effect or an

agreement (of agency) may be implied from the circumstances of each particular case. In *Re FG Films Ltd [1953] 1 WLR 483 (Ch)* a company sought a declaration that it had made a British film for financial reasons. The court held that in fact the UK company was only the agent for an American company which owned the vast majority of its shares. The UK company also had no place of business and existed only so that the film could be called 'British'. The court, therefore, lifted the veil.

b) Lifting by statute

- ***Breach of statutory requirements - Section 130***

The registrar on forming an opinion that a company is in breach of statutory requirements he may direct the company to take action to rectify the breach.

- ***Holding and subsidiary section 645***

Although both holding and subsidiary companies are separate entities there are instances where a subsidiary may lose its separate identity to a certain extent. Where at the end of the financial year a company has subsidiaries, it may lay before the members in a general meeting not only its own account but also a set of group accounts showing the profits and loss earned by the company and its subsidiaries and their collective state of affairs. In *DHN Food Distributors Ltd v Tower Hamlets London Borough Council [1976] 1 WLR 852*, three companies in a group of food distributors were treated by the court as one. In this case one company, D.H.N. Food Distributors [DHN], owned and controlled a business of importing and distributing groceries. It operated out of a warehouse which was owned by a subsidiary, called Bronze Investments Ltd. Vehicles which were used in the business were owned by another subsidiary, D.H.N. Food Transport Ltd. DHN held all the shares in both the subsidiaries and the companies had common directors.

- ***Investigation of company membership section 801***

The Act section 801 empowers the registrar to appoint one or more competent inspectors to investigate and report on the membership of any company for the purpose of determining the true persons who are or have been financially interested in the success or failure of the company or able to control or to influence the policy of the company. To investigate the corporate veil is lifted to ascertain the real persons controlling it.

- ***Take over bids section 618***

A scheme or contract inviting the transfer of shares or class of shares in the company to another company has been approved by the holders

of not less than seventy five percent in the value of shares whose transfer is involved the transferee company may at any time within two months after the making of the offer by the transferor company, give notice in the prescribed manner to any dissenting shareholder that it deserves to acquire his shares.

- **Fraudulent conduct of business section 787(2)**

The Act section 787(2) allows the court upon receiving the report from the Attorney General on the company that it appears that any business of the company has been carried on with intention to defraud creditors, the court may declare that any person who were knowingly, parties to the carrying on such business are to be personally liable for the debts and other liabilities of the company.

- ***Prosecution of delinquent officers and members of company***

In the course of winding up of a company it appears that any past or present officer or any member of the company has been guilty of any offence in relation to the company then the court may declare such a person liable for his offence.